

**Comprehensive Guidelines for Supervision of Financial  
Instruments Business Operators, etc.**

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**Financial Services Agency**

## **Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.**

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## **I. Basic Concept**

### I-1 Basic Concept for Supervision of Financial Instruments Business Operators, etc.

(1) The primary preconditions for investors to actively make investments and for companies to smoothly raise funds in the financial instruments market are that the market be fair and efficient, and that Financial Instruments Business Operators, etc., ("Financial Instruments Business Operators, etc." refers to Financial Business Operators and Registered Financial Institutions; the same shall apply hereinafter) play an important role as market intermediaries.

The purpose of the supervision of Financial Instruments Business Operators, etc., is to secure sound and appropriate business operations of persons who conduct Financial Instruments Business, to ensure fairness in the issuance of securities and transactions of financial instruments, to facilitate the smooth distribution of securities and to realize fair price formation of financial instruments by fully utilizing the functions of the capital market through the appropriate exercise of their own market intermediary function, thereby contributing to the sound development of the national economy and the protection of investors.

(2) Since its establishment, the Financial Services Agency (FSA) has aimed to establish transparent and fair administration based on clear rules, in principle. Therefore, it is determined to improve the efficiency and effectiveness of administration in supervision and various other areas, including inspection and surveillance, and to further clarify rules and improve administrative procedures.

(3) Transparency and fairness of administration will continue to be the fundamentals of administrative management in the future. However, if the FSA formulates excessively detailed checklists, etc. in an effort to clarify rules, and merely automatically repeats and continues uniform, ex-post facto examination based on exhaustive examination items without conducting substantive examination, etc. that takes into account the fundamental cause of problems and the possibility that such cause could further generate other wide-ranging problems, it could bring about adverse effects to Financial Instruments Business Operators, etc., such as obstructing them from identifying truly important issues by taking into account their entire business management and the fundamental cause of problems, resolving the fundamental cause for preventing the recurrence of problems, taking early measures for the future, and making creative efforts for better practice.

In cooperation with the Securities and Exchange Surveillance Commission, etc. that inspect Financial Instruments Business Operators, etc. (hereinafter referred to as "inspection departments"), the FSA will continue to monitor Financial Instruments Business Operators, etc. by combining on-site and off-site techniques through identification of the actual state and dialogue, according to the size and characteristics of each Financial Instruments Business Operator, etc. and the probability of occurrence of a serious problem related to compliance, etc. in the business operator, etc. It will implement supervisory measures as necessary to prevent the occurrence of serious problems in advance. In addition, it will encourage Financial Instruments Business Operator, etc. to make various efforts for better practice through dialogue, as necessary.

(Reference) "JFSA's supervisory approaches -Replacing checklists with engagement-" (June 29, 2018)

(4) Officials that engage in supervision of Financial Instruments Business Operators, etc. are to comply with the following code of conduct in performing their duties and endeavor to secure the confidence of supervisory administration, while observing the basic concept set forth in (1) through (3).

(i) Entrustment by the Citizens and Maintenance of Ethics Pertaining to the Duties

The officials will be aware that their work is based on duties entrusted by citizens, and that they need to give top priority to attaining the purpose of supervision of Financial Instruments Business Operators, etc. set forth in I-1(1) in performing their work. In addition, they will strive to maintain ethics pertaining to duties, and aim to ensure public trust in financial administration.

(ii) Maintenance of Discipline, Decorum, and Confidentiality

In performing financial administration, the officials will strictly maintain discipline, decorum, and confidentiality as well as a calm and composed attitude.

(iii) Broad and Medium- to Long-term Viewpoint

The officials will consider the standpoint of citizens and corporations that use financial services, and instead of being content with focal and short-term problem setting and solving alone, they will identify the fundamental causes and address problems at an early stage from a broad and medium- to long-term viewpoint.

(iv) Fairness

The officials will perform their work in a fair manner, following appropriate procedures based on laws and regulations, and taking into account the conditions of each Financial Instruments Business Operator, etc. In addition, the officials will not treat domestic Financial Instruments Business Operators, etc. and branches of Financial Instruments Business Operators, etc. that are foreign corporations conducting business in Japan or Financial Instruments Business Operators, etc. that are subsidiaries of foreign corporations differently without reasonable grounds that are based on laws and regulations.

(v) Respect of Voluntary Efforts by Financial Instruments Business Operators, etc.

The officers will recognize that voluntary initiatives and creative efforts of Financial Instruments Business Operators, etc. are essential for attaining the purpose of supervision set forth in I-1(1), and give consideration to respect the voluntary efforts regarding business operations made by Financial Instruments Business Operators, etc. in their capacity as private companies.

(vi) Self-improvement

The officials will acquire knowledge on financial laws, regulations, and rules and trends of Financial Instruments Business Operators etc. in Japan and other countries, as well as wide-ranging social and economic events surrounding finance as economic infrastructure. In addition, in performing their work of having a dialogue, etc., as they not only need to have deep knowledge on the actual circumstances specific to each Financial Instruments Business Operator, etc., but also the ability to conduct analyses and other work based on high expertise according to issues, such as business analysis, governance, and risk management, they will make self-improvement efforts on a daily basis toward acquiring that knowledge and ability.

(vii) Appropriate and Close Cooperation with Parties Concerned Inside and Outside the Organization

As a broad perspective beyond their own jurisdiction is important for realizing highly effective supervision, the officials will appropriately and closely cooperate with various entities inside and outside the FSA.



## I-2 Purpose of Establishment of Guideline for Supervision

### I-2-1 Purpose of Establishment of Guideline for Supervision

In order to enable the Japanese economy to achieve sustainable development, it is important to accelerate a shift of funds “from savings to investment,” which means a shift in emphasis from indirect financing to direct financing and market-based indirect financing. This shift is expected to contribute to the stability of Japan’s financial system, the creation of an attractive market for both domestic and foreign market participants as well as corporate growth and economic development, by bringing about the following four benefits:

- (i) Creating a robust financial system with an advanced risk-dispersion capability by moving to a market structure in which a wide range of market participants share risks according to their own capabilities (avoiding vulnerability of the financial system that may result from concentration of risks on indirect finance).
- (ii) Promoting corporate innovation by facilitating smooth provision of risk money.
- (iii) Improving the efficiency of capital and the profitability of Japanese companies by promoting a shift of funds from savings to investment, thereby creating a market with sufficient depth to keep a watchful eye on business managers.
- (iv) Creating an affluent and colorful society by providing investors with a diverse range of means to manage assets amid the declining birth rate and the aging of society.

In order to promote the shift of funds from savings to investment, it is essential not only that Financial Instruments Business Operators, etc., which act as market intermediaries, gain and maintain public confidence, but also that financial authorities design appropriate institutional frameworks and properly motivate Financial Instruments Business Operators, etc., to strengthen governance while bearing in mind the protection of investors and appropriate risk management.

Since the financial system reform of 1998, which was carried out under the banner of “a free, fair and global market,” Japan has implemented a variety of measures, including making it easier for securities companies to advance into new businesses, liberalizing their business operations and diversifying the range of institutions allowed to undertake securities business, in order to invigorate the securities market. These measures gradually produced benefits in the form of the diversification of financial instruments and sales channels, thereby bringing about changes in the environment for securities business and promoting the globalization of the financial and capital markets.

Even as the reform described above proceeded, protecting investors, improving convenience for them and ensuring the reliability of Japan’s markets remained as major challenges. Regarding cases of financial damage to ordinary customers, such as losses caused by fraudulent sales of unregulated financial instruments, Japan reformed the institutional framework for the protection of investors by strengthening relevant measures on a case-by-case basis, an example of which was the introduction of regulation on foreign exchange margin trading (put into effect in July 2005) through a revision of the Financial Futures Trading Act.

The revamping of the Securities and Exchange Act as the FIEA (put into effect on September 30, 2007), is

intended to promote financial innovation, in order to reap further benefits from the reform measures already implemented and to ensure appropriate protection of users through the establishment of comprehensive and cross-sectoral rules concerning the protection of investors. In order to accelerate the shift of funds “from savings to investment,” the supervisory authorities will need to take advantage of the results of the past reform measures while dealing with Financial Instruments Business Operators, etc., in an appropriate manner under the cross-sectoral legal framework, as their businesses are becoming increasingly diverse.

In order to conduct daily supervisory processes under these circumstances, we decided to systematically sort out the contents of sector-by-sector guidelines for supervision and administrative processes, and work out concepts concerning supervision, supervisory viewpoints and methods of supervision in a comprehensive manner on a cross-sectoral basis.

This Guideline was compiled with due consideration of the actual state of Financial Instruments Business Operators, etc., so that it can be applied to various cases, and the requirements of the supervisory evaluation points specified in the Guideline shall not be uniformly applied to all Financial Instruments Business Operators, etc.

Accordingly, when applying this Guideline, it is necessary to bear in mind that even if a Financial Instruments Business Operator does not literally meet the requirements of all evaluation points, the case shall not be judged inappropriate insofar as there is no problem from the viewpoint of protecting public interests and investors; it is necessary to avoid applying the Guideline in a mechanical and uniform fashion. On the other hand, it should also be borne in mind that even if a Financial Instruments Business Operators etc. formally fulfills all the functions concerning evaluation points, the case could be deemed to be inappropriate from the viewpoint of protecting public interests and investors.

Local Finance Bureaus (including the Fukuoka Local Finance Branch and the Okinawa General Bureau. The same shall apply hereinafter), as well as relevant divisions of the FSA, shall implement supervisory processes regarding Financial Instruments Business Operators, etc., that operate in their districts of jurisdiction based on this Guideline. Following the establishment of this Guideline, we abolished “the Comprehensive Guideline for Supervision of Securities Companies,” “Comprehensive Guideline for Supervision of Financial Futures Traders,” “Guideline for Administrative Processes (points of attention regarding the supervision of investment trust management companies, investment corporations and securities investment advisory companies)” and Section 10 “Trust Beneficiary Rights Sales Business” of the “Comprehensive Guideline for Supervision of Trust Companies, etc.” and Section 6 “Commodity Fund Business” of the “Points of Attention in Financial Supervision, etc. (Guideline for Administrative Processes) Vol. 3: Financial Companies.”

#### I-2-2 Structure of This Guideline

(1) This Guideline was compiled as a comprehensive one applicable to the supervision of a diverse range of Financial Instruments Business Operators, etc., with a view to limiting overlapping descriptions to a minimum.

Accordingly, the contents of Section I "Basic Concept" and Section II "Points of Attention in the Conduct of Administrative Processes Regarding the Supervision of Financial Instruments Business Operators " basically cover

persons engaging in Financial Instruments Business (Type I Financial Instruments Business, Type II Financial Instruments Business, Investment Management Business and Investment Advisory and Agency Business) or registered financial institutions, but also take into consideration the supervision of persons engaging in businesses specially permitted for qualified institutional investors, etc., businesses specially permitted for overseas investors, etc., and businesses specially permitted for the transitional period, and foreign securities companies, financial instruments intermediary service providers, securities finance companies, investment corporations and commodities investment sales companies.

Sections I and II are followed by “Supervisory Evaluation Points and Various Administrative Procedures,” which comprises Sections III to VII. Section III sets forth general supervisory viewpoints and procedures that are common to all types of Financial Instruments Business Operators, while Sections IV to VII set forth additional supervisory viewpoints that are specific to individual types of Financial Instruments Business Operators.

Therefore, supervisors of Financial Instruments Business Operators, etc., shall first refer to Section III and then to either of Sections IV to VII according to the attributes of the businesses they supervise.

Section VIII and the following sections set forth supervisory viewpoints and various administrative procedures regarding registered financial institutions, persons engaging in businesses specially permitted for qualified institutional investors, etc., foreign securities companies, financial instruments intermediary service providers and securities finance companies, selecting suitable points of attention and procedures from among those specified in the preceding sections and applying them *mutatis mutandis*, so supervisors should refer to them when necessary..

It is noted that High Speed Trading (HST), operated as part of business by Financial Instruments Business Operators, registered financial institutions or authorized transaction-at-exchange operators (as defined in Section X-2-1(1)), shall be supervised by applying *mutatis mutandis* supervisory viewpoints in the “Guidelines for Supervision of High Speed Traders,” established as supplemental to this guideline.

(2) While the FSA has indicated the Guideline for Supervision as well as various documents including theme-specific reports and various principles, annual policies, and requests to industry organizations, etc. as policies on supervision, when conducting supervision, supervisors shall use these documents based on the gist and purposes of the documents, and provide detailed explanation on those gist, etc. to Financial Instruments Business Operators, etc.

(Reference)

Application Table for the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc

Sections of the Guideline	Financial Instruments Business Operators				Registered Financial Institutions	Specially Permitted Businesses	Foreign Securities Company	Financial Instruments	Securities Finance Company
	Type I Financial	Type II Financial	Investment Management	Investment Advisory and					
I. Basic Concept	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
II. Points of Attention in the Conduct of Administrative Processes Regarding the Supervision of Financial Instruments Business Operators, etc.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
III. Supervisory Evaluation Points and Various Administrative Procedures (General)									
Evaluation points (general)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>					
Various administrative procedures (general)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>					
IV. Supervisory Evaluation Points and Various Administrative Procedures (Type I Financial Instruments Business)									
Evaluation points (Type I Financial Instruments Business)	<input type="checkbox"/>								
Various administrative procedures (Type I Financial Instruments Business)	<input type="checkbox"/>								
V. Supervisory Evaluation Points and Various Administrative Procedures (Type II Financial Instruments Business)									
Evaluation points (Type II Financial Instruments Business)		<input type="checkbox"/>							
Various administrative procedures (Type II Financial Instruments Business)		<input type="checkbox"/>							
VI. Supervisory Evaluation Points and Various Administrative Procedures (Investment Management Business)									
Evaluation points (Investment Management Business)			<input type="checkbox"/>						
Various administrative procedures (Investment Management Business)			<input type="checkbox"/>						
VII. Supervisory Evaluation Points and Various Administrative Procedures (Investment Advisory and Agency Business)									
Evaluation points (Investment Advisory and Agency Business)				<input type="checkbox"/>					
Various administrative procedures (Investment Advisory and Agency Business)				<input type="checkbox"/>					
VIII. Supervisory Evaluation Points and Various Administrative Procedures (Registered Financial Institutions)									
Evaluation points (Registered Financial Institutions)					<input type="checkbox"/>				
Various administrative procedures (Registered Financial Institutions)					<input type="checkbox"/>				
IX. Supervisory Evaluation Points and Various Administrative Procedures (Specially Permitted Businesses for Qualified Institutional Investor, etc.)									
Evaluation points (Specially Permitted Businesses for Qualified Institutional Investor, etc.)						<input type="checkbox"/>			
Various administrative procedures (Specially Permitted Businesses for Qualified Institutional Investor, etc.)						<input type="checkbox"/>			
X. Supervisory Evaluation Points and Various Administrative Procedures (Foreign Securities Company)									
Evaluation points (Foreign Securities Company)							<input type="checkbox"/>		
Various administrative procedures (Foreign Securities Company)							<input type="checkbox"/>		
XI. Supervisory Evaluation Points and Various Administrative Procedures (Financial Instruments Intermediary Service Provider)									
Evaluation points (Financial Instruments								<input type="checkbox"/>	

	Intermediary Service Provider)									
	Various administrative procedures (Financial Instruments Intermediary Service Provider)								○	
XII. Supervisory Evaluation Points and Various Administrative Procedures (Securities Finance Company)										
	Evaluation points (Securities Finance Company)									○
	Various administrative procedures (Securities Finance Company)									○

## **II. Points of Attention in the Conduct of Administrative Processes Regarding the Supervision of Financial Instruments Business Operators, etc.**

### II-1 Basic Concept Concerning Supervisory Processes

As mentioned earlier (I-1(1)), in order to attain the purpose of supervision of Financial Instruments Business Operators, etc., supervisory departments also need to continuously take actions with regard to Financial Instruments Business Operators, etc. according to the size and specific characteristics of individual Financial Instruments Business Operators, etc.

Therefore, in carrying out supervisory processes of Financial Instruments Business Operators, etc., it is indispensable for supervisory departments to first understand the policy adopted by each Financial Instruments Business Operator, etc. in addressing issues such as building business models, exercising the market intermediary function, ensuring fairness in transactions, protecting investors, establishing a control environment for managing compliance and risk, and then precisely identify the details of arrangements and procedures under which that policy is implemented, the potential risks and challenges the policy incorporates, and how the Financial Instruments Business Operator, etc. recognizes such risks, etc. and how it intends to address them.

In order to respond to priority issues with the entire business management in view and to make that effort lead to the sound development of the national economy and the protection of investors, each Financial Instruments Business Operator, etc. needs to reform its business arrangements and procedures itself so as to voluntarily make improvements for best practice without being pointed out by supervisors. In the process of continuous monitoring through identification of the actual state and dialogue, etc., the FSA will encourage the efforts of each Financial Instruments Business Operator, etc. to pursue better practice.

On such basis, when, in the abovementioned process, it is deemed that there is a serious problem from the perspective of public interest or investor protection or it is deemed that business improvement will not be made by the voluntary efforts of the Financial Instruments Business Operator, etc., the FSA shall consider issuance of an administrative disposition such as a business improvement order under Article 51, etc. of the Financial Instruments and Exchange Act (hereinafter referred to as the "FIEA").

In addition, in carrying out supervisory processes of Financial Instruments Business Operators, etc., the following points should also be fully taken into consideration.

#### (1) Securing Sufficient Communications with Financial Instruments Business Operators, etc.

In the supervision, it is important to precisely grasp and analyze information concerning the business management of the Financial Instruments Business Operators, etc. and take actions in an appropriate and timely manner. Therefore, rather than merely waiting for reports from Financial Instruments Business Operators, etc., supervisory departments need to proactively gather information by engaging in communications with them on a daily basis as necessary under a sound and constructive, tense relationship. To be more specific, supervisory departments should ensure daily communications with Financial Instruments Business Operators, etc., through periodic and timely interviews and exchanges of opinions with various officers and employees of Financial Instruments Business Operators, etc., including the management team, outside directors, and those in charge of internal audit, so as to grasp information not only concerning their financial conditions, but also various business

management matters.

(2) Respect of Voluntary Efforts by Financial Instruments Business Operators, etc.

The standpoint of supervisory departments is to examine, in the light of laws and regulations, management decisions made by Financial Instruments Business Operators, etc., in their capacity as private companies, based on the principle of self-responsibility, and to encourage correction of problems. With due consideration of this standpoint, supervisory departments must give consideration to respect the voluntary efforts of Financial Instruments Business Operators, etc. regarding business operations when supervising them.

(3) Securing Efficient and Effective Supervisory Processes

In order to make effective use of the limited resources of supervisory departments as well as those of Financial Instruments Business Operators, etc., it is necessary to implement supervisory processes in an efficient and effective manner in full consideration of the size and specific characteristics of Financial Instruments Business Operators, etc. Therefore, when requiring Financial Instruments Business Operators, etc. to submit reports and other materials, supervisors must make sure to limit the volume of the required reports and materials to the minimum necessary for the supervisory purpose and strive to improve the efficiency and effectiveness of supervision by, for example, constantly reviewing the necessity of existing supervisory processes and the method of implementing them and by making improvements as necessary.

The submission of existing reports and other materials shall be periodically reviewed once a year based on such perspectives as reducing the administrative burden on Financial Instruments Business Operators, etc. In doing so, it should be kept in mind that the opinions of the Financial Instruments Business Operator, etc. should be sufficiently heard.

Furthermore, the supervisory authorities need to maintain close cooperation with Financial Instruments Firms Associations (which refer to the Authorized Financial Instruments Firms Association and Public Interest Corporation-Type Financial Instruments Firms; the same shall apply hereinafter), which are self-regulatory organizations as specified by the Financial Instruments and Exchange Act (hereinafter referred to as "FIEA"), as well as financial instruments exchanges, since they, in their capacity as entities familiar with the circumstances of the market, are responsible for exercising the function of self-regulation that is intended to secure investors' confidence in Financial Instruments Business Operators, etc.

At the same time, in the case of supervising Financial Instruments Intermediary Service Providers, supervisory authorities must be implemented in a manner whereby the sound and proper implementation of operations of the Financial Instruments Intermediary Service Providers are basically ensured through supervision of the Entrusting Financial Instruments Business Operators, etc. However, if the supervisory authorities must directly guide and supervise Financial Instruments Intermediary Service Providers in the case where Financial Instruments Intermediary Service Providers have their own problems or the case where specific Financial Instruments Intermediary Service Providers have common problems, the supervisory authorities need to pay attention to the reduction of their administrative burdens in full consideration of their size and specific characteristics.

(Note) In the case of requesting Financial Instruments Business Operators, etc. to produce reports, materials, etc.

concerning their small offices, etc., attention should be paid so as not to disturb the smooth implementation of their operations in full consideration of the specific characteristics of the services, products, etc., of such offices, etc.

#### (4) Risk Management of Financial Groups Covering Multiple Business Types

In Japan, financial groups covering multiple business types have been formed with the lifting of the ban on mutual business entries through subsidiaries in respective business fields as a result of the financial reform in 1993, the lifting of the ban on financial holding companies, and the development of regulations concerning subsidiaries by the Financial System Reform Act in 1998.

On one hand, formation of financial groups covering multiple business types by Type I Financial Instruments Business Operators or investment management business operators may help strengthen the business structure of financial institutions and improve the quality of services. On the other hand, however, it has the risk of causing inefficient business operations resulting from the complex organizational structures, occurrence of conflicts of interest, increased inducements for tie-in sales, intra-group risk contagion, risk concentration and so on.

In light of such specific characteristics, it is important particularly for designated parent company groups (meaning those defined in IV-5) and special financial instruments business operator groups (meaning those defined in IV-6) that conduct international activities to not only ensure the soundness, etc. of individual financial institutions, but also identify the actual state of the control environment for governance of the entire group and the financial soundness and appropriateness of business operations of the group. From the perspective ensuring the appropriateness of business operations, it is necessary to facilitate integrated management of financial groups.

In addition, also in the case where the Type I Financial Instruments Business Operator or the investment management business operator is a financial institution of another business type or a subsidiary corporation, etc. of a foreign financial group or of a non-financial company, it is important to examine whether the Financial Instruments Business Operator is subject to the abovementioned risk contagion, risk concentration and so on by exercising the supervisory authority on major shareholders of the Financial Instruments Business Operator and by holding in-depth hearings, etc.

Meanwhile, as a result of the modes of financial groups being varied and the characteristics of the risks faced by groups and the risk contagion processes being different, their control environments for governance naturally differ, so consideration shall be given to the fact that each financial group's control environment needs to be examined based on the actual state of that group. For financial groups covering multiple business types and financial groups that integrally provide comprehensive financial services, it is necessary to ensure monitoring at similar levels regarding similar or integrated acts conducted in different types of business or by different financial institutions, and also regarding regulations related to such acts, and it is also important to strengthen cooperation between relevant departments and divisions such as divisions in charge of the supervision of banks and other supervisory departments and inspection departments.

#### (5) Implementation of Supervisory Processes Taking Diversity into Account

Financial Instruments Business Operators, etc. include various kinds of business operators, such as Type I Financial Instruments Business Operators as well as Type II Financial Instruments Business Operators, investment management business operators, and investment advisory business operators, and their sizes and specific



characteristics as well as the conditions of the control environment for compliance to the FIEA and other laws and regulations are varied. Therefore, in carrying out the supervisory processes described in this Guideline for Supervision for Financial Instruments Business Operators, etc., it should particularly be kept in mind that techniques that match the size and specific characteristics, etc. of individual Financial Instruments Business Operators, etc. need to be selected, while taking into account such diversity of Financial Instruments Business Operators, etc.

#### (6) Cooperation with Inspection Departments

It should be kept in mind that supervisory departments should cooperate with inspection departments by, for example, sharing information through timely exchange of information identified in monitoring and sharing each other's problem awareness.

### II-1-1 Method of Implementation of Supervisory Processes

The fundamentals of supervisory processes of Financial Instruments Business Operators, etc. are to encourage each Financial Instruments Business Operator, etc. to make necessary improvements, by appropriately combining techniques such as monitoring through identification of the actual state and dialogue, etc., supervisory measures, feedback, and dissemination of information according to the conditions of the Financial Instruments Business Operator, etc. and the characteristics and seriousness of the problems it has.

In addition, supervisory departments are required to precisely identify changes in the global economic and market environments of Financial Instruments Business Operators, etc. through daily monitoring. At the same time, supervisory departments are required to conduct monitoring in full consideration of the size and specific characteristics of Financial Instruments Business Operators, etc., and based on the results, encourage the initiatives of Financial Instruments Business Operators, etc. for solving issues, such as the pursuit of best practice concerning risk management, etc. and development of the control environment for managing business management and governance that can flexibly respond to changes, in dialogues held with them.

### II-1-2 Specific Method of Supervisory Processes

#### (1) Continuous and Intensive Monitoring Combining On-site and Off-site Techniques

Supervisory departments will identify the specific characteristics and issues of each Financial Instruments Business Operator, etc., and conduct continuous monitoring, following up on the status of improvement, by flexibly using different monitoring techniques, including on-site inspections by inspection departments, according to the nature and priority of the issues.

Supervisory departments will use different monitoring techniques by fully taking into account the individual and specific conditions of each Financial Instruments Business Operator, etc., as well as viewpoints such as how effectively the actual state can be identified by each technique, the extent of burden on supervisors and that on the Financial Instruments Business Operator, etc., and urgency of the issue. In principle, they shall first conduct monitoring including analysis of materials concerning business management, finance, and risk coefficients and hearings with parties concerned inside and outside the Financial Instruments Business Operator, etc., and determine

whether or not on-site inspections by inspection departments are required based on analysis results, such as whether there are issues relating to the immediate soundness and appropriateness of operations.

## (2) Specific Method

### (i) Acts that Serve as the Basis in Carrying Out Identification of the Actual State and Dialogue

#### A. Information Gathering and Profiling (Identification of Specific Characteristics)

The FSA will conduct monitoring for the purpose of identifying the individual and specific conditions of each Financial Instruments Business Operator, etc. at a given time, such as its specific characteristics and issues and the state of its voluntary initiatives toward improvement. This includes identification of the effects that changes in the environment of Financial Instruments Business Operators, etc. have on their business management and the state of actions taken by each Financial Instruments Business Operator, etc. against such changes.

In addition, as trends in economies and financial/capital markets in Japan and overseas and behaviors of individual Financial Instruments Business Operators, etc. may affect each other, the FSA also needs to analyze and identify their mutual effects.

Such information gathering and profiling are an accumulation of the results of daily monitoring, and are not bound by any specific formats, but they will for example be conducted from the following perspectives.

##### a. Macro Perspective

It is necessary to analyze and identify the effects that changes in the environment in Japan and overseas, such as changes in the economy, financial markets, politics, society, etc., have on each Financial Instruments Business Operator, etc. and the financial system. To this end, it will be useful for supervisory departments to, for example, cooperate with related divisions within the FSA, Local Finance Bureaus, inspection departments, and related ministries and agencies, and gather information on changes in the environment in Japan and overseas, such as scandals of Japanese and overseas entities, including general non-financial companies, trends in legal and institutional amendments and court judgments in Japan and overseas, trends in discussions in overseas authorities and international organizations, and changes in the economic/social environment (e.g., growth of attention to SDGs), and then analyze and identify issues that also commonly exist in other companies in the industry, other industries, similar businesses and products, and legal systems, etc.

Supervisory departments will strive to identify or specify issues inherent in the entire financial sector by analyzing the lateral development or spread of problematic events through such information gathering and analysis.

##### b. Micro Perspective

In order to realize effective dialogue, etc. with Financial Instruments Business Operators, etc., it is indispensable to accumulate deep knowledge on the actual circumstances specific to each Financial Instruments Business Operator, etc. In particular, as the starting point, it will be necessary to confirm the management philosophy of the Financial Instruments Business Operator, etc., such as what kind of organization it aims to become in its respective business environments (customer characteristics,

competitive environ, etc.) and what it wants to do to achieve that aim. To this end, it will be useful to gather information from that Financial Instruments Business Operator, etc. and its stakeholders (employees, customers, local community, shareholders, etc.) as described below, for example:

- To analyze not only typical materials such as financial data and risk coefficient data, but also materials and minutes of the conference body involved in decision-making concerning management.
- To conduct not only periodic hearings regarding financial results and risk management, but also hearings on an as-needed basis regarding business trends, etc. with the manager of each division and persons from the respective levels of the organization.
- To exchange opinions with the internal control division, members of the audit (and supervisory) committee, auditors, outside directors, etc. in order to identify how the Financial Instruments Business Operator, etc. itself recognizes risks and conducts business.
- To analyze external information, including financial services users' opinions gathered through various channels, such as information on inquiries and complaints brought to the Counseling Office for Financial Services Users, as well as media reports and external inquiries.

Through the information gathering and analyses mentioned above and conventional monitoring, supervisory departments will gain an understanding of the business models, management strategies, business operations, and organizational structures of Financial Instruments Business Operators, etc., and identify their respective issues and specific characteristics as well as the effects that changes in the environment of Financial Instruments Business Operators, etc. have.

#### B. Identification of Priority Issues and Formulation of Monitoring Policy and Plan

It is necessary to order, in terms of priority, the issues of each Financial Instruments Business Operator, etc. and cross-sectional issues commonly shared across business types, etc. that have been identified through the abovementioned information gathering and identification of specific characteristics, while fully taking into account the degree of importance and urgency at the given time, such as the level of social demand, in order to discuss matters that are practically important for business management with the management team of the Financial Instruments Business Operator, etc. and to use the limited administrative resources as effectively as possible. The cross-sectoral, high-priority issues that have been identified in this way are specified and published in the annual policy, etc. at the beginning of the program year.

Next, there is a need to formulate the monitoring policy and plan, decide on the policy and plan for specific actions to be taken against the priority issues, and establish arrangements and procedures, such as allocating appropriate personnel, based on the state of management and other conditions that are specific to each Financial Instruments Business Operator, etc. In that process, in order to enable the Financial Instruments Business Operator, etc. to concentrate its management resources on the improvement of practically important matters, the authorities will selectively use the on-site inspection by inspection departments and other monitoring techniques, and the monitoring of individual Financial Instruments Business Operators, etc. and horizontal monitoring, according to the nature of priority issues.

In addition, the authorities will make an effort to implement appropriate monitoring according to the

situation, such as flexibly reviewing the monitoring plan if a new issue occurs or is found during the period.

(ii) Detailed Identification of the Actual State of Each Financial Instruments Business Operator, etc.

In order to identify the actual state, the authorities shall select the most efficient and effective techniques from among various hearings, requests for voluntary submission of materials, questionnaires, requests for reports under laws and regulations, on-site inspections by inspection departments, and so on, according to the nature of issues or the progress in the actions taken to address them, or according to the actual state of each Financial Instruments Business Operator, etc.

In addition, the authorities will give consideration to reducing the burden on the Financial Instruments Business Operator, etc.; for example, if they have acquired information in the past or are acquiring information in another process, they will confirm the contents of the information in advance, and make use of that information as much as possible.

Moreover, even in the case of implementing monitoring based on an analysis that has been conducted, if a new issue is found as a result of information gathering, identification of the actual state, or dialogue, appropriate actions will be taken according to the nature of the new issue.

The selected techniques will be implemented by respectively keeping in mind the following points, for example. Whichever technique is implemented, the authorities will provide detailed explanation to the Financial Instruments Business Operator, etc. as to what kind of issues have been recognized and what kind of discussions are being sought by the authorities.

A. Various Hearings

In order to deepen the mutual understanding of priority issues with the Financial Instruments Business Operator, etc., the authorities will hold hearings on multiple levels with the top management, division or branch managers, working level employees, etc. according to the nature of the issues.

With regard to initiatives for pursuing best practices, it is necessary to keep in mind that the authorities should not press a specific answer on the Financial Instruments Business Operator, etc., given that the Financial Instruments Business Operator, etc. should make creative efforts according to its environment and its specific characteristics.

In addition, as part of such various hearings, the authorities sometimes hold intensive hearings or dialogue on a specific theme over a certain period inside a facility of the Financial Instruments Business Operator, etc.

B. Request for Voluntary Submission of Materials

In consideration of the burden on the Financial Instruments Business Operator, etc. and with the aim of clearly and accurately conveying the purpose of the request, the authorities will provide a detailed explanation to the Financial Instruments Business Operator, etc. and strive to gain its understanding, clarifying what kind of issues have been recognized as the basis for making the request and what kind of materials are required for this purpose. In that process, the authorities shall make effort to reduce the burden imposed on the Financial Instruments Business Operator, etc. by, for example, spacing out the timings for making such requests, avoiding overlapped requests, and allowing ample time for the submission. In particular, when targeting multiple Financial Instruments Business Operators, etc. such as

in the case of conducting a questionnaire survey, sufficient consideration should be given to the specific characteristics and the environment of each Financial Instruments Business Operator, etc.

C. Request for Reports under Laws and Regulations

When it is deemed to be necessary, the authorities will request submission of a report under laws and regulations. In that process, the authorities will provide a detailed explanation to the Financial Instruments Business Operator, etc. as to what kind of issues have been recognized as the basis for requesting the report.

D. On-site Inspections under Laws and Regulations

When it is deemed to be necessary, such as when detailed examination on the immediate soundness and appropriateness of operations is judged to be necessary, the authorities will request the inspection departments to conduct on-site inspections under laws and regulations.

(iii) Dialogue

Dialogue is held according to individual and specific conditions at a given time, such as occurrence, non-occurrence, or probability of occurrence of a serious problem related to ensuring of fairness in transactions, protection of investors, or compliance, etc., the state of voluntary initiatives by the Financial Instruments Business Operator, etc. for improving its management or the state of exercising the market intermediary function, or according to the nature of issues.

When holding dialogue, the authorities will ensure that they first fully identify the concepts and policies of the Financial Instruments Business Operator, etc., and then hold the dialogue while presenting facts, and while striving to avoid making assumptions or pressing a hypothesis on the Financial Instruments Business Operator, etc., and enabling the Financial Instruments Business Operator, etc. to assert its standpoint at ease insofar as possible.

Furthermore, in holding dialogue, the authorities need to strive to fully take into account their past communication with each Financial Instruments Business Operator, etc., and give consideration to the continuity of dialogue.

A. Even when it is deemed in the process of identification of the actual state by the authorities that the probability of occurrence of a serious problem related to the ensuring of fairness in transactions, protection of investors, or compliance, etc. has increased, the Financial Instruments Business Operator, etc. itself is to first examine the issue, the fundamental cause, and the appropriateness of improvement measures, and then in-depth dialogue is to be held between the authorities and the Financial Instruments Business Operator, etc. about formulation and implementation of improvement measures. However, if a high degree of urgency is found, such as in the case where the abovementioned problem has already occurred, the authorities first clearly point out the matters which they consider should be improved, and then confirm what actions the Financial Instruments Business Operator, etc. will take.

B. With regard to Financial Instruments Business Operators, etc. for which the probability of occurrence of the abovementioned problem is not found, it is important that they continue to strive to further advance their business models and risk management by demonstrating diverse, proactive, and creative efforts according to their circumstances. Thus, the authorities will hold in-depth dialogue with Financial Instruments Business Operators, etc. about business models, risk management, human resource

development, and so on after gaining a deep understanding of the business environment or management issues of each Financial Instruments Business Operator, etc. or strategies and policies of each Financial Instruments Business Operator, etc. based on identification of their specific characteristics through daily monitoring, for the purpose of having Financial Instruments Business Operators, etc. gain awareness themselves without premising a specific answer (in this process, the authorities and Financial Instruments Business Operators, etc. will share other reference cases of best practices, etc. as necessary).

(iv) Flexible and Appropriate Combination of Diverse Techniques

As mentioned above, supervisory departments use various techniques as administrative actions against Financial Instruments Business Operators, etc., but these techniques have advantages and disadvantages from the viewpoint of their effectiveness and the burden and costs to be borne by the authorities and by the Financial Instruments Business Operators, etc. Therefore, supervisory departments will aim to realize effective and efficient inspection and supervisory processes by flexibly combining these techniques in a manner that maximize their advantages according to the individual and specific conditions at a given time, such as the state of issues of each Financial Instruments Business Operator, etc. and occurrence or non-occurrence of a serious problem related to the ensuring of fairness in transactions, protection of investors, or compliance, etc. For example, the following methods can be considered apart from the already mentioned techniques:

- Providing feedback of information on the industry's common state or issues or information on case examples in a specific field contributes to the demonstration of creative efforts by Financial Instruments Business Operators, etc. themselves. In particular, providing feedback of information on such initiatives according to the issues facing each Financial Instruments Business Operator, etc. makes it possible to hold in-depth dialogue after establishing a high level of common value between the authorities and the Financial Instruments Business Operator, etc. In that case again, consideration needs to be given so that the authorities respect the voluntary management decisions of the Financial Instruments Business Operator, etc. and do not inappropriately intervene in decisions on individual transactions.
- Information on management policy, initiatives for its improvement, the state of exercise of the market intermediary function, and so on voluntarily disclosed by the Financial Instruments Business Operator, etc. may not only contribute to the dialogue between the Financial Instruments Business Operator, etc. and the authorities, but also deepen the dialogue with parties concerned, such as customers, and contribute to initiatives by the Financial Instruments Business Operator, etc. for improving its management.
- When the issue facing a Financial Instruments Business Operator, etc. is in the field of market intermediary or customer convenience, it will be possible to enhance the effect of the dialogue by not merely communicating between the authorities and the Financial Instruments Business Operator, etc., but by conducting a questionnaire survey or hearings with third parties, such as business partners or users, and feeding back the results at the time of holding dialogue between the authorities and the Financial Instruments Business Operator, etc.
- The FSA could influence stakeholders involved in the business management of Financial Instruments Business Operators, etc. by sharing common values or targets with parties concerned other than Financial Instruments Business Operators, etc. or sending out information on its various analysis results and its

stance on financial administration as needed.

(v) Actions Based on Monitoring Results

In providing feedback of the monitoring results as mentioned above, the feedback will be provided in a manner suitable for conducting intensive discussions on priority issues, such as continuing discussions on an ongoing basis while confirming any differences in recognition between the authorities and the Financial Instruments Business Operator, etc. regarding any points.

The authorities will conduct an appropriate follow-up by, for example, providing feedback to the Financial Instruments Business Operator, etc. in the following manner and holding continuous discussions or requiring actions for improvement as necessary:

- A. Informing the results of on-site and off-site monitoring conducted throughout the year in the form of documents by issuing "feedback letters" throughout the year as needed.
- B. In addition to A. above, sending out information on the industry's common issues as needed.

The authorities will classify the problems identified and information gathered through monitoring into (i) those specific to individual Financial Instruments Business Operators, etc., (ii) those that are common to the business type, (iii) those that are also common to other business types, and (iv) those that affect the authorities' other operations, related ministries and agencies, or industry organizations, etc. and through processes such as those mentioned in II-1-2(2)(i)A. above, the authorities will reflect them in the annual policy and the monitoring plan for the following period, consider implementation of horizontal monitoring across business types, and not only conduct monitoring, but also influence the authorities' other operations, related ministries and agencies, or industry organizations in light of the extensive effects of problems.

### II-1-3 Quality Control

The authorities will carry out quality control as an organization to ensure appropriate determination on the quality and depth of monitoring conducted through identification of the actual state and dialogue in all supervisory processes. The authorities will strive to secure the quality of supervisory processes to make sure that the creative efforts of each Financial Instruments Business Operator, etc. are being respected and the supervision does not impose an inappropriate burden on each Financial Instruments Business Operator, etc., in light of the specific circumstances of the Financial Instruments Business Operator, etc. such as its business environment and management philosophy, from a broad viewpoint of maximizing the welfare of all citizens, so that market fairness and investor protection will be secured in the business operation of the Financial Instruments Business Operator, etc.

To this end, senior officials of supervisory departments, etc. will conduct multi-faceted and multi-layered examination on the following points, for example, while taking into account opinions they have received from Financial Instruments Business Operators, etc., and continuously make necessary improvements:

- When conducting information gathering, a hearing, or dialogue, whether effective cooperation and information sharing are conducted between monitoring teams of different business types or sectors so as not to impose an excessive burden, such as overlapping requests, on Financial Instruments Business Operators,

etc. In addition, when requesting submission of materials, whether the contents of the request are clear, whether consideration is given to the size and specific characteristics of the Financial Instruments Business Operator, etc., and whether ample time is allowed for the submission.

- In identifying specific characteristics, whether the specific circumstances of the Financial Instruments Business Operator, etc. such as its business environment and management philosophy are fully taken into account. Also, whether objective materials and facts are taken into account so that the supervisors in charge do not fall into making assumptions.
- In identifying priority issues, whether focus is placed on issues that are practically important for business management according to the actual circumstances specific to each Financial Instruments Business Operator, etc. In addition, whether any issues commonly shared by other Financial Instruments Business Operators, etc. or across business types have been overlooked.
- In formulating the monitoring policy and plan, whether appropriate monitoring targets and techniques are selected and arrangements and procedures for conducting monitoring have been developed.
- In requesting reports, whether a detailed explanation on the authority's recognition of issues is provided to the Financial Instruments Business Operator, etc.
- Whether dialogue is conducted appropriately based on II-1-2(2) above. In addition, whether dialogue is conducted in a manner that is not deemed to be one-way guidance.
- Whether analysis of the fundamental cause is conducted for issues and problems identified as a result of monitoring.
- In providing feedback of the monitoring results, whether a method that is most suitable for conducting intensive discussions on priority issues is selected. In addition, whether precise discussions and requests for improvement are made on the contents of the feedback according to the importance of the problems, whether trivial problems have not been pointed out, and whether the feedback has not resulted in making inappropriate intervention in management.

In that process, the senior officials will strive to increase opportunities for receiving frank opinions or criticisms from Financial Instruments Business Operators, etc. by, for example, visiting Financial Instruments Business Operators, etc. and directly hearing opinions on monitoring from them.

In addition, they will evaluate financial administration through hearings, etc. with Financial Instruments Business Operators, etc. and FSA officials, and hear the opinions of outside experts through expert panels, etc.

#### II-1-4 General Supervisory Processes

##### (1) Submission of Monitoring Survey Reports

As part of offsite monitoring, supervisors shall, based on Article 56-2(1) of the FIEA, require Financial Instruments Business Operators, etc. to submit a monitoring survey report regarding the following matters.

Upon receipt of a monitoring survey report, the director-general of the Local Finance Bureau (including the directors-general of the Fukuoka Local Finance Branch and the Okinawa General Bureau; the same shall apply hereinafter) shall, in accordance with guidelines issued by the FSA Commissioner, conduct administrative processes



pertaining to offsite monitoring reports. In conducting the administrative processes, the relevant sections of the Local Finance Bureau shall cooperate fully with the FSA divisions concerned.

[Monitoring of Type I Financial Instruments Business Operators]

- (i) Capital Adequacy Ratio
- (ii) Status of business operations and accounting
- (iii) Status of segregated management of customer assets
- (iv) Market risk
- (v) Counterparty risk
- (vi) Operational risk
- (vii) Liquidity risk

[Monitoring of persons engaged in the investment of a fund, etc. above a certain size (for each fund or customer assets)]

- (i) Name of the fund, etc.
- (ii) Operator category
- (iii) Type of the fund, etc.
- (iv) Items related to the investment period
- (v) Items related to rights holders (including investors and excluding individuals)
- (vi) Items related to the amount of the investment assets
- (vii) Items related to the amount of the net assets
- (viii) Items related to asset class exposure
- (ix) Items related to financial instruments classification
- (x) Items related to borrowings
- (xi) Items related to counterparty risk
- (xii) Items related to liquidity risk

(Note) A "person engaged in the investment of a fund, etc. above a certain size," who is required to submit a monitoring survey report, refers to a person who falls under any of the following and is engaged in the investment of a fund or customer assets for which the net assets per fund or per contract is at least 50 billion yen as of the end of the latest business year prior to the last day of June every year:

- A person who performs the act set forth in Article 2(8)(xii) of the FIEA on a regular basis
- A person who performs the act set forth in Article 2(8)(xiv) of the FIEA on a regular basis
- A person who is engaged in the investment of money or other property invested or contributed by a person that holds the rights set forth in Article 2(8)(xv)(c) of the FIEA, on a regular basis, as an investment mainly in securities or in rights connected with derivatives transactions, based on investment decisions that are grounded in an analysis of the values, etc. of financial instruments.

(2) Points of Attention Regarding Public Notice of Administrative Dispositions

A public notice of an administrative disposition based on Article 54-2 of the FIEA shall specify the following items:

- (i) Name of the financial instruments business operations and individuals concerned
- (ii) Location of the head office, etc.

(Note) The “head office, etc.” refers to the head office, or the principal office engaging in sales and administrative work (the principal office in Japan in the case of foreign corporations or individuals, and the head office in the case of no principal office, etc. in Japan). The same shall apply hereinafter.

- (iii) Registration number
- (iv) Registration date
- (v) Date of the administrative disposition
- (vi) Contents of the administrative disposition

### (3) Grasp of the Actual State of Unregistered Business Operators and Operators Using Similar Trade Names

When supervisors have recognized the existence of operators engaging in financial instruments business without registration, or operators’ names that may be confused with other operators that are registered, based on complaints from investors, inquiries from investigative authorities, information provided by Financial Instruments Firms’ Associations, advertisements carried by newspapers, etc., they shall make active efforts to grasp the actual state of such operators through means such as inquiring with police, local consumer centers, etc., about the operators and directly contacting the operators via telephone.

When they have received complaints from consumers and inquiries from investigative authorities in particular, supervisors shall take sufficient care to do more than merely respond to the complaints and inquiries.

### (4) Handling of Unregistered Business Operators and Other Questionable Operators

When supervisors have received information regarding unregistered business operators and other questionable operators, they shall take the following measures in order to prevent financial damage to customers from spreading.

#### (i) Receipt of Complaints

When supervisors have received information from investors and other persons with regard to business operators engaging in financial instruments business without registration, they shall take the following measures after collecting information as detailed as possible (e.g. the corporate name, location, telephone number, the state of sales activities of the said business operators and the names of the operators’ representatives, the names of the information providers and whether the information providers agree to have their information communicated to the investigative authorities).

A. When a Local Finance Bureau has received information regarding an unregistered business operator based in a region under the jurisdiction of another Local Finance Bureau, it shall communicate the information to the competent bureau. (The competent Local Finance Bureau shall handle the case thereafter, in principle.)

B. Regarding business operators who cannot be contacted, supervisors shall strive to collect more information.

C. When the information provider asks supervisors to refrain from contacting the business operator concerned or other organizations, supervisors shall make sure to prevent his/her interests from being damaged.

D. Regarding information related to a business operator suspected of conducting business without registration, supervisors shall encourage the information provider to provide information directly to investigative authorities.

E. A registry book (the format is specified in the Attached List of Formats II-6) shall be compiled to systematically record complaints and inquiries from investors, guidance given by the authorities to business operators, and the operators' responses thereto.

(ii) Cases where it is found that business operators could be engaging in financial instruments business without registration

Regarding a questionable business operator whose name and contact details have been identified through information and so forth received directly or via the FSA or other bureaus, and whose actual state of sales activity has become known to a certain extent, supervisors shall strive to grasp the actual state by directly contacting the said business operator by telephone or through other means. If it is subsequently found that the business operator could be conducting financial instruments business without registration (including cases where contact cannot be made for such reasons as the business operator being absent), supervisors shall issue a document using the Attached List of Formats II-5, and the following measures shall be taken:

A. If the business operator is found to be unintentionally operating without registration and with no malicious intent and to have no problem from the viewpoint of investor protection, it shall be immediately required to be registered.

B. If the business operator is found to be intentionally operating without registration and with malicious intent or to have other problems from the viewpoint of investor protection, the investigative authorities shall be notified and the business operator shall be warned in writing, in the format specified in the Attached List of Formats II-4, to stop conducting business immediately.

Although it is unnecessary to issue a document using the Attached List of Formats II-5, if it is identified that a business operator is conducting financial instruments business without registration, supervisors shall immediately warn the business operator in writing using the Attached List of Formats II-4.

C. In cases where a business operator, although not found to be conducting financial instruments business without registration, is found to be indicating that it will conduct financial instruments business or is soliciting customers to sign contracts for financial instruments transactions for the purpose of conducting financial instruments business, instead of using the Attached List of Formats II-4, supervisors shall warn the business operator using the Attached List of Formats II-13.

(iii) Cases Where Correction Is Not Made in Response to a Warning

Regarding business operators who refuse to take corrective action despite being issued with a warning by means of the Attached List of Formats II-4 or II-13, complaints shall be filed with the investigative authorities as necessary.

(iv) Publication, etc.

Regarding cases where a warning has been issued against a business operator or a complaint has been filed with the investigative authorities, the name or trade name of the business operator subject to these measures (including the name of a representative director or a person equivalent thereto in the case of a juridical person),

the location or address of the business operator (the names of the prefecture and the municipality or special ward in the case of an individual, or the equivalent thereto in the case of a nonresident) and the content of the financial instruments business that was conducted unregistered, etc. shall be made public, and a set of copies of the relevant section of the aforesaid registry book, the written warning and other relevant documents shall be immediately sent to the FSA Commissioner. On receipt of a report, the FSA shall make a list of the business operators that have been made public, and shall publicize this on the FSA website.

In cases where issuing a warning is difficult, such as where it is clear that the location of the business operator issued with the warning is false or where the location of the business operator is unknown, the FSA shall carry out the above publication, etc. without issuing the warning.

(Note) Regarding the handling of unregistered business operators and other questionable operators, cases where the investigation by the investigative authorities could be impeded shall be excluded. It should be kept in mind that receipt of an inquiry or the like from an investigative authority regarding the registration pertaining to the said business operator does not immediately mean that it should be judged a case where the investigation by the investigative authorities would be impeded.

#### (5) Handling of Business Operators Using Similar Trade Names

- (i) A business operator whose trade name is deemed to be undoubtedly similar to an existing trade name (e.g. “XXX Securities Company,” “Type X Financial Business Operator” and “XXX Investment Corporation”) shall be warned in writing, in the format specified in the Attached List of Formats II-1, and ordered, through direct contact such as telephone conversations or face-to-face interviews, to take corrective action. In addition, such cases shall be notified to the investigative authorities and the exchange of information with the authorities shall be maintained.

In the case of a business operator whose trade name is deemed to be similar to an existing one, and who is found to be possibly conducting financial instruments business without registration, supervisors shall, in principle, take action in accordance with the procedures set forth in (4) above.

- (ii) A business operator using a trade name that could be confused with that of a Financial Instruments Business Operator (refer to Note) shall be warned in writing, in the format specified in the Attached List of Formats II-2. In addition, the details of the business operators’ business shall be investigated through means such as inquiring with police, local consumer centers and other entities about the operators and directly contacting them via telephone.

Unless the business operator is found as a result of the investigation to be engaging in a business that is obviously different from Financial Instruments Business, it shall be warned in writing again, this time in the format specified in the Attached List of Formats II-3 and ordered, through direct contact such as telephone conversations and face-to-face interviews, to take corrective action.

- (iii) Regarding a business operator who refuses to take corrective action in response to warnings issued in the formats specified in the Attached List of Formats II-1 and II-3, a complaint shall be filed with the investigative authorities as necessary.
- (iv) In cases where the measures (i) to (iii) above have been taken, the Director-General of the competent Local Finance Bureau shall immediately report to the FSA Commissioner the name of the business operator

concerned, the name of its representative, the location of its stores and other facilities, the nature and size of its business and so on. On receipt of a report, the FSA shall publicize the name, etc. of the person who has been warned on the FSA website.

- (v) Regarding business operators using similar trade names, and other questionable business operators, the directors-general of Local Finance Bureaus shall compile a registry book (in the format specified in the Attached List of Formats II-6) to systematically record complaints and inquiries from investors, guidance given by the authorities to the business operators, and the business operators' response thereto.

(Note) "Examples of Trade Names Which Could be Confused with Those of Financial Instruments Business Operators"

Of Financial Instruments Business Operators, those who were registered under Article 28 of the former Securities and Exchange Act at the time when the FIEA was put into force, and those who started engaging in securities-related businesses after the FIEA was put into force are entitled to include the word "Securities" in their trade names. Judgment on the appropriateness of trade names that could be confused with the names of these business operators (hereinafter referred to as "Specified Securities Companies, etc.") shall be made on a case-by-case basis in light of the degree of the risk of such confusion. The following are examples of names that could cause confusion:

- (a) Trade names which could be confused with those of specified securities companies although they combine "Securities" with words describing other types of businesses.

<Examples>

"XXX Securities Transactions," "XXX Securities Trader," "XXX Securities Broker," "XXX Securities Investment," "XXX Securities Trading Company," "XXX Securities Call Loan," "XXX Securities Entrustment," "XXX Securities Intermediation," "XXX Securities Agency"

However, names that are obviously different from those of specified securities companies, for example, "XXX Securities Printing," shall be excluded.

- (b) Trade names which could be confused with those of specified securities companies although not using the word "Securities."

<Examples>

"XXX Stock Entrustment," "XXX Stock Investment," "XXX Stock Brokerage," "XXX Stock Trade," "XXX Stock Transactions," "XXX Stock Agency (Regarding these names, "Stock" may be substituted with "Bond")," "XXX Financial Instrument Trade"

## II-1-5 Cooperation between Supervisory Departments

### (1) Cooperation between the FSA and Local Finance Bureaus

The FSA and Local Finance Bureaus need to strengthen the effectiveness of monitoring through sharing the recognition of the location of risks and perspectives on problems by properly exchanging information deemed necessary for the supervision of Financial Instruments Business Operators, etc. To that end, they shall strive to strengthen their cooperation through means such as by providing information to each other in a timely and appropriate manner and actively exchanging views with regard to various matters, including matters other than

those that concern consultations related to the internal delegation processes set forth in II-1-7, and by sharing know-how obtained through the accumulation of case examples. In addition, Local Finance Bureaus shall strive to strengthen cooperation among themselves. For example, when a Local Finance Bureau has detected publicly unknown risks or problems regarding a Financial Instruments Business Operator, etc., under the jurisdiction of the FSA or another Local Finance Bureau, it shall provide relevant information to the FSA or the competent bureau as necessary.

(2) Coordination and Liaison with the Director-General of the Competent Local Finance Bureau

- (i) When the FSA Commissioner and the directors-general of Local Finance Bureaus have received a notification of the establishment, relocation, name change, abolition, temporary suspension or resumption of operation of a sales office of a Financial Instruments Business Operator in a region not under their jurisdiction, they shall send a copy thereof to the director-general of the Local Finance Bureau that has jurisdiction over the region where the said sales office is located.
- (ii) When the FSA Commissioner and the directors-general of the Local Finance Bureaus have taken an administrative disposition under either of Articles 51 to 54 of the FIEA against a sales office of a Financial Instruments Business Operator, etc., under their jurisdiction that is located in a region not under their jurisdiction, they shall immediately notify the details of the action to the director-general of the Local Finance Bureau that has jurisdiction over the region where the said sales office is located.
- (iii) When the director-general of a Local Finance Bureau has received a notification submitted under Article 32 of the FIEA by a major shareholder in a Financial Instruments Business Operator under the jurisdiction of the FSA Commissioner or the director-general of another Local Finance Bureau, he/she shall immediately send the original of the notification to the FSA Commissioner or the director-general of the competent Local Finance Bureau.
- (iv) When the FSA Commissioner and the directors-general of the Local Finance Bureaus have issued an order based on Article 32-2 of the FIEA to a major shareholder in a Financial Instruments Business Operator under their jurisdiction, they shall notify the details of the order to the director-general of the Local Finance Bureau (to the director-general of the Kanto Local Finance Bureau in cases where the shareholder is a nonresident) that has jurisdiction over the region where the head office or principal office of the said major shareholder (the residence of the shareholder in cases where the shareholder is an individual) is located.
- (v) When a Financial Instruments Business Operator, etc. under the jurisdiction of the FSA Commissioner and the Directors-General of Local Finance Bureaus entrusts business operations to a financial instruments intermediary service provider, etc. (referring to a financial instruments intermediary service provider and a financial service intermediary (referring to the financial service intermediary prescribed in Article 11(6) of the Act on the Provision of Financial Services and the Development of the Environment for Using Financial Services, and limited to such financial service intermediary engaged in securities, etc. intermediary business operations (referring to the securities, etc. intermediary business operations prescribed in Article 11(4) of the same Act; the same shall apply hereinafter); the same shall apply hereinafter)) located in a region not under their jurisdiction, the FSA Commissioner and the Directors-General of Local Finance Bureaus shall cooperate with the Director-General of the Local Finance Bureau that has jurisdiction over said financial instruments

intermediary service provider, etc. by, for example, providing the information necessary for the supervision thereof.

#### II-1-6 Cooperation with Self-Regulatory Organizations

It should be kept in mind that in the supervision of Financial Instruments Business Operators, etc., it is necessary to attach importance to rules set by relevant self-regulatory organizations as well as to laws and regulations. In addition, supervisors shall maintain the appropriate exchange of information necessary for supervision with self-regulatory organizations, to the extent necessary for the purpose of ensuring the fairness of transactions and protecting investors. It is also essential that supervisors strive to share the recognition of the location of risks and perspectives on problems with self-regulatory organizations. Furthermore, they shall provide active support to self-regulatory organizations' efforts to exercise cross-sectoral self-regulatory functions through participation in meetings aimed at facilitating liaison and coordination between self-regulatory organizations.

Also, in order to exclude crime syndicates and other illegal organizations from financial instruments business, supervisors shall maintain appropriate cooperation with relevant organizations through the securities security liaison group.

#### II-1-7 Internal Delegation

##### (1) Consultations with the FSA Commissioner

The directors-general of Local Finance Bureaus shall hold prior consultations with the FSA Commissioner with regard to the following matters when they conduct delegated supervisory processes concerning Financial Instruments Business Operators, etc.

In addition, directors-general shall report the results of the deliberations made by their bureaus and express the opinions thereof in the consultations.

- (i) Refusal of registration under Article 29-4(1) and Article 33-5 of the FIEA
- (ii) Granting of authorization of the conduct of business under Article 30(1) of the FIEA
- (iii) Administrative disposition against a major shareholder under Article 32-2 of the FIEA (including cases where the provision of Article 32-4 of the FIEA is applied mutatis mutandis)
- (iv) Approval of exclusion from application regarding preventive measures against internal collusion under the proviso of Article 44-3(1) and (2) of the FIEA
- (v) Administrative dispositions, including orders to improve or suspend business operation and rescission of registration and authorization under Article 51, Article 51-2, Article 52 (1) and Article 52-2(1) of the FIEA
- (vi) Dismissal of officers of Financial Instruments Business Operators (limited to officers stationed at sales and other offices in Japan or representative persons in Japan in the case of foreign securities companies) under Article 52(2) and Article 52-2(2) of the FIEA
- (vii) Administrative dispositions, including business improvement orders in relation to the Capital Adequacy Ratio under Article 53 of the FIEA
- (viii) Rescission of registration of Financial Instruments Business Operators, etc., who have suspended their

business operations for an extended period of time under Article 54 of the FIEA

- (iv) Dispositions necessary for investigation under Article 187 of the FIEA
- (v) Approval of the use of the interest rate sensitivity analysis under Article 7(1) of the Notice of the Establishment of Criteria for the Calculation of Financial Instruments Business Operators' Market Risk Equivalent, Counterparty Risk Equivalent and Basic Risk Equivalent (hereinafter referred to as the "Capital Adequacy Notice")
- (vi) Approval of the use of an internal control model under Article 10 of the Capital Adequacy Notice
- (xii) Rescission of approval under Article 14(5) of the Capital Adequacy Notice

## (2) Reporting to the FSA Commissioner

When the directors-general of Local Finance Bureaus conduct delegated supervisory processes regarding Financial Instruments Business Operators, etc., they shall complete the relevant processes and then report to the FSA Commissioner on the following matters:

- (i) When a Financial Instruments Business Operator, etc., under the jurisdiction of the FSA has obtained registration from a Local Finance Bureau under Article 29-3(1) or Article 33-4(1) of the FIEA, the director-general of the said bureau shall immediately send the original of the registration application and attached documents to the FSA Commissioner.
- (ii) The directors-general of Local Finance Bureaus shall report on the conditions of major shareholders (major shareholders as specified under Article 29-4(2) of the FIEA) as of the end of each financial quarter to the FSA Commissioner by the 20th day of the month following the end of the quarter, in the format specified in the Attached List of Formats II-7.
- (iii) The directors-general of Local Finance Bureaus shall compile a report regarding administrative processes concerning the confirmation of problems (as specified in the proviso of Article 39(3) of the FIEA) on a half-yearly basis, in the format specified in the Attached List of Formats II-8 (Report on the Status of the Conduct of Administrative Processes concerning Confirmation), and submit the report to the FSA Commissioner by the 15th day of the month following the end of each six-month period.
- (iv) When the directors-general of Local Finance Bureaus have received the following documents, they shall immediately send a copy thereof to the FSA Commissioner.
  - A. Reports regarding international businesses (Article 173 (2) of the Cabinet Office Ordinance regarding Financial Instruments Business, etc. (hereinafter referred to as the "FIB Cabinet Office Ordinance")
  - B. Reports regarding the establishment or abolition of representative offices of foreign securities companies (Article 199 (11) H of the FIB Cabinet Office Ordinance)
- (v) When the directors-general of Local Finance Bureaus have received reports based on Article 50-2(1) and (7) of the FIEA, they shall immediately send a copy thereof to the FSA Commissioner.
- (vi) When the directors-general of Local Finance Bureaus have issued a notice based on Article 57(3) of the FIEA (limited to cases where a notice to the Minister of Finance based on Article 194-4(1) of the FIEA is required), they shall immediately send a copy thereof to the FSA Commissioner.
- (vii) In cases where the directors-general of Local Finance Bureaus received a notification under Article 63-9(1) of the FIEA from a person who will become a Financial Instruments Business Operator, etc. under the



jurisdiction of the FSA, the directors-general shall immediately send the original of the written notification and attached documents to the FSA Commissioner.

(viii) In cases where the directors-general of Local Finance Bureaus received a notification under Article 3-3(1) of the Supplementary Provisions of the FIEA (including cases where applied mutatis mutandis pursuant to paragraph (7) of the same Article; the same shall apply in II-6) from a person who will become a Financial Instruments Business Operator, etc. under the jurisdiction of the FSA, the directors-general shall immediately send the original of the written notification and attached documents to the FSA Commissioner.

(ix) When the directors-general of Local Finance Bureaus have received reports based on Article 14(1) and (2) of the Capital Adequacy Notice, they shall immediately send a copy thereof to the FSA Commissioner.

(x) The directors-general of Local Finance Bureaus shall examine the status of the payment, for the previous business year, of the Registration and License Tax (the registration license tax as specified under Article 2 of the Registration and License Tax Act) by Financial Instruments Business Operators, etc., under their jurisdiction, and report the findings to the FSA Commissioner by April 30 every year.

### (3) Re-delegation to Director-General of Local Finance Offices, etc.

Of the processes delegated to the directors-general of Local Finance Bureaus under Article 42 of the Order for the Enforcement of the Financial Instruments and Exchange Act (hereinafter referred to as the “FIEA Enforcement Order”), the directors-general may re-delegate the following processes to the director-general of local Finance Offices that have jurisdiction over the regions where the head offices of the applicants and Financial Instruments Business Operators, etc., are located as well as to the heads of the Oar and Kitami Branch Offices.

(i) Administrative processes regarding the receipt of applications for registration as specified under Article 29-2 (1) and Article 33-3(1) of the FIEA

(ii) Administrative processes regarding the receipt of applications for authorization specified under Article 30-3(1) of the FIEA

(iii) Administrative processes regarding the receipt of applications for approval as specified under Article 35(4) of the FIEA

(iv) Administrative processes regarding the receipt of notifications based on Article 31(1) and (3), Article 33-6(1) and (3), Article 31-2(5) and (8), Article 35(3) and (6), Article 46-6(1), Article 50(1), Article 50-2(1) and (7) of the FIEA

(v) Administrative processes regarding the receipt of notifications based on Article 32(1) and (3), Article 32-3, Article 32-4 and Article 57-26(1) of the FIEA

(vi) Administrative processes regarding the receipt of documents submitted under Article 46-3(1) and (2), Article 47-2, Article 48-2(1) and (2) and Article 49-3(1) and (2)

### (4) Points of Attention

The provisions of (ii), (iii), (vii), and (x)-(xii) of II-1-7(1), (ii), (iv) and (ix) of II-1-7(2) and (ii), (iii) and (v) of II-1-7(3) shall not be applicable to the conduct of administrative processes concerning the supervision of registered financial institutions.

## II-1-8 Points of Attention Regarding Submission Documents Required for Financial Instruments Business Operators, etc.

It should be noted that an officer, etc. who has changed his/her surname may enter, in addition to the current surname, the former surname (meaning the former surname prescribed in Article 30-13 of the Order for Enforcement of the Residential Basic Book Act (Cabinet Order No. 292 of 1967); the same shall apply hereinafter) in the parentheses in the column when entering officers' names in the Formats attached to the Guidelines.

With regard to attached Formats III-1, VI-11, VI-12, VI-13, VI-14, and VI-15, it should also be noted that a person who has submitted a written application for registration referred to in Article 29-2(1) of the Act or a written notification referred to in Article 31(1) of the Act in which he/she entered both his/her former surname and current surname may enter either the former surname or current surname or both until the person has filed a notification to the effect that he/she changes the relevant former surname and current surname entered in such written application or written notification.

## II-1-9 Points of Attention Regarding Procedures in Writing and by Face-to-Face Contact

With regard to applications and notifications filed by Financial Instruments Business Operators, etc. and notices on dispositions issued by the authorities to Financial Instruments Business Operators, etc., Article 6(1) and Article 7(1) of the Act on the Promotion of Administration Using Information and Communications Technology (hereinafter referred to as the "Digital Procedures Act") provide that a means that involves the use of an electronic data processing system may be used even in cases where procedures in writing or by any other means are prescribed under the provisions of laws and regulations, irrespective of the provisions of the relevant laws and regulations.

In light of the purport of the Digital Procedures Act, the provisions of the Supervisory Guidelines pertaining to the procedures subject to the Digital Procedures Act are revised to permit the use of a means that involves the use of an electronic data processing system for those procedures, irrespective of the provisions requiring procedures in writing or by face-to-face contact.

In addition, with the rapid progress of digitalization in economic and social activities as a whole, the national government is reviewing Japan's systems and practices that require written documents, seals, and face-to-face procedures, and is working toward the realization of a remote society where procedures can be completed without actually visiting an office.

In order to steadily promote these efforts, the FSA has also been promoting the computerization of administrative procedures by revising the Electronic Application and Notification System of the FSA to enable online submission of all applications and notifications filed by Financial Instruments Business Operators, etc., as well as by revising the Cabinet Office Ordinance and Supervisory Guidelines to abolish the use of seals.

Furthermore, with regard to procedures among private businesses, the national government held the "Panel for Reviewing Procedures Requiring Documents, Seals and Face-to-Face Contact in the Financial Industry" to encourage the entire industry to review its practices, thereby working to digitize documents, eliminate the need for seals, and review face-to-face regulations.

Based on these efforts in the public and private sectors, the provisions of the Supervisory Guidelines pertaining to documents and face-to-face contact regarding procedures other than those subject to the Digital Procedures Act are revised to permit the use of a means that involves the use of an electronic data processing system or other information and communications technology, except for the cases where the original documents are required to be sent as described in II-1-10.

In light of the purpose of the above-mentioned treatment, it is recommended that procedures based on the provisions of the Supervisory Guidelines be conducted, to the extent possible, in a manner other than in writing or by face-to-face contact, while taking into consideration the intentions of the other party to the procedures.

#### II-1-10 Points of Attention when Submitting Written Applications, etc.

Based on II-1-9, applications and notifications to the authorities filed by Financial Instruments Business Operators, etc. shall, in principle, be required to be submitted by the methods set forth in (1) and (2) below.

However, for attached documents issued by public institutions (copy of resident certificate, ID card, copy of family register, documents certifying payment of taxes and fees, etc.), the original documents should be sent.

##### (1) The Electronic Application and Notification System of the FSA

Applications and notifications, etc. to the authorities filed by Financial Instruments Business Operators, etc., shall, in principle, be required to be submitted by the submission deadline stipulated by laws and regulations using the Electronic Application and Notification System of the FSA, except for the procedures for which the use of the Integrated System for Supporting the Operation of the FSA (hereinafter referred to as the "Integrated System") set forth in (2) is required.

However, for procedures for which written applications, etc. may be submitted by using the e-Gov, which the FSA introduces on its website, submission using the e-Gov is permitted, for the time being, together with submission using the Electronic Application and Notification System of the FSA.

##### (2) The Integrated System for Supporting the Operation of the FSA

A written notification of the capital adequacy ratio prescribed in Article 46-6(1) of the FIEA, a business report prescribed in Article 47-2 of the same Act, a business report based on Article 48-2(1) of the same Act, a written report on the business or on the status of property prescribed in Article 188(ii) of the FIB Cabinet Office Ordinance based on Article 48-2(2) of the FIEA, a business report prescribed in Article 63-4(2) of the same Act, and a business report prescribed in Article 63-12(2) of the same Act (including cases where applied pursuant to Article 3-3(4) of the Supplementary Provisions of the same Act (including cases where applied mutatis mutandis pursuant to paragraph (7) of the same Article; the same shall apply hereinafter)) shall, in principle, be required to be submitted by using the Integrated System.

## II-2 Response to Inquiries, Complaints, etc.

### (1) Basic Response

At the FSA, the Counseling Office for Financial Services Users is primarily responsible for handling inquiries, complaints, etc. regarding Financial Instruments Business Operators, etc., and financial instruments transactions. At Local Finance Bureaus, such complaints are primarily handled by relevant divisions. The FSA and Local Finance Bureaus shall explain to persons who lodge complaints that they are not in a position to act as a mediator for specific transactions, and they shall refer such persons to a designated ADR body (meaning a designated dispute resolution body specified in Article 156-38(1) of the FIEA; the same shall apply hereinafter), Financial Instruments Firms' Associations and Certified Investor Protection Organizations, which respond to inquiries, complaints, etc. based on the FIEA.

If persons who have made inquiries, complaints, etc. consent to the provision of information to the Financial Instruments Business Operators, etc., the supervisory departments shall, in principle provide information to the Financial Instruments Business Operators, etc.

### (2) Accumulation of Information

Local Finance Bureaus shall record the inquiries, complaints, etc. regarding Financial Instruments Business Operators, etc. that are deemed to be useful for supervising such operators (in the format specified in the Attached list of Formats II-9). When they find any information that is deemed to be particularly important, they shall immediately report such information to the relevant FSA divisions.

### (3) Cooperation with the Counseling Office for Financial Services Users

In order to ensure that inquiries, complaints, etc. brought to the Counseling Office for Financial Services Users are appropriately reflected in the administrative processes regarding supervision, supervisory departments shall take the following measures:

- (i) analyze the inquiries, complaints, etc. referred from the counseling office; and
- (ii) exchange information with the counseling office.

## II-3 Response to External Inquiries about Interpretations of Laws and Regulations, etc.

### II-3-1 Inquiries about Laws and Regulations

#### (1) Scope of Laws and Regulations Regarding Which Inquiries May be Processed

Inquiries may be processed only regarding the FIEA and related laws and regulations that are under the FSA's jurisdiction. Comments shall never be made in response to inquiries regarding laws and regulations outside the FSA's jurisdiction.

#### (2) Method of Response to Inquiries

- (i) Regarding an inquiry to which a reply can be made based on existing documents and reference materials, such as this Guideline for Supervision and reports compiled by advisory councils, the reply shall be provided promptly.
- (ii) When Local Finance Bureaus have received an inquiry to which they find it difficult to reply on their own, they shall compile an inquiry mail in the format specified in the Attached List of Formats II-10 and consult with the relevant FSA division via e-mail, etc.
- (iii) When business operators to which the laws and regulations under the FSA's jurisdiction are directly applicable or business associations comprising such business operators have made a general inquiry that meets the requirements specified in the following A and B with regard to the said laws and regulations, the head of the relevant FSA division shall provide a written reply and make it public if it is deemed to be appropriate to do so from the viewpoint of improving the predictability of the application of laws and regulations.

(Note) A "business association" refers to a group formed by a substantial number of business operators engaging in the same type of business to which the laws and regulations under the FSA's jurisdiction are directly applicable in order to promote their common interests, or a federation of such groups (limited to the top-tier organization in the case of business sectors where there are layers of associations and federations).

#### A. Scope of Inquiries for Which the Reply may be Published

An inquiry must meet all of the following requirements if the written reply thereto is to be made public:

- a. Must not ask whether a law or regulation is applicable to a specific transaction involving a specific business operator, but rather ask about the general interpretation of the law or regulation. (Not eligible for the application of the Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies ("no action letter" system).)
- b. Must not seek factual recognition.
- c. Must relate to transactions and other matters common to business operators to which the laws and regulations under the FSA's jurisdiction are directly applicable (in cases where the inquirer is an association of business operators, the inquiry must concern transactions and other matters common to business operators constituting the association) and must be regarding matters that a number of business operators are expected to make an inquiry into.

- d. Must not ask about points that are clear in light of the Guideline for Administrative Processes and other documents and materials that have been made public in the past.

B. Written Inquiry Forms (including Electronic Forms)

The inquirer shall submit a written inquiry that specifies the following items. In addition to the written inquiry, the inquirer may be asked to submit additional or corrected documents, if necessary, in order to judge the contents of the inquiry and whether it meets the criteria specified in “A” above.

- a. The legal provision which the inquiry concerns and specific points of issue
- b. The inquirer’s opinion concerning the inquired points of issue and the basis thereof
- c. A statement from the inquirer agreeing to have the contents of the inquiry and the response thereto made public.

C. Contact Point for Inquiry

A written inquiry shall be submitted to the FSA division with jurisdiction over the law or regulation in question or the relevant section of the Local Finance Bureau that has jurisdiction over the inquirer. When a Local Finance Bureau section has received an inquiry, it shall immediately forward it via e-mail, etc., to the relevant FSA division.

D. Reply

- a. The head of the relevant FSA division shall strive to reply to the inquirer within two months in principle of the arrival of a written inquiry at the contact point. In cases where it is not possible to reply within two months, it is necessary to provide the reason for the delay and the expected date of reply to the inquirer.

- b. Written replies shall contain the following disclaimer:

“This reply expresses a general view regarding the law or regulation in question that the FSA formed at this time exclusively on the basis of information contained in the written inquiry, in its capacity as the entity that has jurisdiction over the said law or regulation. Therefore, the reply does not provide judgment regarding the application of the said law or regulation to a specific case or have binding power on the judgment of the investigative or judicial authorities.”

- c. When the relevant FSA division decides not to reply to the inquiry through said process, it shall notify the inquirer with the decision and provide the basis thereof.

E. Publication

When the FSA has provided a reply according to the procedures prescribed in “D” above, it shall immediately publish the inquiry and the reply on its web site.

- (iv) Regarding inquiries which do not fit the description of (iii) above but are made frequently, a reference circular that describes the reply to the inquiry (in the format specified in the Attached List of Formats II-11) shall be compiled, distributed to the relevant departments and stored at the planning sections of the relevant departments of the FSA and the Local Finance Bureaus.

- (v) In cases where the inquirer seeks a written reply from the FSA and where the Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies (“no action letter” system) are applicable in light of II-3-2(2), the inquirer shall be asked to apply for the said procedures.

## II-3-2 Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies (“No Action Letter” System)

Under the Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies (hereinafter referred to as the “No Action Letter System”), private companies seek prior confirmation as to whether specific practices related to their planned business activities are subject to specific laws and regulations, and the said organizations make the replies they receive public. The FSA has established detailed rules concerning the No Action Letter System. This section only specifies the administrative procedures concerning the No Action Letter System, so supervisors shall make sure to refer to “Detailed Rules concerning the Prior Confirmation Procedures on the Application of Laws and Regulations by Administrative Agencies” when using the No Action Letter System.

### (1) Contact Point for Inquiry

Inquiries shall be submitted to the Coordination Division of the Supervisory Bureau. The Coordination Division shall immediately process the inquiry if it meets the requirements specified in (2) (iii) below and forward it to the division that has jurisdiction over the law or regulation in question. Financial institutions under the jurisdiction of Local Finance Bureaus shall submit an inquiry to the relevant bureaus, which shall in turn immediately forward the written inquiry to the Coordination Division of the Supervisory Bureau via e-mail, etc.

(Note) In principle, the local Finance Bureau forwarding the written inquiry to the Coordination Division of the Supervisory Bureau shall attach its own opinion thereto.

### (2) Flow of Processes after Receipt of a Written Inquiry

The relevant division that has received the inquiry shall check whether it is appropriate to reply thereto in light of (i) and (iii) below in particular. In cases where the inquiry is not eligible for the No Action Letter System, the inquirer shall be notified of the ineligibility. In cases where it is deemed to be necessary for the inquirer to submit additional or corrected documents, the inquirer may be asked to do so. However, it is important to avoid imposing an excessive burden on the inquirer, by minimizing the volume of requested additional or corrected documents.

#### (i) Scope of Matters Subject to Inquiry

Whether the inquiry has been submitted by a private company planning to engage in a new business or transaction in order to inquire about the following matters, in relation to the laws and ordinances listed on the FSA’s web site as subject to the No Action Letter System (hereinafter referred to as “Relevant Laws and Regulations (Provisions)” and government orders based thereon.

- A. Whether engaging in the business or transaction in question amounts to operating without authorization.
- B. Whether engaging in the business or transaction in question amounts to operating without notification.
- C. Whether engaging in the business or transaction in question leads to the suspension of business operation or rescission of a license (adverse dispositions).
- D. Whether engaging in the business or transaction in question leads to the direct imposition of a certain obligation or limitation of rights.

#### (ii) Scope of Eligible Inquirers

Whether the inquirer is an individual or a legal person planning to start a new business and wishing to

inquire about the applicability of the Relevant Laws and Regulations (Provisions), or a lawyer or the like employed by the said individual or legal person. Whether the inquirer has submitted a written inquiry that meets the criteria specified in (iii) below and agreed to have the content of the inquiry and the reply thereto made public.

(iii) Inquiry Content

An inquiry must meet the following criteria:

- A. Describing specific and concrete facts relating to planned business activity.
- B. Containing specific indication of the provisions of the relevant laws and regulations (Provisions) regarding which the inquirer wishes to check the applicability to the planned activity.
- C. Containing a statement from the inquirer agreeing to have the contents of the inquiry and the reply thereto made public.
- D. Clarifying the inquirer's opinion concerning the applicability of the provisions of the laws and regulations in "B" above and the basis thereof.

(iv) Response Timeframe

In principle, the head of the division that has received the inquiry shall reply to the inquirer within 30 days from the arrival at the contact point of a written inquiry from the inquirer. However, in the following cases, the response timeframe shall be set as follows. In any case, the FSA shall strive to ensure that the response time, including the time needed for submitting additional or corrected documents, is made as short as possible.

- A. In cases where the inquiry concerns advanced financial techniques or technologies, thus requiring a careful judgment, the FSA shall make a reply within 60 days in principle from the receipt of the inquiry.
- B. In cases where the relevant section's conduct of administrative processes may be impeded significantly by an excessive volume of inquiries, a reply may be delayed till 30 days from the initial receipt of the inquiry or later but must be made within a reasonable period of time.
- C. In cases where the law or regulation in question is under the joint jurisdiction of the FSA and another government agency, a reply shall be made within 60 days in principle from the receipt of the inquiry.

In cases where the inquirer has been asked to submit corrected or additional information, the days involved in gathering the said information shall not be counted in the 30-day period. If it is not possible to make a reply within 30 days, the FSA shall provide the reason for the delay and the expected date of reply to the inquirer.

(v) Publication of Inquiries and Replies

As a general rule, the contents of inquiries and the replies thereto shall be posted on the FSA's web site in their entirety within 30 days from the issuance of the reply.

However, in cases where the inquirer requests a delay in the publication of the inquiry and the reply thereto, and provides a rational reason for the delay and specifies the time when publication may be made, the FSA may delay the publication of the inquiry and the reply. In such cases, the publication may not necessarily be delayed until the date requested by the inquirer. When the reason for the requested delay has ceased to be valid, the FSA may make the inquiry and the reply thereto public after giving prior notice to the inquirer. In cases where an inquiry or the reply thereto contains information that falls under the category of matters of non-disclosure, as specified under the provisions of Article 5 of the Act Concerning the Disclosure of Information Retained by Administrative Agencies, the FSA may, as necessary, withhold such information from



disclosure.

### II-3-3 System to Eliminate Regulatory Gray Zones

Article 7(1) of the Industrial Competitiveness Enhancement Act (hereinafter referred to as the “Enhancement Act”) stipulates a system under which persons who intend to conduct new business activities may request confirmation of the interpretation of provisions of the law that stipulates regulations concerning the intended new business activities and related business activities, as well as ordinances based on the law (including notifications; hereinafter referred to as the “laws and regulations” in this paragraph), and the presence or absence of application of said provisions to the new business activities and related activities (hereinafter referred to as the “Gray Zone Elimination System”). This paragraph prescribes the administrative processes of the Gray Zone Elimination System. Reference shall invariably be made to the “Guide to the Use of the ‘Gray Zone Elimination System,’ ‘Regulatory Sandbox,’ and ‘Special Measures on Regulations for New Businesses’” (Ministry of Economy, Trade and Industry (METI), July 15, 2022) (hereinafter referred to as the “Usage Guide,” including those after revisions by the METI in this paragraph).

#### (1) Contact Point for Inquiry

The contact point for inquiry shall be the Strategy Development Division, the Strategy Development and Management Bureau of the FSA.

The Strategy Development Division shall promptly accept an inquiry form that satisfies the requirements indicated in the criteria for items to be included as shown in (2)(iii) below when it arrives. If the inquiry form is to be submitted to multiple competent ministers, confirmation of those other competent ministers shall be obtained.

Financial Instruments Business Operators, etc., under the jurisdiction of Local Finance Bureaus shall make inquiries to the relevant Local Finance Bureaus, respectively. When a Local Finance Bureau has received an inquiry, it shall promptly send the inquiry form to the Strategy Development Division, the Strategy Development and Management Bureau of the FSA.

(Note) When sending an inquiry form to the Strategy Development Division, the Strategy Development and Management Bureau of the FSA, a Local Finance Bureau shall attach review comments to only those requests for confirmation described in said inquiry form that concern laws and regulations under the jurisdiction of the FSA.

#### (2) Procedures Following the Receipt of Inquiry Form

After accepting an inquiry form, the Strategy Development Division, the Strategy Development and Management Bureau shall promptly forward said inquiry form to the responsible section that has jurisdiction over the laws and ordinances related to the request for confirmation described in the inquiry form. While discussing with said responsible section, the Policy and Legal Division, Planning and Coordination Bureau shall check the following (i) through (iii) in particular regarding whether or not a response shall be given to the matter, and in the case of a request for confirmation that cannot use the System, the person who submitted said inquiry form (hereinafter referred to as the “submitter” in this paragraph) shall be thus notified. In addition, if any corrections to the inquiry form or submission of additional documents is necessary, the required responses may be requested of the submitter.

However, additional documents shall be limited to the minimum to avoid excessive burden on the submitter.

(i) Subject of the Request for Confirmation

Whether A. and B. below are satisfied.

A. Whether the submitter is a person who intends to conduct new business activities.

(Note) “New business activities” refer to the development or production of new products, the development or provision of new services, the introduction of new production or sales methods of products, the introduction of new provision methods of services and other new business activities through which improvement of productivity (including resource productivity (the degree of the contribution of the use of energy or the use of mineral resources (excluding their use as energy) to the economic activities of those who intend to conduct new business activities)) or cultivation of new demand is expected and which have no danger of injuring public order or morals (Article 2(4) of the Enhancement Act, and Article 2 of the Order on Testing of New Technology, Development of Special Measures on Regulations for New Businesses, and Promotion of Regulatory Reform Based on the Industrial Competitiveness Enhancement Act (hereinafter referred to as the “Order Based on the Enhancement Act”).

B. The submitter is a person who intends to conduct new business activities related to businesses under the jurisdiction of the FSA. Or, the submitter is a person who intends to request confirmation of the interpretation of provisions of the laws and regulations under the jurisdiction of the FSA that stipulate regulations concerning the new business activities and related business activities the submitter intends to conduct, as well as the presence or absence of application of said provisions.

(ii) Subject of the Inquiry

Whether the submitter requests confirmation of the interpretation of provisions of the laws and regulations under the jurisdiction of the FSA that stipulate regulations concerning the new business activities and related business activities the submitter intends to conduct, as well as the presence or absence of application of said provisions, and inquires on matters such as the following:

A. Whether conducting the business or transaction corresponds to unlicensed trading.

B. Whether conducting the business or transaction corresponds to unregistered trading.

C. Whether conducting the business or transaction would be subject to suspension of business or rescission of license (adverse disposition).

D. Whether obligations will be directly imposed or rights be restricted in relation to the conduct of the business or transaction.

(iii) Criteria for Items to be Included in the Inquiry Form

Whether the following matters are included in accordance with Form 5 of the Ordinance for Enforcement of the Enhancement Act and based on the Usage Guide.

A. The goals of the new business activities and related business activities

B. The particulars of the new business activities and related business activities

C. Timing of conducting the new business activities and related business activities

D. Clauses of the laws and ordinances for which confirmation of interpretation and presence or absence of

application are requested

E. Specific matters to be confirmed

(3) Response

The section to which the inquiry form was forwarded shall, in the case where the Strategy Development Division, the Strategy Development and Management Bureau, has decided to respond, issue a written response to the submitter by using Form 11 of the Order Based on the Enhancement Act within one month, in principle, from when the inquiry form arrived from the submitter at the contact point for inquiry.

If there are unavoidable circumstances that prevent the issuance of a written response within the above period, in light of the status of examination of the interpretation of the provisions of the laws and regulations and the applicability of the provisions with regard to the request for confirmation stated in the inquiry form, the section to which the inquiry form was forwarded shall notify the submitter of that fact and its reason every period that does not exceed one month, until said written response is issued.

## II-4 Points of Attention in Providing Administrative Guidance, etc.

### II-4-1 Points of Attention in Providing Administrative Guidance, etc.

When providing administrative guidance, etc., (“Administrative guidance, etc.,” includes administrative guidance as specified under Article 2(vi) of the Administrative Procedure Act as well as the advice and other acts that cannot be clearly distinguished from administrative guidance) to Financial Instruments Business Operators, etc., supervisors shall abide by the Administrative Procedure Act and other relevant laws and regulations. The following points shall be taken into consideration.

#### (1) General Principles (Article 32 of the Administrative Procedure Act)

- (i) Whether the administrative guidance, etc., is followed entirely on the basis of voluntary cooperation of the supervised business operator. For example, the following points shall be taken into consideration:
  - A. Whether the supervisor has obtained the understanding of the supervised business operator on the contents and application of the administrative guidance, etc., and the conduct of the official in charge.
  - B. Whether the administrative guidance has been continued despite the supervised business operator’s expression of an unwillingness to cooperate.
- (ii) Whether the supervisor has given unfavorable treatment to a business operator for failing to follow administrative guidance, etc.
  - A. It should be kept in mind that disclosing a failure to follow administrative guidance, etc., without due legal grounds could amount to “unfavorable treatment” in a situation where such disclosure would serve as a social punishment by causing economic losses, for example.
  - B. In cases where the authority to take administrative dispositions may be exercised depending on the circumstances following the provision of administrative guidance, etc., the supervisor may provide the administrative guidance, etc., while indicating the possibility of the exercise of the said authority.

#### (2) Administrative Guidance, etc. Related to Applications (Article 33 of the Administrative Procedure Act)

Whether the supervisor has prevented the applicant’s exercise of its rights by continuing administrative guidance, etc., despite the applicant’s expression of an intention not to follow the said administrative guidance, etc.

- (i) Even if the applicant has not clearly expressed an intention not to follow administrative guidance, etc., the supervisor shall consider whether the applicant has no intention to do so by taking into consideration the background to the administrative guidance etc., and changes in the objective circumstances, etc.
- (ii) It should be kept in mind that even if the applicant is following administrative guidance etc., this does not necessarily constitute voluntary consent to the supervisor’s possible suspension of the screening and response processes regarding the application.
- (iii) The following points shall be taken into consideration, for example:
  - A. Whether the supervisor has prevented the applicant’s exercise of its rights by putting the applicant in a situation in which it is impossible not to follow administrative guidance, etc.
  - B. In cases where the applicant has not clearly expressed an intention to not follow administrative guidance, etc., whether the supervisor has not suspended the screening and response processes regarding the

application on the grounds that the applicant is receiving administrative guidance, etc.

- C. In cases where the applicant has expressed an intention to not follow administrative guidance, etc., whether the supervisor has ceased the said administrative guidance, etc., and processed the application in a prompt and appropriate manner.

(3) Administrative Guidance, etc., Concerning Authority over Granting of License and Approval (Article 34 of the Administrative Procedure Act)

In cases where the supervisor does not have the authority to grant a license or approval or take administrative dispositions based thereon, or where the supervisor has no intention to exercise such authority, whether the supervisor is forcing a business operator to follow administrative guidance, etc., by making an ostensible show of the possibility of exercising the authority.

For example, the following points shall be taken into consideration:

- (i) Whether the supervisor is requiring a business operator to engage in or refrain from engaging in a particular act by pretending to have the authority to deny a license or approval in cases where the supervisor does not in reality have such authority.
- (ii) Whether the supervisor is forcing a business operator to follow administrative guidance, etc., by indicating the possibility of exercising the authority regarding licensing and approval at any time unless the administrative guidance, etc., is followed, or by implying that some kind of unfavorable treatment would be given.

(4) Method of Administrative Guidance (Article 35 of the Administrative Procedure Act)

- (i) When providing administrative guidance, etc., whether the supervisor clarifies to the supervised business operator what the purpose and contents of the said guidance, etc., are and who the officer in charge is.

The following points shall be taken into consideration, for example:

- A. Whether the supervisor clarifies what act the supervised business operator should engage in or refrain from engaging in.
  - B. Whether the supervisor indicates which officer is responsible for the provision of relevant administrative guidance, etc.
  - C. In cases where administrative guidance, etc., is provided based on a specific law, whether the supervisor indicates the legal provision used as the basis.
  - D. In cases where the provided administrative guidance, etc., is not based on a specific law, whether the supervisor gains the business operators understanding of the necessity of the said guidance by explaining the purpose thereof.
- (ii) In cases where the supervised business operator requests the provision of a document that specifies the officer in charge and the purpose and contents of administrative guidance, etc., whether the supervisor meets the request in principle, unless there is any particular problem from the viewpoint of the conduct of administration (excluding cases that fit the description of either item of Article 35 (3)).
    - A. In cases where the provision of a written document is requested, it is necessary to meet the request as soon as possible.

- B. A “particular problem from the viewpoint of the conduct of administration” that justifies a refusal to provide the requested document refers to the case in which a significant impediment could be caused to the conduct of administration by the indication in writing of the officer in charge and the purpose and contents of administrative guidance, etc. For example, if the document specifying those matters is utilized or interpreted regardless of the intention of the person who compiled it, achieving a certain administrative objective could become impossible.
- C. It should be kept in mind that a large backlog of work to be conducted or a need to conduct work in a short period of time alone would not constitute a “particular problem from the viewpoint of the conduct of administration.”

#### II-4-2 Points of Attention in Holding Interviews, etc.

When FSA employees hold interviews, etc., (“Interviews, etc.,” include face-to-face interviews, telephone conversations and e-mail exchanges) with management and employees of Financial Instruments Business Operators, etc., they shall take the following points into consideration:

- (i) Whether the FSA employees who participate in interviews, etc., always maintain discipline and decorum as well as a calm and composed attitude.
- (ii) Whether FSA employees confirm the purpose of interviews, etc., and the names and affiliation of the interviewees.
- (iii) Whether FSA employees ensure that the place and time of their interviews, etc., as well as the composition of participants from the FSA side and the interviewed business operator are appropriate in light of the purpose and contents thereof.
- (iv) Whether FSA officials make sure, as necessary, to have both sides share the recognition of the contents and results of interviews, etc. In particular, when the contents and results of an interview, etc., are subject to a confidentiality obligation, whether it is ensured that the need for confidentiality is made clear to both sides.
- (v) In cases where FSA officials face a need to consult their superiors with regard to the contents of interviews, etc., whether they seek the superiors’ judgment in advance or make a report to the superiors immediately after the interviews, etc., depending on the circumstances. Furthermore, when they hold interviews with two or more business operators regarding matters that require consultations with their superiors, whether FSA officials take care to ensure the consistency and transparency of the conduct of administration.

#### II-4-3 Procedures for Communications and Consultations

When supervisors find it difficult to make judgment in light of the Administrative Procedure Act as to the appropriateness of the administrative guidance, etc., that they plan to provide through interviews, etc., they shall contact the relevant FSA division and hold consultations as necessary about what to do.

## II-5 Points of Attention in Taking Administrative Dispositions

### II-5-1 Response to Inspection Results, etc.

#### (1) Response to Inspection Results

Supervisory departments shall properly reflect the results of inspections of Financial Instruments Business Operators, etc., conducted by inspection departments in supervisory processes as follows:

- (i) Regarding violation of laws pointed out in inspection reports, and acts and situations that are related to Financial Instruments Business Operators' business operations and assets and registered financial institutions' business operations, and that are problematic from the viewpoint of protecting public interests and investors, as well as important matters pointed out in the previous inspection regarding which improvement is not sufficient, supervisors shall order, under Article 56-2(1) of the FIEA, the submission within one month (the deadline for the submission may be shortened on an item-by-item basis) of a report on factual confirmation, the analysis of causes, and improvement and corrective measures, when they deem it necessary and appropriate to do so.

In addition, regarding a Financial Instruments Business Operator, etc., that is planning a system integration as part of a merger or another similar business restructuring move, and regarding which a problem has been pointed out with regard to the internal control environment for managing system integration risk, the supervisor shall order the submission of a report under the same legal provision on the policy for implementing its system integration plan precisely and on the internal control environment regarding the system risk (including internal audits), among other matters, when they deem it necessary and appropriate to do so.

Orders for the submission of the above reports shall be issued in the format specified in the Attached List of Formats II-12.

- (ii) When receiving the above reports, the supervisor shall hold sufficient hearings with the Financial Instruments Business Operator, etc. When holding the hearings, the supervisor shall maintain close cooperation with inspection departments.
- (iii) In cases where a certain period of time is deemed to be necessary in order to implement improvement and corrective measures specified in the reports and to make improvement regarding the matters pointed out in the inspection, the supervisor shall strive to ensure appropriate follow-up through periodic hearings, for example.
- (iv) In cases where the Securities and Exchange Surveillance Commission has issued a recommendation regarding administrative dispositions and other measures to be taken based on Article 20 (1) of the Act for Establishment of the Financial Services Agency, supervisory authorities shall consider issuing an order for the submission of reports based on Article 56-2(1) of the FIEA and taking administrative dispositions based on Articles 51 to 52-2 of the FIEA and other appropriate measures after examining the contents of the recommendation.

#### (2) Requirement for the Submission of Reports Based on Off-site Monitoring

- (i) In cases where a Financial Instruments Business Operator, etc., is deemed to have a problem in its control

environment for risk management, legal compliance and governance, etc., the supervisor shall require the submission of a report, based on Article 56-2(1) of the FIEA, on factual recognition regarding the problem, the analysis of the cause, improvement and corrective measures and other necessary matters.

- (ii) In cases where it is deemed necessary to conduct more detailed investigation as a result of verifying the report, the supervisor shall require the submission of an additional report based on Article 56-2(1) of the FIEA.
- (iii) In cases where any serious problem from the viewpoint of protecting public interests and investors has not been detected as a result of the examination of the above reports, and where it is deemed possible for the Financial Instruments Business Operator, etc., to make voluntary improvement efforts, the supervisor shall follow up on the reported improvement and corrective measures through voluntary hearings and other means.
- (iv) When necessary, the supervisor shall require the submission of periodic reports based on Article 56-2(1) of the FIEA and follow up thereon.

#### II-5-2 Administrative Dispositions Based on Articles 51 to 52-2 (1) (Business Improvement Orders, Business Suspension Orders, etc.)

In cases where a serious problem from the viewpoint of protecting public interests and investors has been detected as a result of the examination of the contents of reports submitted by Financial Instruments Business Operators, etc., or the contents of recommendations issued by the Securities and Exchange Surveillance Commission in light of the evaluation items specified in this Guideline for Supervision, the supervisory departments shall decide which administrative dispositions to take with due consideration of the factors described in (1) to (3) below after considering, among other factors, the following points:

- Whether it is appropriate to leave it to the Financial Instruments Operator, etc., to make improvement efforts on a voluntary basis.
- Whether substantial improvement is required and it is necessary to have the Financial Instruments Business Operator, etc. concentrate on business improvement for a certain period of time.
- Whether it is appropriate to allow the Financial Instruments Business Operator, etc., to continue business operations.

##### (1) Seriousness and Maliciousness of Acts

###### (i) Degree of Damage to Public Interests

Whether the Financial Instruments Business Operator, etc., is undermining public interests significantly by, for example, originating and providing products markedly inappropriate from the viewpoint of appropriate disclosure of financial conditions to customers, thereby damaging confidence in the financial markets.

###### (ii) Extent of Damage to Users

Whether a number of users across wide regions have suffered damage. How serious the damage done to individual users is.

###### (iii) Maliciousness of Acts

Whether the Financial Instruments Business Operator, etc., has acted in a malicious way, such as by continuing to sell similar products despite receiving numerous complaints from users.

###### (iv) Duration and Repetitive Nature of Acts



Whether the act in question committed by a Financial Instruments Business Operator, etc., has been committed for a long period of time. Whether the act has been committed repeatedly and continuously or only once. Whether the Financial Instruments Business Operator, etc., committed a similar illegal act in the past.

(v) Intentionality

Whether the Financial Instruments Business Operator, etc., has committed the illegal/inappropriate act intentionally while recognizing the illegality and inappropriateness, or has done so through negligence.

(vi) Institutional Involvement

Whether the act has been committed based on an individual employee's judgment or a manager has been involved. Whether the management team has been involved.

(vii) Presence or Absence of Cover-Up Actions

Whether an attempt to cover up the act has been made after its illegality was recognized. Whether a cover-up, if one exists, was an institutional act.

(viii) Involvement of Anti-Social Forces

Whether any anti-social forces have been involved. How much involvement, if any.

(2) Appropriateness of Control Environment for Governance and Business Operation

(i) Whether the representative director and the board of directors are fully aware of the importance of legal compliance and make sufficient efforts to ensure compliance.

(ii) Whether the internal audit section is adequately staffed and equipped to conduct audits and whether the division is functioning properly.

(iii) Whether the compliance and risk management divisions are adequately staffed and equipped to perform their tasks and whether they are functioning properly.

(iv) Whether employees engaging in business are fully aware of the importance of legal compliance and whether sufficient internal training is provided.

(3) Attenuation Factors

Apart from (1) and (2) above, whether there are attenuation factors, such as the implementation of voluntary efforts by the Financial Instruments Business Operator, etc. to protect investors before the administrative response. In particular, if the Financial Instruments Business Operator, etc. precisely implements voluntary efforts based on principles that have been shared with administrative authorities, this fact is to be taken into consideration as an attenuation factor.

II-5-3 Points of Attention Regarding Administrative Dispositions against Registered Financial Institutions

In cases where inappropriate practices have been recognized with regard to securities-related businesses conducted by registered financial institutions, supervisory departments shall require the submission of reports and issue orders for business improvement, etc., as necessary in cooperation with the divisions in charge of the supervision of banks, from the viewpoint of not only protecting investors under the FIEA but also ensuring the soundness of the management under the Banking Act and other relevant laws.

#### II-5-4 Standard Processing Period Regarding Supervisory Actions Based on Inspection Results

In cases where supervisory actions are to be issued based on Articles 51 to 52-2 of the FIEA, the following procedures shall be followed:

- (i) The supervisor shall determine supervisory actions within one month from the receipt of letters of recommendations or inspection reports (copies) (within two months in cases where the chief of the relevant Local Finance Bureau needs to consult the FSA Commissioner and in cases where the actions are based on laws that are under the joint jurisdiction of the FSA and other ministries and agencies).
- (ii) In cases where the Financial Instruments Business Operators, etc., and other business operators are required to submit reports, regarding the matters pointed out in the said letters of recommendations and inspection reports, for factual confirmation or other purposes, the said orders shall be issued within one month from the receipt of the reports (within two months in cases where the chief of the relevant Local Finance Bureau needs to consult the FSA Commissioner and in cases where the orders are based on laws that are under the joint jurisdiction of the FSA and other ministries and agencies).

(Note 1) In determining the timing of the “receipt of a report,” the following points shall be taken into consideration:

- (a) In cases where the submission of a report based on Article 56-2(1) of the FIEA is required twice or more (limited to cases where the submission of an additional report is required within the prescribed period from the receipt of the most recent report), the receipt of the last report shall be the starting point of the counting of the standard processing period.
- (b) In cases where the submission of corrected or additional documents (excluding those concerning minor corrections and additions) is required, the receipt of the said documents shall be the starting point of the counting of the standard processing period.

(Note 2) The time necessary for legal explanations and hearings shall not be included in the counting of the standard processing period.

(Note 3) The standard processing period shall be applied on the basis of each item of information used as the basis for determining what supervisory action to take.

#### II-5-5 Removal of the Requirement for the Submission of Reports on Compliance with Business Improvement Orders under Articles 51 and 51-2 of the FIEA

In cases where business improvement orders are issued against Financial Instruments Business Operators, etc., based on Articles 51 and 51-2 of the FIEA, the supervisor shall follow up on their business improvement efforts and, in principle, require the submission of reports on the implementation of business improvement plans so as to promote such efforts. Regarding the follow-up and the requirement for the submission of reports, the following points shall be taken into consideration:

- (1) In cases where Financial Instruments Business Operators, etc., who have received business improvement orders based on Article 51 and 51-2 of the FIEA are required to submit reports on the implementation of their business improvement plans for a specified period of time, the requirement shall be removed upon the arrival of the end of the said period.

(2) In cases where Financial Instruments Business Operators, etc., who have received business improvement orders based on Article 51 and 51-2 of the FIEA are required to submit reports on the implementation of their business improvement plans continuously without any set timeframe, the requirement shall be removed when it is recognized that sufficient improvement measures have been taken in line with their business improvement plans with regard to the problems that constituted the basis of the issuance of the orders. A decision on whether to remove the requirement shall be made in light of the implementation of improvement efforts as identified through the submitted reports and other means.

## II-5-6 Relation to the Administrative Procedure Act and Other Laws

### (1) Relation to the Administrative Procedure Act

It should be kept in mind that in cases where supervisors intend to take adverse dispositions, including issuing orders for business improvement and business suspension and rescinding registration and licenses, they must hold legal hearings based on Article 57(2) of the FIEA.

It should also be kept in mind that in the case where supervisors reject permits and licenses requested by application, and where supervisors take an adverse disposition, they must indicate the reason for the action based on Article 8 and Article 14 of the Administrative Procedure Act, respectively (when taking the dispositions in writing, they must indicate the reason for the action also in writing).

Upon doing so, it should be kept in mind that it is required to clarify the facts on which the disposition was based as well as which laws and ordinances or standards were applied in taking the disposition, instead of simply indicating the basis provisions alone.

### (2) Relation to the Administrative Appeals Act

It should be kept in mind that in cases where supervisors reject permits and licenses requested by application, or intend to require the submission of reports, issue orders for business improvement or business suspension, and rescind registration and licenses, etc., the relevant Financial Instruments Business Operators, etc., must be advised in writing that they are entitled to request examination to the Commissioner of the FSA, etc., based on Article 82 of the Administrative Appeals Act.

### (3) Relation to the Administrative Case Litigation Act

It should be kept in mind that in cases where supervisors reject permits and licenses requested by application, or intend to require the submission of reports, issue business improvement or business suspension orders, and rescind registration or licenses, etc., the relevant Financial Instruments Business Operators, etc., must be advised in writing matters concerning the filing of suits to seek the rescission of the said administrative dispositions based on Article 46 of the Administrative Case Litigation Act.

## II-5-7 System for Exchange of Opinions

In cases where adverse dispositions are to be taken, it may be useful for supervisors to exchange opinions with

the relevant Financial Instruments Business Operators, etc., at several levels upon their request, in addition to holding legal hearings and granting opportunities for making explanations based on the Administrative Procedure Act, in order to share the recognition of the facts that constitute the basis of the administrative dispositions and their seriousness.

In cases where a Financial Instruments Business Operator, etc., who has recognized the likelihood of becoming the target of an adverse disposition during the hearing process concerning the requirement for the submission of a report, requests that an opportunity be provided for an exchange of opinions (refer to Note 1) between senior supervisors (refer to Note 2) and senior officials of the business operator, and where the supervisory authorities intend to take adverse disposition that involves opportunities for hearings or explanations, an opportunity for an exchange of opinions about the facts that constitute the basis of the adverse disposition and their seriousness shall be granted before the notification of the said opportunity for hearings and explanations, unless it is necessary to take the said administrative disposition urgently.

(Note 1) Requests from Financial Instruments Business Operators, etc., for an opportunity for an exchange of opinions shall be met only if they are made between the receipt of reports on the facts that constitute the basis of the relevant adverse dispositions that have been submitted based on Article 56-2(1) of the FIEA and the notification of opportunities for hearings and explanations.

(Note 2) “Senior supervisors” include the directors-general of the relevant divisions of the FSA and Local Finance Bureaus.

#### II-5-8 Notification to Relevant Authorities, including Overseas Supervisory Authorities

In cases where supervisors intend to take adverse dispositions, including issuing orders for business improvement and business suspension and rescinding registration and licenses, they shall, as necessary, notify other relevant authorities, including overseas supervisory authorities

#### II-5-9 Concept on the Publication of Adverse Dispositions

(1) It should be kept in mind that when supervisors have issued orders for business suspension and rescinded registration and licenses, they must publish the administrative dispositions in official gazettes.

(2) This means that the facts that constitute the basis of adverse dispositions, such as the issuance of orders for business improvement and the contents of the dispositions, should be published, except for cases where the publication of those matters could undermine efforts to improve the management of the relevant Financial Instruments Business Operators, etc. The purpose of this publication is to make it easier for financial institutions in general to predict what administrative dispositions will be taken under what circumstances, thereby reducing the possibility of similar inappropriate incidents arising in the future

## II-6 Application Mutatis Mutandis

(1) Application Mutatis Mutandis to Persons Engaging in Businesses Specially Permitted for Qualified Institutional Investors, etc., Businesses Specially Permitted for Overseas Investors, etc. and Businesses Specially Permitted for the Transitional Period.

The provisions of II-1-4 (2) to (4), II-1-5(1), II-1-7(1)(v) and (ix), (2)(iii), II-1-8, II-2, II-3, II-4 and II-5 shall be applied mutatis mutandis to administrative processes regarding persons engaging in businesses specially permitted for qualified institutional investors, etc. (referring to businesses specially permitted for qualified institutional investors (referring to businesses specially permitted for qualified institutional investors prescribed in Article 63(2) of the FIEA; the same shall apply hereinafter) or specially-permitted investment management businesses (referring to specially-permitted investment management businesses prescribed in Article 48(1) of the Supplementary Provisions of the Act for Partially Amending the Securities and Exchange Act, etc. (2006 Act No. 65; hereinafter referred to as the "Amendment Act" except for VI-2-11-1); the same shall apply hereinafter); the same shall apply hereinafter), businesses specially permitted for overseas investors, etc. (referring to businesses specially permitted for overseas investors, etc. prescribed in Article 63-8(1) of the FIEA; the same shall apply hereinafter), businesses specially permitted for the transitional period (referring to businesses specially permitted for the transitional period prescribed in Article 3-3(5) of the Supplementary Provisions of the FIEA; the same shall apply hereinafter), or businesses pertaining to acts prescribed in Article 3-3(7) of the Supplementary Provisions of the FIEA (hereinafter referred to as "businesses specially permitted for the transitional period, etc." together with businesses specially permitted for the transitional period). Additionally, for re-delegation of tasks to directors-general of local finance offices, etc., II-1-7(3) shall apply by replacing the following with the re-delegated tasks. It should be noted that words and sentences in the relevant format specified in the Attached List of Formats shall be replaced as necessary.

- (i) Administrative processes for receiving notifications based on Article 63(2), (8) and (13), Article 63-2(2) to (4) of the FIEA (including cases where these provisions are applied mutatis mutandis pursuant to Article 63-3(2) of the FIEA or applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply in IX) and Article 63-3 (1) of the FIEA
- (ii) Administrative processes for receiving copies of contracts based on Article 63(9) and (10) of the FIEA (including cases where these provisions are applied mutatis mutandis pursuant to Article 63-3(2) of the FIEA; the same shall apply in IX)
- (iii) Administrative processes for receiving documents based on Article 63-4(2) (including where this provision is applied mutatis mutandis pursuant to Article 63-3 (2) or applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act)
- (iv) Administrative processes for receiving notification based on Article 63-9(1), (7) and (10) of the FIEA, Article 63-10(2) to (4) of the FIEA (including cases where these provisions are applied mutatis mutandis pursuant to Article 63-11(2) of the FIEA or are applied pursuant to Article 3-3(4) of the Supplementary Provisions of the FIEA; hereinafter the same shall apply in VI-3-3), Article 63-11(1) of the FIEA, and Article 3-3(1) of the Supplementary Provisions of the FIEA.
- (v) Administrative process for receiving documents submitted based on Article 63-12(2) of the FIEA (including

cases where applied mutatis mutandis pursuant to Article 63-11(2) of the FIEA or applied pursuant to Article 3-3(4) of the Supplementary Provisions of the FIEA).

(2) Application Mutatis Mutandis to Financial Instruments Intermediary Service Providers

The provisions of II-1-4(3) and (4), II-1-7, II-1-8, II-2, II-3, II-4 and II-5 shall be applied mutatis mutandis to administrative processes regarding financial instruments intermediary service providers, and the provisions of II-1-5(2)(i) and (ii) shall be applied mutatis mutandis to the coordination and liaison with the competent directors-general of Local Finance Bureaus regarding the supervisory processes related to financial instruments intermediary service providers. In addition, the following points shall be taken into account. It should be noted that words and sentences in the relevant format specified in the Attached List of Formats shall be replaced as necessary.

- (i) When the directors-general of Local Finance Bureaus supervise financial instruments intermediary service providers who handle financial products on behalf of Financial Instruments Business Operators, etc., under the jurisdiction of the FSA Commissioner or the directors-general of other Local Finance Bureaus, they shall strive to cooperate therewith by, for example, providing information necessary for supervising the said Financial Instruments Business Operators, etc.
- (ii) The directors-general of Local Finance Bureaus, when sales offices or other facilities of financial instruments intermediary service providers under the jurisdiction of the directors-general of other Local Finance Bureaus are located in their areas of jurisdiction, shall strive to cooperate with those Local Finance Bureau directors-general by, for example, providing information necessary for the supervision of the said financial instruments intermediary service providers.

(3) Application Mutatis Mutandis to Securities Finance Companies

The provisions of II-1-8, II-2, II-3, II-4 and II-5 shall be applied mutatis mutandis to administrative processes regarding securities finance companies.

(4) Application Mutatis Mutandis to Investment Corporations

The provisions of II-1-4(3) and (4), II-1-8, II-2, II-3, II-4 and II-5 shall be applied mutatis mutandis to administrative processes regarding investment corporations. It should be noted that words and sentences in the relevant format specified in the Attached List of Formats shall be replaced as necessary.

(5) Application Mutatis Mutandis to Commodities Investment Sales Companies

The provisions of II-1-5(1) and (2)(ii), II-1-6, II-1-7(1), II-1-8, II-2, II-3, II-4 and II-5 (excluding II-5-9(1)) shall be applied mutatis mutandis to administrative processes regarding commodities investment sales companies, based on the Act on Regulation on Commodities Investment-Related Business. It should be noted that words and sentences in the relevant format specified in the attached list of formats shall be replaced as necessary.

### **III. Supervisory Evaluation Points and Various Administrative Procedures (General)**

#### III-1 Governance (General)

In order to realize the sound development of the securities market, it is important for Financial Instruments Business Operators themselves to endeavor to develop their control environment for legal compliance and conduct management in a manner to ensure full customer protection. In conducting daily supervisory administrative processes, it is necessary to examine what the desirable status of governance by a Financial Instruments Business Operator is, from the viewpoint of whether its management team's checking of the execution of the business operators' business is conducted effectively and whether the monitoring and control of the management team is conducted effectively.

##### (1) Major Supervisory Viewpoints

In order to ensure that governance by a Financial Instruments Business Operator functions effectively, all officers and employees need to recognize that the business operator bears important social responsibilities as an intermediary of the financial instruments market, and need to be involved in business operations based on a full understanding of the roles assigned to them. In particular, the representative director, individual directors and the board of directors, individual auditors and the board of auditors, and the internal audit section bear important responsibilities.

Naturally, the representative director, as the director empowered to represent the Financial Instruments Business Operator, bears the greatest responsibility for the management thereof. The board of directors, as the highest decision-making body of the Financial Instruments Business Operator, is not only empowered to make specific decisions regarding the execution of business, but also has the functions of monitoring the execution of business by the representative director and the director in charge, and preventing autocratic management. Auditors and the board of auditors are granted broad and strong authority so as to audit the execution of business by directors, etc., who bear important responsibilities for the management of the Financial Instruments Business Operator as stated above, thereby bearing important responsibilities for the task of monitoring governance.

In addition, the amendment of the Companies Act in 2014 and the provisions of financial instruments exchanges stipulate that listed companies secure outside directors, while the provisions also prescribe that listed companies respect the Corporate Governance Code and make efforts to strengthen corporate governance. As such, listed companies are required to meet a higher level of governance than unlisted companies.

Therefore, in monitoring the control environment of governance of listed Financial Instruments Business Operators, supervisors shall pay attention to whether the business operator is making efforts appropriately in accordance with the Corporate Governance Code in establishing a control environment of governance of a level required by the principles of the Corporate Governance Code, and examine whether its functions are appropriately performed.

With regard to business operators whose parent company is a listed company, supervisors shall check the control environment of governance of the parent company including the state of efforts regarding compliance with the Corporate Governance Code within the scope necessary for examining governance of the business operator.

(Note) Supervisors shall pay attention to ensure that the Corporate Governance Code adopts the so-called

“principles-based approach” and the “comply or explain” (either comply with a principle or, if not, explain the reasons why not) approach.

It shall also be taken into consideration that the scope of application of each principle of the Corporate Governance Code is stipulated in each market for listed companies.

In view of the above, it is necessary to examine whether the representative director, directors/the board of directors and auditors/the board of auditors are fully performing their important responsibilities for the management of the Financial Instruments Business Operator, by paying attention to the following points, for example:

(Note) In the case of Financial Instruments Business Operators that are companies with nominating committees, etc., it is necessary to examine whether the board of directors, committees, executive officers, etc., exercise their respective authority appropriately. In addition, in the case of business operators that are companies with an audit and supervisory committee, it is necessary to examine whether the board of directors, audit and supervisory committee, etc., exercise their respective authority appropriately. In this case, examination should be conducted with due consideration of the actual status of management based on the purpose of this Guideline.

(i) Representative Director

- A. Whether the representative director counts matters concerning the execution of business as well as those concerning the development and establishment of legal compliance and internal control environment among the most important management issues. Also, whether the director is sincerely leading efforts to formulate a specific policy for implementing compliance and is ensuring full compliance.
- B. Whether the representative director fully recognizes that disregard of the risk management division may have a serious impact on corporate earnings and attaches importance to the said division.
- C. Whether the representative director, based on the recognition of the importance of internal audits, sets appropriate objectives of internal audits and establishes arrangements for enabling the internal audit section to fully perform its functions (including securing the independence of the internal audit section), and periodically checks the performance of the functions. Whether the representative director approves basic matters concerning internal audit plans, including an audit policy and priority items, in light of the risk management status, etc., of divisions subject to audits, and implements appropriate measures based on the results of internal audits.
- D. Whether the representative director fully understands that banning any relations with anti-social forces and firmly excluding such forces are vital for maintaining public confidence in the Financial Instruments Business Operator and securing the appropriateness and soundness of its business. In addition, based on this understanding, whether the representative director has made clear, both throughout the company and to the outside, a basic policy decided by the board of directors with due consideration of the “Guideline for Prevention of Damages from Anti-Social Forces in Industry” (agreed upon at a meeting on June 19, 2007 of cabinet ministers responsible for anti-crime measures; hereinafter referred to as the “Government Guideline”).

(ii) Directors/Board of Directors

- A. Whether directors check and prevent autocratic management by the representative director and other officers who are responsible for business execution, and are actively involved in the board of directors'



decision-making and checking process concerning business execution.

- B. Whether the Board of Directors has specified a management policy based on the overall vision of the desirable status of the Financial Instruments Business Operator. Whether it has established management plans in line with the management policy and communicated the plans throughout the company. Whether it regularly reviews and revises the progress status thereof.
- C. Whether the board of directors counts not only matters concerning the execution of business, but also those concerning the development and establishment of legal compliance and internal control environment among the most important management issues, and is sincerely leading efforts to formulate a specific policy for implementing compliance and ensuring full compliance. Whether it makes sure to communicate the said policy throughout the company. In addition, whether the board of directors has decided a basic policy based on the Government Guideline, established a framework for implementing it and clearly positioned the prevention of damage that could be inflicted by anti-social forces as a matter of legal compliance and risk management by, for example, periodically examining the effectiveness thereof.
- D. Whether the board of directors fully recognizes that disregarding the risk management division may have a serious impact on corporate earnings, and attaches importance to the said division. In particular, whether the director in charge has in-depth knowledge and understanding concerning the methods of measuring, monitoring and managing risks, in addition to an understanding of where risks reside and what kind of risks they are.
- E. Whether the board of directors has set up a policy for managing various risks based on strategic objectives. Whether it reviews and revises the risk management policy on a periodic or as-needed basis so as to adapt the policy to changes in strategic objectives, and the development of risk management techniques, etc. In addition, whether the board of directors makes use of risk-related information in the execution of business and the development of risk management systems by, for example, making necessary decisions based on risk-related information reported periodically.
- F. Whether the board of directors recognizes the importance of segregated custody of customer assets based on their understanding that it contributes to investor protection and the sound development of the financial instruments market. In addition, whether the board of directors makes use of information related to the status of the segregated custody of customer assets when developing systems for ensuring appropriate segregated custody by, for example, receiving status reports on a periodic or as-needed basis.
- G. Whether the board of directors has set appropriate objectives of internal audits and established arrangements for enabling the internal audit section to fully perform its functions based on the recognition of the importance of internal audits (including securing the independence of the internal audit section), and periodically checks the performance of the function. Whether the board of directors approves basic matters concerning internal audit plans, including an audit policy and priority items, in light of the risk management status, etc., of divisions subject to audits, and implements appropriate measures based on the results of internal audits.

(iii) Auditors/Board of Auditors

- A. Whether the independence of the board of auditors is ensured in accordance with the purpose of the

board of auditors system.

- B. Whether the board of auditors properly exercises the broad authority granted thereto and conducts audits of business operations in addition to audits of accounting affairs
- C. Whether individual auditors recognize the importance of their own independence within the board of auditors and actively take the initiative to conduct audits.
- D. Whether the board of auditors strives to ensure the effectiveness of its audits by, for example, receiving reports on the results of external audits, depending on the contents thereof.

(iv) Internal Audit Section

Internal audits are conducted by entities independent from audited divisions, in order to examine and evaluate the status of business execution and the appropriateness, effectiveness and reasonableness of internal management and control, and to provide advice and make recommendations to the management based thereon, with a view to contributing to the achievement of the management goals of Financial Instruments Business Operators. Therefore, internal audits constitute one of the most important corporate activities for Financial Instruments Business Operators if they are to secure autonomous corporate management. In light of the importance of internal audits, it is necessary to examine whether the function of internal audits is working effectively at Financial Instruments Business Operators, by paying attention to the following points, for example.

- A. Whether the internal audit section has been established as an organization that is independent from divisions subject to audit so as to fully check the actions thereof, and is sufficiently staffed and equipped to conduct effective internal audits.
- B. Whether the internal audit section formulates internal audit plans based on its understanding of the status of risk management by divisions subject to audits and the types of risks faced thereby with regard to all businesses conducted by the Financial Instruments Business Operator.
- C. Whether the internal audit section audits divisions subject to audits in an efficient and effective manner based on internal audit plans.
- D. Whether the internal audit section reports important issues identified and pointed out in internal audits without any delay to the representative director and the board of directors.
- E. Whether the internal audit section appropriately oversees the improvement status of divisions subject to audits, with regard to matters pointed out in internal audits and reflects it in future internal audit plans.

(v) Use of External Audits

This Guideline does not obligate Financial Instruments Business Operators to undergo external audits of their business operations by external auditors (including audits by the head offices and group companies) in addition to mandatory audits of financial statements, etc., by accounting auditors. However, in order to acquire the profits and secure the effectiveness of the risk management and internal control environment, it is desirable to ensure effective use of external audits by accounting auditors and others, as well as internal audits by Financial Instruments Business Operators themselves. Therefore, examination of the status of external audits should be conducted by paying attention to the following points, for example.

- A. Whether important issues identified and pointed out in external audits are reported without any delay to the board of directors or to the board of auditors.

- B. Whether divisions subject to audits make improvements with regard to matters pointed out in external audits within a certain time period. In addition, whether the internal audit section appropriately identifies and examines the improvement status.

(2) Supervisory Method and Actions

Supervisors shall examine the status of governance through the following hearings and daily supervisory administrative processes.

(i) Hearings Regarding Management Challenges, etc.

Supervisors shall hold hearings regarding Financial Instruments Business Operators' management challenges, strategies and the status of risk management and governance, among other matters, as necessary. In addition, senior supervisors shall directly hold hearings with top managers of Financial Instruments Business Operators, as necessary.

(ii) Hearings Regarding Internal Audits

Supervisors shall hold hearings with the internal audit sections of Financial Instruments Business Operators as necessary, with regard to their control environment for internal audits, the status of the implementation of internal audits and the correction of problems, from the viewpoint of identifying the status of the divisions' exercise of their functions.

In addition, supervisors shall hold hearings with Financial Instruments Business Operators' auditors and outside directors when a particular need to do so is recognized.

(iii) Examination of Governance through Daily Supervisory Administrative Processes

Supervisors shall examine the effectiveness of governance not only through the hearings described above but also through daily supervisory administrative processes, such as receiving reports on problematic conduct in financial instruments business.

(iv) Recording of Monitoring Results

Supervisors shall compile and store records on matters of particular note based on the results of monitoring conducted through procedures described above, and make effective use thereof in future supervisory administrative processes.

(v) Supervisory Method and Actions

In cases where doubt has arisen about the effectiveness of a Financial Instruments Business Operator's governance, the supervisor shall monitor voluntary business improvement made by the business operator, by holding an in-depth hearing regarding the cause of problems and improvement measures and, when necessary, requiring the submission of a report based on Article 56-2(1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisor shall take actions such as issuing a business improvement order based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious illegal act, the supervisor shall consider necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

## III-2 Appropriateness of Businesses (General)

### III-2-1 Control Environment for Legal Compliance

#### (1) Development of Control Environment for Legal Compliance

In order to ensure the development of the Japanese financial market as well as the economy, it is necessary to provide financial instruments and services in an appropriate manner in a fair and transparent securities market, and the confidence of users in Financial Instruments Business Operators is one of the important elements thereof. Financial instruments business operators must make sure to strictly comply with laws and regulations as well as business rules and maintain sound and appropriate business operations. The development of the control environment for legal compliance by Financial Instruments Business Operators shall be examined in light of their business profile with due consideration of the following points, for example.

- (i) Whether the Financial Instruments Business Operator has counted compliance as one of the most important management issues and formulated a basic policy concerning the implementation of compliance, a comprehensive implementation plan (compliance program) and a code of conduct (rules concerning ethics and a compliance manual, etc.). In addition, whether it has informed all officers and employees of the existence and contents of the implementation policy, etc., and ensured a full understanding thereof and the implementation of compliance in daily business operations.
- (ii) Whether the Financial Instruments Business Operator conducts evaluation and a follow-up regarding the implementation policy and the code of conduct on a periodic or as-needed basis. Whether it reviews and revises the contents thereof.
- (iii) Whether the Financial Instruments Business Operator has established a system for ensuring appropriate communications and reporting of compliance-related information among divisions in charge of sales (which refer to all divisions engaged mainly in profit-generating business operations; hereinafter referred to as “sales divisions”), the division/manager in charge of compliance and the management team.
- (iv) Whether the Financial Instruments Business Operator has established robust systems for training and educating officers and employees on compliance and strives to foster and enhance a sense of compliance among officers and employees. In addition, whether it strives to ensure the effectiveness of training by, for example, conducting evaluation and follow-up in a timely manner and by reviewing and revising the contents thereof.
- (v) Whether the Financial Instruments Business Operator has established a system for enabling the person in charge of supervising the status of compliance with laws, regulations, rules, etc. (the person specified by Article 15-4(i) of the FIEA Enforcement Order) to perform his or her functions fully so as to enhance the internal control environment and contribute to appropriate business execution. For example, whether it ensures independence of the internal control division and gives the internal control division the authority to fully perform the function to check the sales division. Whether the internal control division conducts an evaluation and follow-up regarding the status of performance of the function of the manager in charge of internal control, etc.

## (2) Supervisory Method and Actions

Regarding issues of supervisory concern identified through daily supervisory administration and the reporting of problematic conduct in relation to a Financial Instruments Business Operator's control environment for legal compliance, the supervisor shall keep track of the status of voluntary business improvement made by the business operator by holding an in-depth hearing and, when necessary, requiring the submission of a report based on Article 56-2(1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem, from the viewpoint of protecting public interests and investors, the supervisor shall take actions, including issuing a business improvement order based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious illegal act, the supervisor shall consider necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

### III-2-2 Supervisory Response to Problematic Conduct in Financial Instruments Business

Supervisory response to problematic conduct in financial instruments business, etc., (refer to Note) shall be made as follows.

(Note) A "problematic conduct in financial instruments business, etc." refers to either of the following cases:

- (a) An act that constitutes a violation of the provisions of Article 199 (vii) of the FIB Cabinet Office Ordinance
- (b) An indictment of a Financial Instruments Business Operator or officers and employees thereof
- (c) Other acts which could undermine the soundness and appropriateness of a Financial Instruments Business Operator's business operations and which are similar to the acts described in (a) and (b).

## (1) Major Supervisory Viewpoints

### (i) Initial Notification of Problematic Conduct in Financial Instruments Business, etc.

Supervisors shall check the following points upon the receipt of an initial notification of problematic conduct in a financial instruments business, etc., at a Financial Instruments Business Operator. It should be noted that cases in which a written report is submitted without an initial notification shall be handled likewise.

- A. Whether the Financial Instruments Business Operator has promptly reported to the internal control and internal audit section as well as to the board of directors, etc., in accordance with compliance rules.
- B. In cases where the conduct could constitute a criminal offense, whether the Financial Instruments Business Operator has reported to the police and other relevant organizations.
- C. Whether a division independent of the division involved in the conduct (e.g., the internal audit section) investigates the conduct.

### (ii) Examination of Appropriateness of Business Operations

Supervisors shall examine the appropriateness of a Financial Instruments Business Operator's business operations in relation to problematic conduct in a financial instruments business, etc., based on the following viewpoints:

- A. Whether an executive has been involved in the conduct and whether there has been an institutional involvement.

- B. What impacts the conduct is expected to have on the management of the Financial Instruments Business Operator and on customers and the financial instruments market.
- C. Whether the internal checks and balances function is properly functioning.
- D. Whether the Financial Instruments Business Operator has formulated improvement measures intended to prevent the recurrence of the conduct, is equipped with a sufficient self-purification function and has clarified the allocation of responsibilities. For example, whether it has analyzed the cause of occurrence of the problematic conduct in financial instruments business, etc. and has formulated measures to prevent the recurrence with active involvement of the management team and has communicated the measures to the sales division, etc.
- E. Whether the Financial Instruments Business Operator acted appropriately immediately after the conduct came to light.
- F. In cases where the Financial Instruments Business Operator provides profits from its assets in order to compensate for the losses caused by the conduct, whether the business operator compiles records on the provided profits and the basis of the compensation calculation. In addition, whether the Financial Instruments Business Operator has established arrangements and procedures for enabling a division independent from the sales division, such as the internal control division, to check the status of the compilation of the said records.

## (2) Supervisory Method and Actions

In cases where supervisors have recognized the occurrence of problematic conduct in financial instruments business, etc., through reports and notification by Financial Instruments Business Operators, they shall identify and monitor voluntary business improvement made by the business operators by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the Financial Instruments Business Operators are deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing a business improvement order based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious illegal act, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

## III-2-3 Control Environment for Customer Solicitation and Explanations

### III-2-3-1 Principle of Suitability and Duty of Good Faith and Fair Dealing

In accordance with Article 40 of the FIEA, Financial Instruments Business Operators must ensure that investment solicitation is conducted in an appropriate manner suited to their customers' attributes, etc., by offering transactions with terms and contents that are commensurate with each customer's knowledge, experience, asset status and investment purpose as well as his/her ability to make judgment regarding risk management. Additionally, Financial Instruments Business Operators need to preform their duty of good faith and fair dealing to their customers under a system developed for ensuring appropriate implementation of investment solicitation.

To this end, Financial Instruments Business Operators need to establish a system for appropriately ascertaining

the details of financial instruments they provide as a premise of conducting investment solicitation, and it is also important to establish a system to manage customers that makes it possible to accurately ascertain customers' attributes and transaction status. Furthermore, it is necessary to review and evaluate whether there is a rational reason to prove that the details of financial instruments are suited to respective customers' attributes. Then, Financial Instruments Business Operators need to ensure that investment solicitation without such rational reason or inappropriate or unfaithful investment solicitation would not be conducted for their customers.

Given those points, the supervisor should pay attention to the following issues, for example. As methods of investment solicitation are diverse, including solicitation to customers coming to business offices and solicitation using a telephone or via the internet, it should be noted that it is necessary to consider appropriate solicitation methods depending on the characteristics of respective methods.

#### (1) Major Supervisory Viewpoints

##### (i) Proper Understanding of the Details of Financial Instruments

With regard to individual financial instruments provided by Financial Instruments Business Operators, whether Financial Instruments Business Operators sufficiently analyze and identify the risks, returns and costs thereof as well as other information that is necessary for customers in making investment in financial instruments, and whether Financial Instruments Business Operators have developed a system to ensure that management and employees accurately understand the relevant information and appropriately provide explanations to customers in accordance with the characteristics, etc. of respective financial instruments, through the provision of training and preparation of explanatory documents for customers, while collaborating with originators of respective financial instruments.

##### (ii) Efforts for Securing of an Appropriate Identification of Customer Attributes and Actual Status of Transactions as well as for Appropriate Management of Customer Information

- A. Whether, in order to grasp customer attributes such as investment purpose and experiences in a timely and appropriate manner, the Financial Instruments Business Operator prepares a system of customer cards, for instance, adequately confirming the investment purpose, and whether the customer's investment purpose registered on the customer cards is shared by both the Financial Instruments Business Operator and the customer. Furthermore, whether the Financial Instruments Business Operator appropriately manages customer information in such manner as when the Financial Instruments Business Operator ascertains any change in the status of a customer's assets and income or his/her investment purpose based on a report, etc. by the customer, the Financial Instruments Business Operator makes changes to the registered details on the customer cards after confirming the customer's intention whether or not to make said changes and shares the modified registered details with the customer, upon conducting investment solicitation thereafter.
- B. Whether the Financial Instruments Business Operator refers to transaction conditions, such as trading profits and losses, evaluation profits and losses, the frequency of transactions and the status of fee payment with regard to each customer account, for example, as part of its effort to identify the actual status of transactions conducted by customers.
- C. Regarding customers who are deemed to require direct contact in order to check the contents of their

transactions, whether the Financial Instruments Business Operator strives to identify the actual transaction status by appropriately, for example, having a sales division manager (this should be a person other than the employee in charge of handling said customers but may be the manager in charge of internal control or the head of a division, a branch office or a person with a similar status; the same shall apply hereinafter) conduct an interview with said customers in a timely and appropriate manner, and whether the same measures are taken to identify the actual status of transactions of derivatives, etc., which continue for a long time after the conclusion of contracts.

(iii) Review and Evaluation of Rational Reason upon Investment Solicitation

- A. Prior to conducting investment solicitation for financial instruments, whether the Financial Instruments Business Operator reviews and evaluates a rational reason to consider that individual financial instruments, and the frequency and amounts of a series of transactions with a customer are suited to the attributes and investment purpose of the relevant customer that the Financial Instruments Business Operator has ascertained.
- B. From the perspective of securing proper review and evaluation, whether the Financial Instruments Business Operator has specified concrete methods, including factors to take into consideration and procedures to follow, in advance, depending on the characteristics of respective financial instruments, while collaborating with originators thereof.

Whether the Financial Instruments Business Operator conducts careful sales management, such as adopting a system of management approval for investment solicitation of certain financial instruments depending on the attributes of respective customers in order to avoid inappropriate solicitation contrary to a customer's investment purpose, such as selling multi-currency funds or other high-risk instruments to customers who are focused on the security of their principal.

(iv) Inappropriate or Unfaithful Investment Solicitation

Whether the Financial Instruments Business Operator does not conduct any of the following inappropriate or unfaithful acts, for example, when soliciting investment in financial instruments.

- A. An act to solicit purchases and sales of financial instruments with a high frequency contrary to the attributes and investment purpose of a customer seen from the developments of a series of transactions with the customer as a result of the Financial Instruments Business Operator's efforts to seek profits, and to cause said customer to bear excessive fees. (When making a judgment as to whether the frequency is unreasonably high, it should be noted whether the percentage of the aggregated total of paid fees against the customer's annual average investment balance and the frequency of his/her past transactions do not significantly deviate from the customer's ordinary investment behavior.)
- B. With the aim of soliciting investment in a financial instrument contrary to the attributes and investment purpose of a customer, an act to request the customer to change his/her investment purpose in line with the relevant financial instrument without making the customer accurately understand the meaning of and the reason for that change.
- C. Under a circumstance where investment in multiple financial instruments is likely to match a customer based on his/her attributes and investment purpose, an act to solicit the customer to invest in a financial instrument that requires higher fees without any rational reason.



(v) Verification by the Internal Control Division

- A. Whether the internal control division verifies (i) to (iv) above and reviews systems based on the verification results, thereby endeavoring to secure the effectiveness.
- B. Whether the internal control division has established concrete methods for interviews with customers by a sales division manager, etc. mentioned in (ii), C. above and has made the relevant methods thoroughly shared among management and employees, and ascertains and verifies the status of the interviews and reviews those methods or otherwise endeavors to establish a system to secure the effectiveness.

(vi) Conversion to a Specified Investor upon Request of an Ordinary Investor

In a case where a customer as an “ordinary investor” requests to convert to a “specified investor” pursuant to the provision of Article 34-3 (1) of the FIEA, whether the Financial Instruments Business Operator determines the acceptability of such request after having judged whether it is appropriate to treat the customer as a “specified investor” in consideration of his/her knowledge, experience, state of property and purpose of investment.

(2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's control environment related to the principle of suitability, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

III-2-3-2 Control Environment for Managing Sales Staff

From the viewpoint of ensuring that Financial Instruments Business Operators solicit customers in an appropriate manner suited to the customer attributes, it is important to identify and keep track of the actual state of customer solicitation conducted by the business operators' sales staff. To this end, particular attention shall be paid to the following points:

(1) Major Supervisory Viewpoints

- (i) Identification of the Actual State of Customer Solicitation by Sales Staff and Efforts to Ensure Appropriate Solicitation
  - A. Whether the manager of each sales division, for example, strives to identify and keep track of the actual state of customer solicitation by directly holding interviews with customers, and takes appropriate measures when necessary.
  - B. Whether the manager of each sales division, in the course of handling securities for specified investors, takes into consideration that SMEs are included in the scope of specified investors, and from this

viewpoint, strives to identify and keep track of the actual state of such handling and takes appropriate measures, focusing on points such as whether sufficient arrangements are made to give notice or deliver documents as required under Article 40-5(1) and (2) of the FIEA.

- C. Whether the internal control division has developed a specific method of identifying and keeping track of the actual state of customer solicitation mentioned in A and B above and communicated it to all officers and employees, and is striving to establish a control environment that ensures the effectiveness of the method by identifying and examining the status of solicitation and is reviewing and revising the method when necessary.

(ii) Efforts to Foster and Maintain Sense of Compliance among All Officers and Employees

- A. Whether the Financial Instruments Business Operator provides case study training, external training and other types of training with a view to enhancing the sense of compliance among all officers and employees.
- B. Whether the internal control division implements measures to enhance the effectiveness of training, such as identifying and examining the contents of training programs and the implementation thereof and reviewing and revising the contents of the programs when necessary.

(2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's control environment for managing sales staff, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

III-2-3-3 Regulation on Advertisements, etc.

The representations in advertisements, etc., of Financial Instruments Business Operators (advertising as specified under Article 73(1) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter) are the starting points of their solicitation for customers to make investments, and the most important thing about the said representations is that they provide clear and precise information. To ensure this, particular attention shall be paid to the following points.

(Note) "Advertisements etc." includes written materials for customer solicitation, Web pages, postal mail, letters, fax messages, e-mails, fliers and pamphlets and other media materials that provide information to a large number of people. However, judgment as to whether specific media materials are actually advertisements etc., shall be made not on the basis of the appearance or form of the materials or the method of providing them, such as an e-mail, etc., exchange, an airing of a commercial message or the provision of a gift, but on the basis of the specific contents of materials in each case.

(1) Major Supervisory Viewpoints

(i) Points of Attention Regarding Important Matters that Could Affect Customers' Judgment

- A. Whether the advertisement, etc., contains a representation that could lead customers to erroneously believe that the fees, commissions, other rewards and expenses they must pay are nil or substantially lower than the actual levels.
- B. Regarding financial instruments whose value could fall below their principal amount or for which the loss amount could exceed the principal amount, whether the advertisement, etc., clearly indicates such risks.

(ii) Clear and Precise Representation

In cases where the items specified under Article 37 of the FIEA are indicated in an advertisement, etc., supervisors shall judge whether the advertisement, etc., meets the requirement for clear and precise representation as specified under Article 73(1) the FIB Cabinet Office Ordinance, with due consideration of the following points:

- A. Whether the letters used in the advertisement, etc., to indicate some items are not too inconspicuous in terms of size, shape and color compared with the letters used for other items.

In particular, whether the letters used to indicate benchmarks whose movements could cause losses, such as interest rates and prices, the risk of losses and the reasons for them, the risk of the loss amount exceeding the principal amount, and the direct cause thereof, are not markedly different in size from the largest letters used in the same advertisement, etc.

- B. Whether the advertisement, etc., avoids placing too much emphasis on the advantages of the financial instruments and indicating its disadvantages in an inconspicuous manner.
- C. In the case of an advertisement shown on displays of electric devices, whether sufficient display time is secured for users to read and understand all necessary items.

(iii) Points of Attention Regarding Advertisements Using Exaggerated Descriptions

- A. Whether the advertisement does not make definitive predictions of the future movements of the prices and other numerical features of securities and other financial instruments as well as rewards they have to pay, or does not unduly stimulate customers' investment appetites by using descriptions that could lead them to erroneously believe that profits are guaranteed.
- B. Whether the advertisement does not use descriptions that could lead customers to erroneously believe that a certain level of yield is guaranteed or that investment losses will be partially or fully compensated for.
- C. Whether the advertisement does not use descriptions that could lead users to believe that the application period and the number of applicants to be accepted are limited whereas in reality they are not limited.
- D. Whether the advertisement avoids descriptions that could lead customers to erroneously believe that the Financial Instruments Business Operator, because of its registration, is recommended by the Prime Minister, FSA Commissioner or other public officials and organizations, or that the contents of the advertisement are guaranteed thereby.
- E. Whether the advertisement avoids descriptions that constitute or could constitute a violation of

prefectural ordinances based on the Act Against Unjustifiable Premiums and Misleading Representations, the Outdoor Advertisement Act or other laws and regulations.

F. Whether the advertisement avoids descriptions that could draw public criticism for being excessive.

(iv) Customer-Soliciting Events

A. In cases where a Financial Instruments Business Operator holds seminars, etc. (events inviting customers in general for the solicitation purpose regardless of whether they are nominally represented as lecture speeches, study sessions or briefings), whether the advertisements and invitation fliers clearly indicate that the events are intended to solicit customers to sign contracts for financial instruments transactions.

B. In order to meet the above requirement for “clearly indicating that the events are intended to solicit customers to sign contracts for financial instruments transactions,” the financial institution should represent the seminars, etc., with titles that clearly indicate association with financial instruments transactions and also clearly state that the seminars, etc., are held for solicitation purposes.

(v) Advertisement Screening System

Whether the Financial Instruments Business Operator has appointed staff in charge of screening advertisements, etc., and whether appropriate screening is conducted in accordance with the prescribed screening criteria from the viewpoint of ensuring compliance with Article 37 of the FIEA.

(2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding advertisements etc., for a Financial Instruments Business Operator, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

III-2-3-4 Control Environment for Providing Explanations to Customers

Although a fairly high level of expert knowledge is necessary to understand some financial instruments transactions, ordinary customers may not necessarily have sufficient expert knowledge and experiences. As a result, it is necessary for Financial Instruments Business Operators to fulfill their responsibility for providing appropriate explanations by, for example, disclosing correct information that may be used as a basis for investment decisions to customers and others in a fair manner. Therefore, supervisors shall pay attention to the following points when examining the status of a Financial Instruments Business Operator’s provision of explanations, etc., to customers.

(Note) It should be kept in mind that “explanations, etc.” include explanations provided at seminars etc. that are intended to attract customers in effect for solicitation purposes.

(1) Major Supervisory Viewpoints Regarding Control Environment for Providing Explanations

(i) Development of Control Environment for Providing Explanations Based on Principle of Suitability

Whether the Financial Instruments Business Operator has developed a control environment that ensures appropriate explanations based on the principle of suitability when providing a pre-contract document, by properly selecting the method and extent of explanation necessary for enabling customers to understand the contents of the financial instruments transaction in light of each customer's knowledge, experiences, asset status and the transaction purpose.

(ii) Provision of Appropriate Explanations Regarding Products and Services

- A. Whether the Financial Instruments Business Operator avoids placing too much emphasis on the advantages of the transaction and makes sure to sufficiently explain disadvantages, such as the possibility of incurring losses and other risks.
- B. Whether the Financial Instruments Business Operator avoids making false statements when promoting products and services or avoids making definitive claims without sufficient grounds when describing products and services.
- C. Whether the Financial Instruments Business Operator explains products and transactions in an objective manner and avoids arbitrary and subjective statements.
- D. Whether the Financial Instruments Business Operator explains the contents of products and transactions (basic characteristics of products, the nature, types, and variable factors of risks involved, etc.) in a manner that enables the customer to fully understand them.

In particular, whether the Financial Instruments Business Operator strives to prevent the customer from losing interest in understanding the contents, by, for example, first explaining important matters that may affect their investment decisions, in accordance with the purpose of rules concerning the order of items listed in a pre-contract document.

- E. Whether the Financial Instruments Business Operator avoids providing explanations that could create misunderstandings regarding the financial instruments transaction. In particular, whether it avoids providing explanations that could lead customers to erroneously believe that the principal is guaranteed; whether the Financial Instruments Business Operator, in connection with transactions of derivatives, avoids providing explanations that could lead customers to erroneously believe, despite the possibility of the risk of a call for additional margin (referring to additional deposits that must be made when the total existing deposits have fallen short of the required level; the same shall apply hereinafter) due to the fluctuations of prices, that such risk rarely exists or that the amount of additional margin to be required is very small compared with the actual product features.
- F. In cases where sudden changes in market trends or an event having a material impact on markets has had a serious impact on the net asset value of an investment trust, whether the Financial Instruments Business Operator strives to provide information to customers in a timely and appropriate manner, and whether it provides customers with careful support for their investment decisions.

Furthermore, at the time of a sudden change in market trends or an event having a material impact on markets, whether an investment trust management company (meaning an investment trust management company as specified under Article 2(11) of the Act on Investment Trusts and Investment Corporations

(hereinafter referred to as the “Investment Trust Act”); the same shall apply in VI-2-3-4) promptly prepares a report on the management status and provides it to the Financial Instruments Business Operators that sold them.

- G. In cases where the Financial Instruments Business Operator solicits customers with the use of materials (including newspaper articles, analyst reports) containing third-party market forecasts, whether it avoids making arbitrary use of forecasts tinged with a particular bias.
- H. Whether the Financial Instruments Business Operator avoids soliciting customers to sign up for products and transactions that impose an undue burden on customers or lack economic rationality, or whether it makes sure to provide sufficient explanations regarding matters important for customers making investment decisions.

(iii) Explanations Regarding Contract Contents

Whether the Financial Instruments Business Operator provides information regarding the contents of the signed contracts (contract date, amount, value, etc.) to the relevant customers in an appropriate manner upon their requests.

(iv) Method of Internet-Based Explanations

Regarding “the explanations provided in a method and to an extent necessary for enabling the customer to understand” specified under Article 117 (1) (i) of the FIB Cabinet Office Ordinance.

In the case of a financial instruments transaction conducted via the Internet, a Financial Instruments Business Operator shall be deemed to have provided “the explanations provided in a method and to an extent necessary for enabling the customer to understand” as specified under Article 117 (1) (i) of the FIB Cabinet Office Ordinance, when the customer has read explanations shown on the computer display and indicated his/her understanding with a click of the button.

(2) Points of Attention Regarding Explanation of Documents

- (i) Financial instruments business operators shall be instructed to be ready to allow customers to view the explanation documents as specified under Articles 46-4 and 47-3 of the FIEA (referred to as the “Explanation Documents” in III-2-3-4(2), III-3-1(10) and V-2-2-2(2)) whenever requested by them to do so. On that occasion, supervisors shall encourage them to display the Explanation Documents using the internet wherever possible.
- (ii) Financial instruments business operators may include additional items, other than items specified under law in the Explanation Documents, at their own discretion.

(3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator’s control environment for providing explanations to customers, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by requiring the submission of reports based on Article 56-2 (1) of the FIEA, when necessary, while paying consideration to the above viewpoints. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors

shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### III-2-4 Control Environment for the Management of Information Related to Customers, etc.

It is extremely important to ensure the appropriate management of customer information, as such information constitutes the basis of financial instruments transactions.

In particular, information regarding individual customers needs to be handled in an appropriate manner in accordance with the Act on the Protection of Personal Information (hereinafter referred to as the “Personal Information Protection Act”), the FIB Cabinet Office Ordinance, the Guidelines Concerning Personal Information Protection Act (General Rules) and its three specific guidelines regarding (i) the provision of personal data to a foreign third party, (ii) verification and recording obligations related to the transfer of data to third parties and (iii) de-identified information and Anonymously processed information (together, “Personal Information Protection Guidelines”) ,and the guideline on the protection of personal information in the financial sector (hereinafter referred to as the “Financial Sector Guidelines”) and the guideline for practical affairs regarding safety control measures specified in the guideline on the protection of personal information in the financial sector (hereinafter referred to as the Practical Guideline).

Furthermore, because Financial Instruments Business Operators are in a position where they can access corporate information (referring to the corporate information specified under Article 1(4)(xiv) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter), they are required to control that information strictly and to prevent insider trading and any other unfair acts.

As described above, it is important for Financial Instruments Business Operators to establish a control environment wherein they can properly manage information related to customers and information related to corporations (hereinafter referred to as “information related to customers, etc.”). Supervisors shall examine this by paying attention to the following points, for example.

#### (1) Points of Attention Regarding Control Environments for the Management of Information Related to Customers, etc.

- (i) Whether the management team recognizes the necessity and importance of ensuring the appropriateness in the management of information related to customers, etc., based on the principle that access and use of information related to customers, etc. should be limited to officers and employees who need to know the information for the execution of business operations (hereinafter referred to as the “Need-to-Know Principle”), and has developed an internal control environment, including steps such as establishing an organizational structure (including ensuring appropriate checks between divisions) formulating internal rules, and cooperating with other financial institutions within the financial group (including holding companies) for ensuring appropriateness, depending on the details and size of business operations.
- (ii) Whether the Financial Instruments Business Operator has formulated a specific standard for the handling of information related to customers, etc. and communicated it to all officers and employees through the provision

of training and other means. Whether the formulated standard is based on the Need-to-Know Principle regarding the sharing of information related to customers, etc. internally and externally, or within the same department or between different departments of the Financial Instruments Business Operator. Additionally, whether the Financial Instruments Business Operator has formulated a standard for the provision of information related to customers, etc. to third parties, based on careful deliberations, so as to ensure that necessary procedures are implemented in accordance with the Personal Information Protection Act, the Personal Information Protection Guidelines, the Financial Sector Guidelines and the Practical Guideline.

(iii) Whether the Financial Instruments Business Operator has established an environment for appropriately managing information related to customers, etc. and has established arrangements and procedures necessary for examining, in a timely and appropriate manner, the status of the management of information related to customers, etc. with the involvement of compliance divisions, including thorough management of access to information related to customers, etc. (such as preventing the people with access rights from deviating from the scope of the Need-to-Know Principle and preventing access rights assigned to certain people from being used by others), measures to prevent the misappropriation of information related to customers, etc. by insiders, and a robust information management system that prevents illegal access from the outside.

Also, whether the Financial Instruments Business Operator has attempted to implement appropriate measures for preventing illegal acts utilizing information related to customers, etc., such as the dispersal of authority concentrated upon specific personnel and the enhancement of the controls and checks over personnel who have broad powers.

(iv) In cases where the Financial Instruments Business Operator entrusts (Note) the handling of information related to customers, etc., whether it has implemented the following measures.

(Note) The term “entrust” includes all contracts in which a Financial Instruments Business Operator allows all or part of the handling of information related to customers, etc. to be conducted by another person, regardless of the form or type of contract.

- A. With regard to the management of outsourced contractors, whether the Financial Instruments Business Operator has clarified the responsible divisions and confirms that outsourced contractors are properly managing the information related to customers, etc., such as by monitoring on a periodic or as-needed basis how business operations are being conducted at outsourced contractors.
- B. Whether the Financial Instruments Business Operator has confirmed that the outsourced contractors have systems in place to take appropriate actions and to promptly report to consignors in the event that information is leaked.
- C. Whether the Financial Instruments Business Operator restricts the rights of outsourced contractors to access information related to customers, etc. to the extent necessary according to the nature of the outsourced business. On that basis, whether the Financial Instruments Business Operator checks that the workers at outsourced contractors to whom access rights are given and the scope thereof have been defined.

Furthermore, whether the Financial Instruments Business Operator checks that access to information is being managed thoroughly at outsourced contractors on a periodic or as-needed basis, such as by confirming how the access rights are being used (including matching authorized persons against actual



users) in order to prevent access rights assigned to certain people from being used by others.

D. In cases where information is being successively entrusted more than once, whether the Financial Instruments Business Operator checks whether the outsourced contractor is adequately supervising the subcontractors and other such business operators. Also, whether direct supervision of the subcontractor's business operators and so forth is being conducted inhouse as necessary.

(v) Whether the Financial Instruments Business Operator has established arrangements and procedures for appropriately reporting to responsible divisions, notifying customers and the public, and reporting to the authorities in a prompt and appropriate manner when information related to customers, etc. has been leaked, so that secondary damage can be prevented.

Also, whether the Financial Instruments Business Operator analyzes the causes of information leaks and has implemented measures designed to prevent a recurrence. Furthermore, in light of incidents of information being leaked at other companies, whether the Financial Instruments Business Operator examines measures needed to prevent a similar incident from recurring.

Regarding operationally important cases such as those posing the possibility of exerting a material impact on customers, whether the management team appropriately gets involved in decision making concerning actions to be taken.

(vi) Whether audits covering the broad range of business operations pertaining to information related to customers, etc. are being conducted by an independent internal audit division or the like on a periodic or as-needed basis. When such broad range of business operations are conducted integrally by the entirety of a financial group, whether efforts for cooperation are being made among the internal audit divisions, etc. of other financial institutions within the group (including holding companies).

Also, whether the Financial Instruments Business Operator has implemented appropriate measures, such as training programs, in order to increase the specialization of the staff engaged in audits pertaining to the management of information related to customers, etc.

## (2) Points of Attention Regarding the Management of Personal Information

(i) With regard to information concerning individual customers, in cases where a Financial Instruments Business Operator entrusts the security control, supervision of employees and handling of the said information to others in accordance with Article 123(1)(vi) of the FIB Cabinet Office Ordinance, whether the Financial Instruments Business Operator has implemented the following necessary and appropriate measures with regard to supervising the contractor in order to prevent such information from being leaked, lost or damaged.

(Necessary and Appropriate Measures Regarding Security Control)

A. Measures based on Article 8 of the Financial Sector Guidelines

B. Measures based on Section I and Attachment 2 of the Practical Guideline

(Necessary and Appropriate Measures Regarding the Supervision of Employees)

C. Measures based on Article 9 of the Financial Sector Guidelines

D. Measures based on Section II of the Practical Guideline

(Necessary and Appropriate Measures Regarding the Supervision of Contractors)

E. Measures based on Article 10 of the Financial Sector Guidelines

F. Measures based on Section III of the Practical Guideline

- (ii) Whether the Financial Instruments Business Operator has implemented measures to ensure, in accordance with Article 123(1)(vii) of the FIB Cabinet Office Ordinance, that information regarding the race, religious belief, family lineage, birthplace, health, and medical and criminal records of individual customers, as well as other specified non-disclosure information (Note), are not used except for the cases specified in Article 5(1) of the Financial Sector Guidelines.

(Note) “Other specified non-disclosure information” includes:

- (a) Information regarding labor union membership
- (b) Information regarding ethnicity
- (c) Information regarding sexual orientation
- (d) Information regarding provisions under Article 2(iv) of the Order for the Enforcement of the Personal Information Protection Act
- (e) Information regarding provisions under Article 2(v) of the Order for the Enforcement of the Personal Information Protection Act
- (f) Information regarding the fact that the related customer has been a victim of crime
- (g) Information regarding social status

- (iii) Article 44-2 of the FIEA, in principle, prohibits Financial Instruments Business Operators from accepting an entrustment, etc. for the buying and selling of securities on credit cards. However, in cases where a Financial Instruments Business Operator meets all of the requirements specified in Article 148 and 149(i)(a) to (c) of the FIB Cabinet Office Ordinance, they will be permitted as an exception.

In such cases, since any leaking of personal information, including credit card information (card numbers, expiry dates, etc.; hereinafter referred to as “credit card information, etc.”) is likely to result in secondary damage, such as unauthorized purchases using a stolen identity, whether the Financial Instruments Business Operator, in addition to (i) and (ii) above, has implemented the following measures in particular.

- A. Whether the Financial Instruments Business Operator has set an appropriate period of time for keeping credit card information, etc., which takes into account the purpose of use and other circumstances, and whether it limits the locations where such information is kept, and disposes the information in a prompt and appropriate manner after the retention period has lapsed.
- B. Whether the Financial Instruments Business Operator has implemented appropriate measures when displaying credit card information, etc. on computer monitors, such as not displaying whole credit card numbers, unless needed for business operations.
- C. Whether the Financial Instruments Business Operator conducts offsite and onsite inspections on a periodic or as-needed basis on whether the rules and systems for protecting credit card information, etc. are functioning effectively.

- (iv) Whether measures have been taken to comply with Article 12, etc. of the Financial Sector Guidelines with regard to the provision of personal data to third parties. In particular, whether the consent of individual customers is obtained according to the nature and method of business, while also giving consideration to the following points:

- A. When obtaining the consent of an individual customer regarding the provision of personal data to a third party by a method without any face-to-face contact, such as via a PC or smartphone, whether the wording

of the consent, font size, screen specifications, or other elements of the method for obtaining the consent have been optimized to enable the individual customer to clearly recognize the third-party recipient, the contents of the information to be provided to the recipient, and the purpose of use by the recipient, based on Article 3 of the Financial Sector Guidelines.

- B. Even if the consent regarding the provision of personal data to a third party has been obtained from an individual customer in the past, whether the consent of the individual customer is obtained again when the third-party recipient or the contents of the information differ, or when the provision exceeds the scope necessary for achieving the pre-specified purpose of use by the third-party recipient.
- C. If there are multiple third-party recipients or if the purpose of use of the information differs by third-party recipient, whether the scope of third-party recipients subject to the consent and the method, timing, etc. of obtainment of the consent are appropriately considered in order to enable the individual customer to recognize that the personal information will be provided to multiple recipients or recognize the purpose of use by each recipient.
- D. When obtaining consent regarding the provision of personal data to a third party, whether consideration is given so as to prevent adverse effects such as abuse of a superior position or conflict of interest with the individual customer. For example, whether an individual customer is being forced to consent to an excessive scope of third-party recipients, purpose of use by the third-party recipient, or contents of the information to be provided.

### (3) Points of Attention Regarding the Prevention of Insider Trading and Other Unfair Acts Using Corporate Information

- (i) Whether the Financial Instruments Business Operator has implemented appropriate measures for preventing insider trading and other unfair acts using corporate information, by measures such as creating a Chinese wall (an organizational or physical barrier or a barrier established on a system for information management; the same shall apply hereinafter) between the private sector (out of sales divisions, divisions that are supposed to constantly obtain corporate information) and the public sector (out of sales divisions, divisions other than those in the private sector, such as divisions engaging in solicitation for the sale, purchase and other transactions of securities or intermediary, brokerage and agency services therefor, and divisions executing principal transactions or brokerage transactions). Whether the Financial Instruments Business Operator has specifically established required procedures for the cases where it exceptionally crosses a wall (meaning information sharing across a Chinese wall; the same shall apply hereinafter), by measures such as recording the names of officers and employees of divisions who conducted information sharing, the date, and the relevant issue, etc., and requiring a prior consent of compliance divisions, from the perspective of effectively preventing misuse of corporate information.

When the Financial Instruments Business Operator grants its officers, etc. the access to corporate information from the need for business management, whether it has put in place required measures from the perspective of effectively preventing leak or misuse of corporate information by said officers, etc.

(Note) “Organizational barriers” include separation of departments and reporting lines and limitation on concurrent holding of positions of officers and employees, etc. “Physical barriers” include limitation on entry to and exit from divisions managing corporate information and management of documents. “Barriers

on a system” include management of authority to access corporate information.

- (ii) Whether the Financial Instruments Business Operator has established an appropriate internal control environment, such as by developing internal rules pertaining to the sale, purchase and other transactions of securities by officers, employees and other persons associated with them, having compliance divisions get involved appropriately in transactions for which prior consent of compliance divisions is required under the internal rules, and conducting the revision thereof as necessary.
- (iii) Whether the Financial Instruments Business Operator has made efforts for strengthening the sense of compliance, such as enhancing professional ethics and ensuring a full understanding of relevant laws and regulations and internal rules, aimed at preventing insider trading and other unfair trading by officers or employees.
- (iv) Whether the Financial Instruments Business Operator grasps the actual state of the sale, purchase and other transactions of securities by its officers, employees and other persons associated with them, who are in a position to access corporate information, and whether it has implemented appropriate measures, such as revising the relevant methods as necessary.
- (v) When the Financial Instruments Business Operator has overseas offices or belongs to a financial group that operates internationally, whether it has developed an appropriate control environment for the management of corporate information at a level commensurate to the details and size of its global business operations, by measures such as conducting management globally on a group-wide basis: not merely domestically, under organizational and integrated policies, procedures and systems, while observing laws and regulations of individual countries.

#### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator’s control environment for managing information related to customers, etc., through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator, by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### III-2-5 Dealing with Complaints, etc. (Including Response to the Financial ADR System)

##### (1) Need for Dealing with Inquiries, Complaints, Disputes, etc. (Complaints, etc.)

Many financial products and services have inherent risks, and coupled with being specialized and invisible in nature, it is considered that there is a strong possibility of them leading to problems. Therefore, with regard to the sale and provision of financial products and services, in addition to providing information and adequately

implementing other advance measures from the viewpoint of preventing problems and protecting customers, dealing with complaints, etc. after the fact is also important.

In recent years, increasing diversity and complexity of financial products and services has led to the greater likelihood of problems, and so from the viewpoint of protecting customers and ensuring customer confidence, dealing with complaints, etc. after the fact has become even more important.

Based on these perspectives, a financial ADR system has been introduced as a framework for simply and expeditiously processing complaints and resolving disputes related to financial products and services (refer to Note for description of ADR), and Financial Instruments Business Operators are required to deal appropriately with complaints, etc. on the basis of this financial ADR system.

(Note) ADR (Alternative Dispute Resolution)

An alternative method to courts for resolving disputes which is based on agreement by the parties, such as mediation or arbitration. ADR is expected to result in prompt, simple and flexible dispute resolution in a manner suited to the nature of the case, the circumstances of the parties and so on.

(2) Scope

There are various forms of expression that can be made regarding the business operations of a Financial Instruments Business Operator. Besides inquiries, there are also expressions of dissatisfaction made by customers, such as complaints and disputes. It is important for Financial Instruments Business Operators to deal with these various forms of expression appropriately, and so they are required to develop appropriate internal control environments that enable such treatment.

In addition, Financial Instruments Business Operators are also required to develop appropriate control environments respectively for complaints and disputes in the financial ADR system.

It must, however, be added that the distinction between these complaints and disputes is relative and they are connected with each other. In particular, in light of the requirement in the financial ADR system for designated ADR bodies to ensure links between complaint processing procedures and dispute resolution procedures, rather than dealing with individual cases by formally dividing applications made by customers into “complaints” and “disputes,” it is important that Financial Instruments Business Operators deal with complaints and disputes appropriately while taking into consideration their relativity and connections.

III-2-5-1 Establishment of Internal Control Environment for Dealing with Complaints, etc.

(1) Significance

Dealing with complaints, etc. in a prompt, fair and appropriate manner is an important activity that carries the connotation of complementing the accountability to customers after the fact, and is important for ensuring the confidence of customers in financial products and services. Financial Instruments Business Operators need to develop internal control environments to deal with complaints, etc. made by customers in a prompt, fair and appropriate manner, including measures and responses required in the financial ADR system.

(2) Major Supervisory Viewpoints

Supervisors shall examine whether the Financial Instruments Business Operator has, in developing an internal control environment for dealing with complaints, etc., developed an appropriate and effective control environment in light of the size and specific characteristics of its business operations. Supervisors shall take the following points, for example, into consideration, while being mindful of not applying them in a mechanical and uniform fashion.

(i) Role of Senior Managers

Whether the Board of Directors has exercised its functions properly with regard to the establishment of a group-wide internal control environment for the function of dealing with complaints, etc.

(ii) Internal Rules

A. Whether the division in charge of complaints, etc., its responsibility and authority, and the procedures for dealing with complaints, etc. have been established in the internal rules so that complaints can be responded to and dealt with in a prompt, fair and appropriate manner. Also, whether procedures concerning business improvement have been established so that the views of customers are reflected in the conduct of business operations.

B. Whether the Financial Instruments Business Operator has developed a control environment, including making sure that internal rules are thoroughly publicized and enforced by means of training and other measures (including the distribution of manuals and so forth) so that business operations for dealing with complaints, etc. can be conducted based on internal rules.

Particularly in cases where complaints, etc. are being made frequently by customers, whether confirmation is first being made of how internal rules (not only those for dealing with complaints, etc.) are publicized and enforced at branches, and whether the causes and problem areas in terms of control environments are being examined.

(iii) Control Environment for Dealing with Complaints, etc.

A. Whether the Financial Instruments Business Operator has appropriately appointed staff in charge of dealing with complaints, etc.

B. Whether the Financial Instruments Business Operator has developed a control environment wherein relevant departments cooperate and promptly deal with any complaints, etc. made by customers.

In particular, whether the Financial Instruments Business Operator has developed a control environment wherein the responsible division or person in charge of dealing with complaints, etc. strives to fully understand the customer complaints, etc. faced by each individual employee, and reports promptly to the relevant departments.

C. Whether the Financial Instruments Business Operator has developed a control environment wherein it promptly settles any outstanding cases and prevents the occurrence of any long-term outstanding cases by conducting progress management aimed at the resolution of complaints, etc.

D. Whether the Financial Instruments Business Operator has developed a control environment wherein it improves the response provided at contact points according to the occurrence of complaints, etc., and wherein it can receive complaints, etc. extensively, such as by setting access hours and means of access (for example, phone, mail, facsimile, email) which are considerate of customer convenience. Also, whether the Financial Instruments Business Operator has developed a control environment wherein it extensively publicizes these contact points and ways of making applications, and wherein it makes them

well known to customers in a way that is easy for them to understand and which also takes into account their diversity.

- E. Whether the Financial Instruments Business Operator has developed a control environment for ensuring the proper handling of personal information in accordance with the provisions of the Personal Information Protection Act, the Personal Information Protection Guidelines, the Financial Sector Guidelines and the Practical Guideline when dealing with complaints, etc. (refer to III-2-4 Management of Customer Information).
- F. With regard to complaints, etc. concerning outsourced business operations conducted by an external contractor, including financial instruments intermediary service providers, etc., whether the Financial Instruments Business Operator has developed a control environment for dealing with such complaints, etc. promptly and appropriately, such as by establishing a system of direct communication to the Financial Instruments Business Operator itself (refer to III-2-7(2), III-2-10(1), VI-2-2-4-2(4) and VII-2-1-5(2)(iv)).
- G. Whether the Financial Instruments Business Operator has developed a control environment for taking appropriate action when dealing with complaints, etc. in light of the relationship with the provisions concerning the prohibition of compensation of loss, etc. (Article 39 of the FIEA).
- H. Whether the Financial Instruments Business Operator has developed a control environment wherein it can communicate quickly with relevant departments and cooperate appropriately (where necessary) with the police and other relevant organizations, in order to distinguish any pressure by anti-social forces disguised as a complaint, etc. from ordinary complaints, etc. and to take a resolute stance (refer to III-2-11 Prevention of Damage that May be Inflicted by Anti-Social Forces).

(iv) Dealing with Customers

- A. Whether the Financial Instruments Business Operator goes beyond perceiving the handling of complaints, etc. as a simple problem of processing procedures, and instead regards it as a question of a control environment for providing after-the-fact explanations and aims to resolve a complaint, etc. with the understanding and agreement of the customer wherever possible while suitably interviewing customers on the circumstances according to the nature of the complaint, etc.
- B. Whether the Financial Instruments Business Operator has developed a control environment wherein it provides customers, who have made a complaint, etc., with appropriate explanations, as necessary, according to the progress of the procedures for dealing with complaints, etc. while also being considerate of the specific characteristics of the customer, from the time the complaint is made to after its settlement (for example, an explanation of the procedures for dealing with complaints, etc., notification to the effect that the complaint, etc. has been received, an explanation on the progress, and an explanation of the results).
- C. With regard to complaints, etc. made by customers, whether the Financial Instruments Business Operator has developed a control environment wherein, rather than only dealing with a complaint, etc. itself, it refers customers to appropriate external organizations according to the nature of the complaint, etc. and the wishes of the customer, and it provides information such as an overview of the standard procedures.

In cases where there is more than one means of processing a complaint or resolving a dispute,

customers should be able to choose freely, and so in referring customers to external organizations, care should be taken so that a customer's choice is not unduly restricted.

D. Whether the Financial Instruments Business Operator has developed a control environment wherein, even during a period when proceedings for dealing with a complaint, etc. are pending at an external organization, the business operator takes appropriate action where necessary with respect to the customer who is the other party to the said proceedings (such as ordinarily providing the customer with general materials or explanations).

(v) Information Sharing, Business Improvements, etc.

A. Whether the Financial Instruments Business Operator has developed a control environment wherein complaints, etc. and the associated results from dealing with them are categorized and reported to the internal control division and sales division, and wherein information necessary for the particular case is shared between those concerned, such as reporting important cases to the audit division and senior managers.

B. Whether the Financial Instruments Business Operator properly and accurately records and stores information on the contents of complaints, etc., and the results of dealing with them, including both complaints it deals with itself, and those dealt with through the mediation of an external organization. Also, whether the Financial Instruments Business Operator has developed a control environment wherein it analyzes the contents of complaints, etc., and the result of dealing with them, taking into consideration information, etc., provided by a designated ADR body, and applies this on an ongoing basis to the improvement of control environments for dealing with customers and conducting administrative processes and to the formulation of measures for preventing any occurrence or recurrence of complaints, etc.

C. Whether the Financial Instruments Business Operator has developed a control environment wherein it checks the status of any complaints, etc. regarding instruments and transactions sold or contracted after having made efforts, such as to improve its control environment for the solicitation of customers and the conduct of administrative processes and to formulate measures to prevent the recurrence of certain conduct, and whether it confirms the effects of the said efforts.

D. Whether the Financial Instruments Business Operator has developed a control environment wherein the internal checks and balances function, such as of audits, can function properly to ensure the effectiveness of how complaints, etc. are dealt with.

E. Whether the Financial Instruments Business Operator has developed a control environment wherein, when reflecting the treatment of complaints, etc. in the conduct of business operations, senior managers supervise over any decisions to implement measures needed for business improvement or recurrence prevention, as well as any examination or ongoing review of how the control environment for dealing with complaints, etc. should be.

(vi) Relationship with External Organizations

A. Whether the Financial Instruments Business Operator has developed a control environment wherein it cooperates appropriately with external organizations in working toward the prompt resolution of any complaints, etc.



- B. Whether the Financial Instruments Business Operator has developed a control environment wherein, when filing a petition for dispute resolution procedures itself, rather than simply filing a petition without fully exhausting its own procedures, it first responds sufficiently to the submission of the complaint, etc. from the customer and goes through an appropriate internal examination of the need for the petition.

### III-2-5-2 Response to the Financial ADR System

#### III-2-5-2-1 In cases where there is a designated ADR body

##### (1) Significance

In order to enhance customer protection and to improve customer confidence in financial products and services, it is important to ensure substantial equality between Financial Instruments Business Operators and customers, and to resolve any complaints, etc. in a neutral, fair and effective manner. Therefore, in the financial ADR system, complaint processing and dispute resolution from a third-person perspective are conducted by designated ADR bodies with the participation of experts and others.

Under the financial ADR system, responses to complaint processing and dispute resolution are primarily regulated according to Basic Agreements to Implement Procedures (Article 156-38(13) of the FIEA) concluded between Financial Instruments Business Operators and designated ADR bodies.

Financial Instruments Business Operators are required to appropriately address their obligations and so forth stipulated in their Basic Agreement to Implement Procedures, while bearing in mind the objective of processing the complaint or resolving the dispute at the designated ADR body.

##### (2) Major Supervisory Viewpoints

Supervisors shall examine whether the Financial Instruments Business Operator has, in responding to the financial ADR system, developed an appropriate and effective control environment in light of the size and specific characteristics of its business operations. Supervisors shall take the following points, for example, into consideration, while being mindful of not applying them in a mechanical and uniform fashion.

Supervisors shall also refer to the points of attention contained in III-2-5-1 Establishment of Internal Control Environment for Dealing with Complaints, etc.

##### (i) Outline

###### A. Basic Agreement to Implement Procedures

- a. Whether the Financial Instruments Business Operator has promptly entered into Basic Agreements to Implement Procedures with designated ADR bodies which exist for each type of business related to dispute resolution, etc. (as specified under Article 156-38(12) of the FIEA).
- b. For example, even in cases where there is a reassignment of designation, such as a designated ADR body having its designation rescinded or a new ADR body being designated, whether the Financial Instruments Business Operator selects the best measure from the perspective of customer convenience, and in addition to promptly implementing any necessary measures (such as implementing new complaint processing measures or dispute resolution measures, or concluding

a Basic Agreement to Implement Procedures), whether it takes appropriate action, such as making it known to all customers.

- c. Whether the Financial Instruments Business Operator has developed a control environment wherein it can execute the contents of the Basic Agreements to Implement Procedures concluded with designated ADR bodies.

#### B. Publication, Publicity and Response to Customers

- a. Whether the Financial Instruments Business Operator has properly publicized the name or trade name and the contact address of designated ADR bodies that are party to any Basic Agreements to Implement Procedures that it has concluded.

With regard to methods of publication, the Financial Instruments Business Operator needs to take measures that are suited to the size and specific characteristics of its business operations, for example, presenting information on its website, putting up posters at its branches, producing and distributing pamphlets, and conducting publicity activities through the mass media. Even supposing that the Financial Instruments Business Operator has posted information on its website, if it is feasible that there are customers who cannot view this information, the business operator needs to give consideration to these kinds of customers.

In publicizing such information, whether the Financial Instruments Business Operator is presenting it in a manner that makes it easy for customers to understand. (For example, in the case of publicizing information on a website, the page should be so designed that customers can easily access the page that provides information on the use of the financial ADR system.)

- b. With respect to the provision of pre-contract documents, whether the Financial Instruments Business Operator provides an explanation on the financial ADR system.

Whether the Financial Instruments Business Operator provides sincere support in cases where a complaint has been made by a customer, and whether it provides an explanation about the financial ADR system again in cases where the customer's understanding cannot be gained through talk between the two parties or where determining the amount of damages is difficult.

- c. Whether the Financial Instruments Business Operator has developed a control environment wherein it publicizes any necessary information to customers, such as the flow of standard procedures by the designated ADR body and the effects of using a designated ADR body (such as the effect of interruption of prescription), in light of the Basic Agreement to Implement Procedures.
- d. In cases in which a Financial Instruments Business Operator sells insurance products arranged by insurance companies, where multiple operators with varied forms of operation are involved, including the insurance companies that arranged the products and the Financial Instruments Business Operator that sold the products, whether the operators involved are responding to customers in a careful manner; for example, whether the operators understand what the customers see as the problem and refer them to designated ADR bodies that are appropriate for the causes of the problems.

(Note) In the case of an insurance product, even if the problem is related to explanation at the time when the Financial Instruments Business Operator (i.e., Insurance Solicitor) sold the product,

the Entrusting Insurance Company, etc., shall be liable for any damage caused by an Insurance Solicitor to a Policyholder in carrying out Insurance Solicitation activities under provisions of Article 283(1) (except in cases provided in (2) of the same Article). As such, supervisors shall be mindful of the fact that customers are in principle eligible to file applications not only to designated ADR bodies with whom the Financial Instruments Business Operator signs a Basic Agreements to Implement Procedures, but also designated ADR bodies with whom the insurance company signs a Basic Agreements to Implement Procedures.

(ii) Points of Attention Regarding Complaint Processing Procedures and Dispute Resolution Procedures

In light of the fact that, under Basic Agreements to Implement Procedures, Financial Instruments Business Operators assume various obligations, including those to comply with procedures, submit materials and respect special conciliation proposals, supervisors shall take the following points, for example, into consideration when conducting examinations.

A. Common Items

- a. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it receives a request from a designated ADR body for compliance with procedures, submission of materials or the like, it responds to the request promptly, unless there is justifiable reason not to.
- b. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it refuses a request from a designated ADR body to comply with procedures, submit materials or the like, rather than the division that caused the complaint or dispute simply deciding itself to refuse the request, the business operator conducts a proper examination as an organization. Also, whether the Financial Instruments Business Operator has developed a control environment wherein, wherever possible, it explains the reasons (justifiable reasons) for that decision.

B. Response to Dispute Resolution Procedures

- a. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it is presented with a recommendation to accept a reconciliation plan or with a special conciliation proposal from a dispute resolution committee member, it makes prompt decisions on whether to accept or not.
- b. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it has accepted a reconciliation plan or a special conciliation proposal, the division in charge takes prompt action, and the audit division conducts a follow-up examination on matters including the progress of its fulfillment.
- c. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it rejects acceptance of a reconciliation plan or a special conciliation proposal, it promptly explains its reasoning and takes necessary action, such as instituting legal proceedings, in light of operational rules (Article 156-44(1) of the FIEA).

III-2-5-2-2 In cases where there is no designated ADR body

## (1) Significance

In the financial ADR system, even in cases where there is no designated ADR body, there is a legal requirement for Financial Instruments Business Operators to instead implement complaint processing measures and dispute resolution measures. Financial Instruments Business Operators are required to ensure complete customer protection and to strive to improve customer confidence in financial products and services by implementing these measures properly and by resolving any complaints or disputes regarding financial products and services in a simple and expeditious manner.

## (2) Major Supervisory Viewpoints

Supervisors shall examine whether the Financial Instruments Business Operator has developed a control environment in light of the size and specific characteristics of its business operations, wherein, in cases where it implements complaint processing measures and dispute resolution measures, it deals properly with any complaints or disputes made by customers while bearing in mind the objectives of the financial ADR system. Supervisors shall take the following points, for example, into consideration, while being mindful of not applying them in a mechanical and uniform fashion.

Supervisors shall also refer to the points of attention contained in III-2-5-1 Establishment of Internal Control Environment for Dealing with Complaints, etc.

### (i) Outline

#### A. Selection of Complaint Processing Measures and Dispute Resolution Measures

- a. Whether the Financial Instruments Business Operator, in view of the nature of its business operations, the occurrence of complaints, etc., its trading area and other factors, appropriately selects one or more of the following matters prescribed by law for each type of registered business (referring to the different Type I financial instruments business, Type II financial instruments business, the investment advisory and agency business or the investment management business) as its complaint processing measures or dispute resolution measures. In addition, it is desirable that the Financial Instruments Business Operator, in doing so, should have measures in place that enhance convenience for the customer in making complaints or disputes, such as providing an environment that makes it easier for the customer to geographically access relevant services.

#### (a) Complaint Processing Measures

- i) The Financial Instruments Business Operator shall have a consumer counselor or the like with a certain level of experience provide guidance and advice to those employees engaged in processing complaints.
- ii) The Financial Instruments Business Operator shall develop its own operational system and internal rules, and shall publicize them.
- iii) The Financial Instruments Business Operator shall utilize financial instruments firms associations and certified investor protection organizations.
- iv) The Financial Instruments Business Operator shall utilize the National Consumer Affairs Center of Japan and consumer centers.
- v) The Financial Instruments Business Operator shall utilize the designated ADR bodies for

other business types.

- vi) The Financial Instruments Business Operator shall utilize corporations that can conduct complaint processing services in a fair and appropriate manner.

(b) Dispute Resolution Measures

- i) The Financial Instruments Business Operator shall utilize certified dispute resolution procedures prescribed in the Act on Promotion of Use of Alternative Dispute Resolution.
- ii) The Financial Instruments Business Operator shall utilize financial instruments firms associations and certified investor protection organizations.
- iii) The Financial Instruments Business Operator shall utilize bar associations.
- iv) The Financial Instruments Business Operator shall utilize the National Consumer Affairs Center of Japan and consumer centers.
- v) The Financial Instruments Business Operator shall utilize the designated ADR bodies for other business types.
- vi) The Financial Instruments Business Operator shall utilize corporations that can conduct dispute resolution services in a fair and appropriate manner.

b. Whether the Financial Instruments Business Operator has developed a control environment wherein it continuously monitors the processing status of complaints and disputes, and where necessary, reviews and revises its complaint processing measures and dispute resolution measures.

c. In cases where the Financial Instruments Business Operator utilizes a “corporation that can conduct complaint processing services or dispute resolution services in a fair and appropriate manner” ((a)vi and (b)vi), whether the business operator assesses whether the said corporation is a corporation adequately staffed and with an adequate accounting basis to conduct complaint processing services and dispute resolution services in a fair and appropriate manner (Article 115-2(1)(v) and (2)(v) of the FIB Cabinet Office Ordinance), in a reasonable manner based on considerable materials and other factors.

d. In cases where the Financial Instruments Business Operator utilizes an external organization, although it is not a requirement for the business operator to necessarily enter an outsourcing contract with the said external organization, it is desirable that they make arrangements in advance with regard to such matters as the flow of standard procedures and items regarding the burden of expenses.

e. With regard to cases where expenses arise when the procedures of an external organization are used, whether the Financial Instruments Business Operator has taken measures to prevent the expenses from becoming an impediment to the filing of a petition for complaint processing or dispute resolution, such as taking measures likely to prevent the customer’s share of expenses from becoming excessive.

## B. Implementation

Whether the Financial Instruments Business Operator implements measures inappropriately, such as making the scope of the complaint processing measures and dispute resolution measures unduly restricted. It should also be kept in mind whether the business operator has maintained appropriate

coordination between complaint processing measures and dispute resolution measures (refer to III-2-5(2)).

(ii) Points of Attention Regarding Complaint Processing Measures (cases where business operators develop their own control environments)

A. Cases where a control environment is developed wherein guidance and advice to employees is given by consumer counselors, etc.

a. Whether the Financial Instruments Business Operator has developed a control environment wherein it improves the skills of those employees engaged in processing complaints, such as periodically conducting training run by consumer counselors and the like.

b. Whether the Financial Instruments Business Operator has developed a control environment wherein it utilizes the specialized knowledge and experience of consumer counselors and the like, where necessary, for processing individual cases, such as building network systems with consumer counselors and the like.

B. Cases where a business operator develops its own operational system and internal rules

a. Whether the Financial Instruments Business Operator has properly developed an operational system and internal rules according to the occurrence of complaints, and whether it has developed a control environment wherein it processes complaints in a fair and appropriate manner based on the said system and rules.

b. Whether the Financial Instruments Business Operator has made customers aware of the contact point for making complaints in an appropriate manner, and whether it has properly published the operational system and internal rules pertaining to complaint processing.

In terms of the content of the publicity and publications, although publishing the full text of the internal rules is not a necessary requirement, in order for customers to confirm for themselves whether complaints are being processed in accordance with appropriate procedures, it is important that the contact address for processing complaints and the flow of standard operations be clearly indicated. Therefore, it should be kept in mind whether the business operator has published the sections related to this.

For the methods of publicity and publication, refer to III-2-5-2-1(2)(i)B.

(iii) Points of Attention Regarding Complaint Processing Measures (when using external organizations) and Dispute Resolution Measures

A. Publicity and Publication

a. In cases where the Financial Instruments Business Operator are using an external organization, from the perspective of protecting customers, it is desirable that the business operator publicizes and publishes information on the external organization, including, for example, the fact that customers are eligible to use the external organization for raising complaints or disputes, the name of the external organization, its contact information, instructions on how to use it and so forth, in ways that customers can readily understand.

b. With respect to the provision of pre-contract documents, whether the Financial Instruments Business Operator provides an explanation on the financial ADR system.

Whether the Financial Instruments Business Operator provides sincere support in cases where a complaint has been made by a customer, and whether it provides an explanation about the financial ADR system again in cases where the customer's understanding cannot be gained through talk between the two parties or where determining the amount of damages is difficult.

- c. Whether the Financial Instruments Business Operator has developed a control environment for referring customers to other external organizations if the petition for complaint processing or dispute resolution is outside the scope handled by the external organization to which the customer was first referred because of geographical reasons, the nature of the complaint or dispute or for some other reason, or if handling of the complaint or dispute by another external organization is appropriate (not limited to external organizations used by the Financial Instruments Business Operator as complaint processing measures or dispute resolution measures).
- d. For cases in which a Financial Instruments Business Operator sells insurance products arranged by insurance companies, refer to III-2-5-2-1(2)(i)B.d.

#### B. Response to Procedures

- a. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it receives a request from an external organization for compliance with complaint processing or dispute resolution procedures, a request for an investigation of the facts or a request for the submission of relevant materials or the like, it responds to the request promptly in light of the rules, etc. of the external organization.
- b. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it refuses a request for compliance with complaint processing or dispute resolution procedures, a request for an investigation of the facts or a request for the provision of relevant materials or the like, rather than the division that caused the complaint or dispute simply deciding itself to refuse the request, the business operator conducts a proper examination as an organization, in view of such matters as the nature of the complaint or dispute, the nature of the facts or materials and the rules of external organizations. Also, whether the Financial Instruments Business Operator has developed a control environment wherein it explains the reasons for the refusal wherever possible in light of the rules, etc. of the external organization.
- c. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it is presented with a proposed solution such as a reconciliation plan or mediation plan from an external organization that has commenced dispute resolution procedures (hereinafter referred to as a "proposed solution" in d and e below), it makes prompt decisions on whether to accept or not, in light of the rules, etc. of the external organization.
- d. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it has accepted a proposed solution, the division in charge takes prompt action, and the audit division conducts a follow-up examination on matters including the progress of its fulfillment.

- e. Whether the Financial Instruments Business Operator has developed a control environment wherein, in cases where it rejects acceptance of a proposed solution, it promptly explains its reasoning and takes necessary action, in light of the rules, etc. of the external organization.

#### III-2-5-3 Statements in Various Documents

Financial Instruments Business Operators are required to state the details of their response to the financial ADR system in various documents (such as pre-contract documents, business reports, explanation documents). In cases where there is no designated ADR body, although business operators are required to state the details of their complaint processing measures and dispute resolution measures in these documents, it should also be kept in mind that appropriate matters should be stated in the context of actual conditions. If, for example, the Financial Instruments Business Operator utilizes an external organization, then the name, contact address and so forth of the said external organization (in cases where part of the services pertaining to the complaint processing or dispute resolution are entrusted to another organization, then including that other organization) should also be stated.

#### III-2-5-4 Administrative Response

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's control environment for processing complaints, through daily supervisory administration, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

Also, in cases where there is a designated ADR body, even if the Financial Instruments Business Operator does not accept a request for to comply with procedures, in the strictest sense, supervisors shall focus on the response of the Financial Instruments Business Operator while also being mindful of the problem of non-fulfillment pertaining to the Basic Agreement to Implement Procedures between the Financial Instruments Business Operator and the designated ADR body.

It should also be kept in mind that an individual dispute that arises between a customer and a Financial Instruments Business Operator is, in general, a problem pertaining to a private-law contract, and as such, is a matter to be resolved between the parties, including basically the place of ADR and the judicature.

#### III-2-6 Measures such as Verification at the Time of Transaction

Financial instruments business operators, which play an important role as market intermediaries, should never be involved or exploited in cases of organized crime such as the provision of profits to corporate extortionists, terrorism financing or money laundering.

In order to prevent Financial Instruments Business Operators from being exploited in cases of organized crime, money laundering, terrorism financing, or contributing to expanding profits gained from criminal activities, it is



necessary to establish an advanced and robust company-wide control environment for legal compliance.

From the viewpoint of preventing abuse of financial services by organized crime groups and maintaining public confidence in Japan's financial and capital markets, it is particularly important to establish an internal control environment for measures such as verification at the time of transaction, preservation of transaction records, etc. and reporting of suspicious transactions (meaning verification at the time of transaction, etc. pursuant to Article 11 of the Act for Prevention of Transfer of Criminal Proceeds (hereinafter referred to as the "Anti-Criminal Proceeds Act"); hereinafter referred to as the "verification at the time of transaction, etc.") based on the Anti-Criminal Proceeds Act.

#### (1) Major Supervisory Viewpoints

When examining a financial institution's control environment for implementing verification at the time of transaction, etc. based on the Act on Prevention of Transfer of Criminal Proceeds and measures stipulated in the "Guidelines on Measures for Anti-Money Laundering and Countering the Financing of Terrorism" (hereinafter referred to as the "AML/CFT Guideline"), including risk-based approach, supervisors shall pay attention to the following points:

(Note1) In properly conducting verification at the time of transaction, etc., reference must be made to the "Points to Keep in Mind Concerning the Act on Prevention of Transfer of Criminal Proceeds" (Financial Services Agency, October 2012).

(Note 2) Risk-based approach means that financial institutions, etc. are expected to identify and assess money laundering and financing of terrorism risks to which they are exposed and take appropriate AML/CFT measures to mitigate the risks effectively.

(i) Whether the Financial Instruments Business Operator has established a control environment for studying and analyzing the risk of being exploited in cases of terrorism financing and money laundering, and for properly conducting measures that take account of the results thereof, based on the Anti-Criminal Proceeds Act.

A. Whether the Financial Instruments Business Operator appropriately studies and analyzes the risk of its transactions being exploited in cases of terrorism financing and money laundering from the viewpoint of the nature of the transaction or product and the form of the transaction, the country or region related to the transaction, and the customer attributes, by taking account of the particulars of the survey of the danger potential of transfer of criminal proceeds that is prepared and published by the National Public Safety Commission based on Article 3(3) of the Anti-Criminal Proceeds Act, and prepares a document, etc. that describes the results of the analysis (hereinafter referred to as the "document, etc. prepared by specific business operators") and conducts a periodical review thereof.

B. Whether the Financial Instruments Business Operator takes account of the particulars of the document, etc. prepared by specific business operators, and collects and analyzes the necessary information, as well as continuously investigating in detail the confirmation records and transaction records it has preserved.

C. When carrying out transactions for which there is especially a strong necessity for conducting rigid customer management set forth in the first sentence of Article 4(2) of the Anti-Criminal Proceeds Act, transactions that require special attention in customer management set forth in Article 5 of the Ordinance for Enforcement of the Act concerning Prevention of Transfer of Criminal Proceeds (hereinafter referred

to as the “Anti-Criminal Proceeds Act Enforcement Ordinance”), and other transactions that are deemed to have a high danger potential of terrorism financing and money laundering in consideration of the particulars of the survey of the potential danger of transfer of criminal proceeds, whether the manager (meaning manager as defined in Article 11(iii) of the Anti-Criminal Proceeds Act; the same shall apply hereinafter) approves the transaction, and whether the Financial Instruments Business Operator prepares a document, etc. that describes the results of the collection and analysis of information, and preserves it along with the conformation record or transaction record.

(ii) Whether the Financial Instruments Business Operator has established a control environment for properly implementing customer identification based on the Anti-Criminal Proceeds Act.

A. Whether the Financial Instruments Business Operator has established internal rules that specify internal arrangements and procedures for implementing verification at the time of transaction. In addition, whether it has fully communicated the rules to all officers and employees and ensured their full understanding thereof.

In particular, the following matters shall be specified:

- a. The department and manager in charge of implementing verification at the time of transaction and the roles thereof.
- b. The department and manager (including a person who makes a final internal decision concerning the relevant operations) in charge of supervising internal administrative processes regarding verification at the time of transaction, including judgment as to the appropriateness of the verification implemented by the relevant department, the identification, examination and analysis of the implementation status thereof, and the roles of the department and manager.
- c. Reporting systems at the departments referred to in a. and b. above (including arrangements for collaboration with other relevant departments).
- d. Timely and appropriate compilation and storage of records concerning verification at the time of transaction for customers and transactions with customers (including the appropriate handling of personal numbers and basic pension numbers).

B. When implementing verification at the time of transaction, whether the Financial Instruments Business Operator verifies the credibility and validity of the identity not only by identifying customer attributes properly, but also by requiring the submission of customer identification documents, for example. Whether it properly responds to and manages a problem identified in relation to a customer.

Regarding the data of verification at the time of transaction obtained from a customer, whether the business operator constantly strives to keep track of up-to-date customer attributes through ongoing monitoring of transactions with the customer, for example.

The following are examples of measures that may be implemented in order to identify and keep track of customer attributes:

- a. To periodically consolidate customer accounts with the same telephone number or e-mail address, select from among the accounts those for which different addresses or names are registered and check whether the nominees of the accounts are not fictitious persons by, for example, examining the actual state of transactions involving the nominee and directly contacting the nominee.

- b. To periodically remind all customers of the need to notify the business operator when there is a change in their address or other items of data of verification at the time of transaction, thereby grasping any such change in a timely manner.
- C. Whether the Financial Instruments Business Operator has properly established internal rules that specify a policy concerning acceptance of customers. In addition, whether it properly applies the said policy to the customer attributes identified through the procedures for verification at the time of transaction.
- D. Whether the Financial Instruments Business Operator checks the substantial controller of transactions with corporate customers and whether the customer is a foreign PEP (Note).

(Note) Meaning the head of a foreign country or a person in an important position as set forth in each item of Article 12(3) of the Order for Enforcement of the Act for Prevention of Transfer of Criminal Proceeds (hereinafter referred to as the “Anti-Criminal Proceeds Act Enforcement Order”) and each item of Article 15 of the Anti-Criminal Proceeds Act Enforcement Ordinance.

In particular, when conducting transactions for which there is especially a strong necessity for conducting rigid customer management as mentioned below, based on the first sentence of Article 4(2) of the Anti-Criminal Proceeds Act and each paragraph of Article 12 of the Anti-Criminal Proceeds Act Enforcement Order, whether (re-)verification at the time of transaction is made in a proper manner (for example, a customer’s identification matters are confirmed not only in a normal way but also in a more rigid way in which customer identification documents or supplementary documents are additionally received. When confirmation of the conditions of assets and revenues is obligated, whether such confirmation is made in a proper manner.

- a. A transaction in the case that a counterparty to the transaction is suspected of impersonating a customer, etc., or representative, etc., for whom related verification at the time of the transaction is conducted.
- b. A transaction with customer, etc., who is suspected of having falsified matters subject to related verification at the time of transaction when such verification has been made.
- c. A transaction, etc., with a customer, etc., who resides or is located in a country or region in which the establishment of a system to prevent the transfer or criminal proceeds (as specified under Article 12(2) of the Anti-Criminal Proceeds Act Enforcement Order) is not considered sufficient.
- d. A specified transaction with a customer, etc. who is a foreign PEP.
- E. Whether the Financial Instruments Business Operator takes measures that take account of the specific characteristics of transactions (e.g., transactions conducted over the Internet without any face-to-face contact) when implementing verification at the time of transaction for customers.
- F. When hiring officers and employees, whether the Financial Instruments Business Operator screened candidates from the viewpoint of, at the minimum, properly implementing anti-terrorism financing and anti-money laundering measures. Also, whether the Financial Instruments Business Operator has appointed an appropriate person as a manager, such as a management-level compliance manager for anti-terrorism financing and anti-money laundering measures.
- G. Whether the Financial Instruments Business Operator provides officers and employees with training and education concerning verification at the time of transaction on a periodic and ongoing basis. Whether it evaluates the level of the understanding of the officers and employees receiving training and takes follow-

up measures, when necessary, in light of their implementation of verification at the time of transaction in daily business processes.

H. Whether the Financial Instruments Business Operator ensures the effectiveness of verification at the time of transaction by identifying and examining the implementation status of the identification through periodic internal reviews and internal audits, and by revising and reviewing the implementation method, for example.

(iii) Whether the Financial Instruments Business Operator has established a control environment for properly implementing the reporting of suspicious transactions based on the Anti-Criminal Proceeds Act.

A. Whether the Financial Instruments Business Operator has established internal rules that specify internal arrangements and procedures for the reporting of suspicious transactions. Also, whether it has fully communicated the rules to all officers and employees and ensured their full understanding thereof.

In particular, the following matters shall be specified:

- a. The department and manager in charge of identifying suspicious transactions and the roles thereof.
- b. The department and manager (including a person who makes the final internal decision concerning the relevant reporting) in charge of supervising operations related to the identification of suspicious transactions within the institution, including the implementation of judgment as to the appropriateness of suspicious transactions identified through the arrangements and procedures mentioned in A. above and the identification, examination, and analysis of the implementation status, and the roles of the department and manager.
- c. Reporting systems at the departments mentioned in a. and b. above (including arrangements for collaborating with other relevant departments).

B. Whether the Financial Instruments Business Operator ensures that the supervisory department reports to the authorities promptly when a certain transaction is judged to constitute a suspicious transaction.

C. In judging whether a certain transaction constitutes a case requiring the reporting of suspicious transactions, whether the Financial Instruments Business Operator comprehensively takes account of the various specific information that it has acquired and holds, such as the data of verification at the time of transaction, customer attributes, specific characteristics of the transaction, and the circumstances at the time of the transaction, as well as the survey of the potential danger of transfer of criminal proceeds, and conducts appropriate examinations based on Article 8(2) of the Anti-Criminal Proceeds Act and Articles 26 and 27 of the Anti-Criminal Proceeds Act Enforcement Ordinance. Whether the business operator properly responds to and manages any problem identified in relation to the relevant transaction.

(Note 1) Among customer attributes and specific characteristics of the transaction that should be considered are the customer's nationality (whether the customer's home country falls within FATF's list of non-cooperative countries and territories), whether the customer is a foreign PEP, the nature of business in which the customer is engaging, the value and number of transactions, and whether it is a foreign or domestic transaction.

(Note 2) Accumulating data regarding matters that may lead to suspicious transactions and establishing formal criteria for such transactions may serve as an effective means for Financial Instruments Business Operators to make judgment on whether a certain transaction constitutes a case of suspicious

transaction. However, if they are to do so, attention must be paid that they make sure to comprehensively take account of the specific characteristics of each transaction and other various factors so as to avoid relying exclusively on the said criteria and relegating the reporting procedure to a matter of formality.

D. Whether the Financial Instruments Business Operator detects, monitors and analyzes suspicious customers and transactions through systems and manuals according to the nature and contents of its own business.

E. When hiring officers and employees, whether the Financial Instruments Business Operator screens candidates from the viewpoint of, at the minimum, properly implementing anti-terrorism financing and anti-money laundering measures. Also, whether the Financial Instruments Business Operator has appointed an appropriate person as a manager, such as a management-level compliance manager for anti-terrorism financing and anti-money laundering measures.

F. Whether the Financial Instruments Business Operator provides officers and employees with training and education concerning the reporting of suspicious transactions on a periodic and ongoing basis. In order to promote understanding by officers and employees, it may be effective to use as a training material the “List of Referred Cases of Suspicious Transactions” (Refer to the FSA web site), which includes examples that may constitute cases requiring the reporting of suspicious transactions and examples of past cases in which Financial Instruments Business Operators actually reported to the authorities.

In addition, whether the business operator evaluates the level of understanding of the officers and employees receiving training and takes follow-up measures when necessary in light of their implementation of reporting in daily business processes.

G. Whether the Financial Instruments Business Operator ensures the effectiveness of the reporting of suspicious transactions by identifying and examining the implementation status of the reporting through periodic internal reviews and internal audits and by reviewing and revising the implementation method, for example.

(iv) Whether the Financial Instruments Business Operator has established an integrated and centralized internal control environment for judging whether to implement the reporting of suspicious transactions, by comprehensively taking account of basic customer information obtained through appropriate implementation of verification at the time of transaction, the specific characteristics of transactions and other matters based on the full recognition of the co-relation between verification at the time of transaction and the reporting of suspicious transactions.

(v) Whether overseas offices (branches, subsidiaries, etc.) have a control environment for properly implementing countermeasures against terrorism financing and money laundering.

A. Whether overseas offices properly implement countermeasures against terrorism financing and money laundering at the same level as in Japan to the extent permitted by applicable local laws and regulations, etc.

(Note) In particular, overseas offices located in countries or regions where the FATF Recommendations are not applied or not fully applied must know the fact that they are required to take countermeasures at the same level as in Japan.

B. If the local obligation to implement countermeasures against terrorism financing and money laundering is

stricter than in Japan, whether overseas offices implement such stricter local countermeasures.

C. If overseas offices cannot implement appropriate countermeasures against terrorism financing and money laundering at the same level as in Japan because such countermeasures are prohibited by local applicable laws and regulations, etc., whether overseas offices immediately provide information on the following to the Financial Services Agency or the Local Finance Bureau that has jurisdiction over the region where the head office is located:

- The country or region concerned
- Specific reasons for the inability to implement appropriate countermeasures against terrorism financing or money laundering; and
- If alternative measures are taken to prevent use for terrorism financing or money laundering, the particulars thereof.

## (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's internal control environment for verification at the time of transaction, etc. or measures stipulated in the AML/CFT Guideline through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

## III-2-7 Control Environment for Managing Administrative Risk

### (1) Administrative Risk Management

Administrative risk is the risk of Financial Instruments Business Operators and their customers incurring losses due to their officers and employees failing to conduct administrative work properly, causing accidents or committing illegal acts in the course of the administrative work process. Financial instruments business operators need to strive to ensure their reliability and creditworthiness by properly developing an internal control environment regarding administrative risk and maintaining the soundness and appropriateness of their business operations. Therefore, supervisors shall pay attention to the following points, for example, when examining a Financial Instruments Business Operator's administrative risk management.

#### (i) Major Supervisory Viewpoints

- A. Whether the Financial Instruments Business Operator has developed an appropriate control environment for managing administrative risk based on the understanding that such risk is involved in all business operations.
- B. Whether the Financial Instruments Business Operator has implemented specific measures to reduce

administrative risk based on the recognition of the importance of reducing such risk.

- C. Whether the Financial Instruments Business Operator has established a sufficient system of checks and balances by, for example, ensuring independence of the division in charge of managing administrative risk from divisions in charge of sales operations. Whether the business operator has specified procedures regarding administrative processes and reviews and revises them when necessary.
- D. Whether the internal audit section properly conducts internal audits in order to examine the control environment for managing administrative risk. Whether the division in charge of managing administrative risk has established arrangements and procedures for checking sales divisions' and branches' control environment for managing administrative risk. Whether the administrative risk management division and the sales divisions and branches cooperate when necessary to improve the standard of administrative processes.

## (2) Outsourcing of Administrative Processes

As Financial Instruments Business Operators are not exempted from the ultimate responsibility regarding administrative processes outsourced to external contractors, supervisors need to pay attention to the following points, for example, in light of the business operators' business profiles, in order to ensure the protection of customers and the soundness of the business operators' management. It should be kept in mind that the following points are general supervisory viewpoints and that supervisors may need to examine other points, too, depending on the contents of the outsourced business operations and other factors.

### (i) Major Supervisory Viewpoints

- A. Whether the Financial Instruments Business Operator has specified a policy and procedures for selecting the business operations to be outsourced and the contractors to outsource them to.
- B. Whether the Financial Instruments Business Operator has developed a control environment that enables sufficient management of administrative risk regarding outsourced business operations.
- C. Whether the Financial Instruments Business Operator has implemented measures to prevent the outsourcing of business operations from impeding the fulfillment of its obligations to the supervisory authorities, such as undergoing inspections, making reports and submitting data.
- D. Whether the Financial Instruments Business Operator has made it clear that the outsourcing of business operations does not cause any change in the contractual rights and obligations involving it and its customers, who continue to have the same rights as if the business operations were conducted by the business operator itself.
- E. Whether the Financial Instruments Business Operator has developed a control environment that ensures the prevention of inconveniences that may be caused to customers should they not be provided the services guaranteed under their contracts related to outsourced business operations.
- F. Whether the Financial Instruments Business Operator has established a system for properly handling complaints and inquiries regarding outsourced business operations by, for example, opening a contact point through which customers can directly consult the business operator.

## (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's control environment for managing administrative risk or for managing the outsourcing of business operations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings with the business operator or the outsourcing contractor and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

### III-2-8 Control Environment for Managing Information Technology Risk

Information technology risk is the risk that customers and Financial Instruments Business Operators will incur losses because of a computer system breakdown, malfunction or other inadequacies, or because of inappropriate or illegal use of computer systems. Information systems used by Financial Instruments Business Operators are becoming increasingly advanced and complex, in line with the integration of systems due to mergers and other management restructuring moves and an expansion of the range of products and services. This, combined with an expansion of computer networks, has increased the risk of important information being illegally accessed or leaked.

As secure and stable operation of computer systems is the overriding prerequisite for ensuring public confidence in the market for financial instruments and in Financial Instruments Business Operators, it is extremely important to enhance the control environment for managing information technology risk.

In addition, taking into account the changes in the financial environment in recent years, information technology (IT) strategies of financial institutions have now become priority issues that affect the business models of financial institutions. Therefore, there is a growing need for financial institutions to consider management strategies and IT strategies in an integrated manner. From such viewpoint, it has become extremely important that "IT governance," which is a mechanism for senior managers to demonstrate leadership, link IT strategies and management strategies, and create corporate value, functions appropriately. The importance of this point is also the same for Financial Instruments Business Operators, etc.

(Reference) Discussion Paper on Dialogues and Practices Regarding Financial Institutions' IT Governance (June 2019)

#### (1) Major Supervisory Viewpoints

When examining a Financial Instruments Business Operator's control environment for managing information technology risk, supervisors shall pay attention to the following points, for example, in light of the business operator's business profile.

##### (i) Recognition of information technology risk



- A. Whether the board of directors has formulated a basic policy for company-wide management of information technology risk based on a full recognition of information technology risk.
- B. Whether the board of directors recognizes that prevention and efforts for speedy recovery from system troubles and cybersecurity incidents (hereinafter referred to as "system trouble, etc.") is an important issue and has developed an appropriate control environment

(Note) "Cybersecurity incidents" refers to instances of cybersecurity being threatened by so-called cyberattacks, including unauthorized intrusion, theft, modification and destruction of data, failure or malfunction of information systems, execution of illegal computer programs and DDoS attacks, committed via the Internet through malicious use of information communication networks and information systems.

- C. Whether the board of directors fully recognizes the importance of information technology risk and has designated a person who has sufficient knowledge on and experience in computer systems and who is able to appropriately execute business as an officer that manages computer systems.
- D. Whether the board of directors has specified in detail the responsibilities to be fulfilled and the measures to be taken at a time of crisis in which system trouble, etc. occurs.  
In addition, whether it ensures the effectiveness of the responsibilities and measures by, for example, providing training under its leadership as needed.

(ii) Establishment of Appropriate Control Environment for Risk Management

- A. Whether the Financial Instruments Business Operator has specified a basic policy for the management of information technology risk and developed a relevant control environment. Whether the basic policy for the management of information technology risk includes a security policy (a basic policy for appropriately protecting the organization's information assets) and a policy on outsourced contractors.
- B. Whether the Financial Instruments Business Operator has developed its control environment for managing information technology risk based on guides that allow it to judge the objective levels of the details of the control environment.

In addition, whether the Financial Instruments Business Operator has constantly reviewed the control environment for managing information technology risk according to identification and analysis of system trouble, etc., risk management implementation results, and technological progress, etc.

(iii) Assessment of information technology risk

Whether the division managing information technology risk recognizes and assesses risks periodically and in a timely manner by recognizing the fact that risks are becoming diversified due to changes in the external environment, such as seen in the examples of system troubles induced by large-scale transactions as a result of increased customer channels and efforts to enhance information networks that bring more diverse and broad-based impact.

Also, whether it is taking sufficient measures to address the risks that have been identified.

(iv) Management of information security

- A. Whether the Financial Instruments Business Operator has developed a policy to appropriately manage information assets, prepared organizational readiness, introduced in-house rules, and developed an internal control environment. Also, whether it is making continuous efforts to improve its information security

control environment through the PDCA cycle, taking notice of illegal incidents or lapses at other companies.

B. Whether the company is managing information security by designating individuals responsible for it and clarifying their roles/responsibilities in efforts to maintain the confidentiality, integrity and availability of information. Also, whether the individuals responsible for information security are tasked to handle the security of system, data and network management.

C. Whether the company is taking measures to prevent unauthorized use of computer systems, unauthorized access, and intrusion by malicious computer programs such as computer viruses.

D. Whether the Financial Instruments Business Operator identifies important customer information it is responsible for protecting in a comprehensive manner, keeps its records and manages them.

Whether the Financial Instruments Business Operator, in identifying important customer information, has set business operations, systems and external contractors as the scope of protection and includes data, such as listed below, in the scope where it tries to identify those calling for protection.

-Data stored in the areas within the system that are not used in ordinary operations

-Data output from the system for analyzing system troubles

-Transaction logs stored in ATMs (including those outside of branches), etc.

E. Whether the Financial Instruments Business Operator is assessing importance and risks regarding important customer information that has been identified.

Also, whether it has developed rules to manage information, such as those listed below, in accordance with the importance and risks of each piece.

-Rules to encrypt or mask information

-Rules for utilizing information

-Rules on handling data storage media, etc.

F. Whether the Financial Instruments Business Operator has introduced measures to discourage or prevent unauthorized access, unauthorized retrieval, data leakage, etc. such as listed below, for important customer information.

-Provision of access authorizations that limits access to the scope necessary for the person's responsibility

-Storage and monitoring of access logs

-Introduction of mutual checking functions such as by separating the individuals in charge of development and those responsible for operations, administrators and those responsible for operations, etc.

G. Whether the Financial Instruments Business Operator has introduced rules for controlling confidential information, such as encryption and masking. Also, whether it has introduced rules regarding the management of encryption programs, encryption keys, and design specifications for encryption programs.

Note that "confidential information" refers to information, such as PIN, passwords, credit card information, etc., whose misuse could lead to losses by customers.

H. Whether the Financial Instruments Business Operator give due consideration to the necessity of holding/disposing of, restricting access to, and taking outside, of confidential information, and treats such information in a stricter manner.

I. Whether the Financial Instruments Business Operator periodically monitors its information assets to see whether they are managed properly according to management rules, etc. and reviews the control

environment on an ongoing basis.

J. Whether the Financial Instruments Business Operator conducts security education (including by external contractors) to all officers and employees in order to raise awareness of information security.

(Reference) Materials that can be used for ensuring security include “FISC Security Guidelines on Computer Systems for Banking and Related Financial Institutions” (compiled by the Center for Financial Industry Information Systems).

(v) Management of cybersecurity

A. Whether the board of directors, etc. recognizes the importance of cybersecurity amid increasingly sophisticated and cunning cyberattacks and has introduced the necessary control environment.

B. Whether the Financial Instruments Business Operator has introduced systems to maintain cybersecurity, such as listed below, in addition to making the organization more secure and introducing in-house rules.

-Monitoring systems against cyberattacks

-Systems to report cyberattacks and public-relation systems when attacks occur

-Emergency measures by Computer Security Incident Response Teams and systems for early detection

-Systems of information collection and sharing through information-sharing organizations, etc.

C. Whether the Financial Instruments Business Operator has introduced a multi-layered defence system against cyberattacks that combines security measures respectively for inbound perimeter control, internal network security control and outbound perimeter control.

-Security measures for inbound perimeter control (e.g. introduction of a firewall, anti-virus software, Intrusion Detection System, Intrusion Protection System etc.)

-Security measures for internal network security control (e.g. proper management of privileged IDs/passwords, deletion of unnecessary IDs, monitoring of execution of certain commands, etc.)

-Security measures for outbound perimeter control (e.g. retrieval and analysis of communication/event logs, detecting/blocking inappropriate communication, etc.)

D. Whether measures such as listed below are implemented to prevent damage from expanding when cyberattacks occur

-Identification of IP addresses from which the cyberattacks originate and blocking off of attacks

-Functions to automatically spread out accesses when under DDoS attacks

-Suspension of the entire system or its part, etc.

E. Whether necessary measures for vulnerabilities in the system, such as updating of the operating system and application of security patches, are introduced in a timely manner.

F. Whether the Financial Instruments Business Operator is, as part of cybersecurity measures, assessing its security levels by taking advantage of tests on network intrusion, vulnerability scanning or penetration tests, etc. and making efforts to improve security.

G. Whether the Financial Instruments Business Operator, when executing transactions using communication methods such as the Internet without any face-to-face contact, has introduced appropriate authentication methods in line with the risks associated with such transactions, such as listed below.

-Authentication methods that do not rely on fixed IDs/passwords, such as variable passwords and digital certificates

- Transaction authentication through multiple channels by using, for example, devices other than the PC web browser used in transactions, such as a mobile phone
- Transaction authentication using transaction signatures by means of a hardware token, etc.

(Note) If measures to prevent illegal withdrawals from customer accounts through unauthorized access (e.g. when, in services to designate or change the accounts to which money can be transferred, changes to accounts of holders different from the customer are not allowed, and measures are introduced to prevent transfers to accounts of a holder who is not the customer, for example by sending an application form for designating/changing accounts to the customer's address by transfer-prohibited mail) are implemented, the Financial Instruments Business Operator is deemed to have introduced measures in line with the risks associated with such transactions.

H. Whether the Financial Instruments Business Operator, when executing transactions using communication methods without any face-to-face contact, such as the Internet, has introduced preventative measures in line with operations, such as listed below.

- Provision of security software that allows the user to detect and remove viruses, etc. when executing transactions
- Introduction of software that allows the Financial Instruments Business Operator to detect virus infection of the user's PC and issue a warning
- Adoption of methods to store digital certificates in mediums or devices separate from PCs used in transactions, such as IC cards
- Introduction of a system that allows the Financial Instruments Business Operator to detect unauthorized log-ins, abnormal transactions, etc. and immediately notify such anomalies to users

I. Whether the Financial Instruments Business Operator has developed contingency plans against potential cyberattacks, conducts exercises and reviews such plans. Also, whether it participates in industry-wide exercises as necessary.

J. Whether the Financial Instruments Business Operator has formulated plans to train and expand the personnel responsible for cybersecurity and implements them.

(vi) System planning/development/management

- A. Whether the Financial Instruments Business Operator has clearly established a policy for system strategy as part of its business strategy and developed medium- to long-term development plans. Also, whether such medium- to long-term development plans are approved by the board of directors.
- B. Whether the Financial Instruments Business Operator is making continuous efforts to identify the risks inherent in the current system and making scheduled investment to maintain and improve it.
- C. Whether rules to authorize plans, development and transitions of development projects are clearly established.
- D. Whether individuals responsible for development projects are designated and progress of the development plans are managed accordingly.
- E. Whether the Financial Instruments Business Operator works out plans to test the system and its system development efforts and conducts tests in an appropriate and sufficient manner, such as by involving user divisions in them.

F. Whether the Financial Instruments Business Operator works out specific plans for the current system structure and development technology to be inherited and to train specialized personnel, and implements them

(vii) Computer System Audits

- A. Whether an internal audit section that is independent from the computer system division conducts periodic audits of the computer system.
- B. Whether the Financial Instruments Business Operator conducts internal audits by subject matter about computer systems and is taking of external audits by information system auditors.
- C. Whether the audited division accounts for all business operations involving information technology risk.
- D. Are the results of computer system audits properly reported to the board of directors?

(viii) Management of Outsourcing of Business Operations

- A. Whether the Financial Instruments Business Operator is assessing outsourced contractors (including system-related subsidiaries) against selection standards, giving careful consideration and selecting them.
- B. Whether the Financial Instruments Business Operator sets out division of roles and responsibilities with outsourced contractors, supervising authority of auditors, procedures to renew contracts, level of services provided, etc. in outsourcing contracts. Also whether the Financial Instruments Business Operator presents to outsourced contractors rules their officers and employees are required to adhere to and security requirements, as well as defines them in contract forms, etc.
- C. Whether risk management is carried out properly in outsourced system-related work (including work further subcontracted). In particular, whether the Financial Instruments Business Operator has risk management arrangements and procedures that have been developed with full awareness that a higher level of risk management is required when there are multiple outsourced contractors as the management work becomes more complicated.

And whether risk management is carried out properly in system-related office functions contracted out, as in system-related work..

- D. Whether the Financial Instruments Business Operator, as a consigner, periodically checks to confirm that outsourced work (including work further subcontracted) is carried out appropriately.

Also, whether there is a system that allows the consigner to monitor and track the status of customer data being processed at outsourced contractors

(ix) Contingency Plan

- A. Whether the Financial Instruments Business Operator has formulated a contingency plan and has established arrangements and procedures for dealing with emergencies.
- B. Whether the Financial Instruments Business Operator is basing the details of its contingency plan on guides that allows it to judge objective levels of its details (such as "Guide to Formulate Contingency Plans at Financial Institutions" compiled by the Center for Financial Industry Information Systems)
- C. Whether the Financial Instruments Business Operator, in developing a contingency plan, assumes not only contingencies due to natural disasters but also system troubles, etc. due to internal or external factors.

Also, whether it assumes risk scenarios of sufficient extent for cases such as a major delay in batch processing.

- D. Whether the Financial Instruments Business Operator reviews assumed scenarios in its contingency plan by, for example, taking into consideration case studies of system troubles at other financial institutions and results of deliberations at the Central Disaster Management Council, etc.
- E. Whether exercises in accordance with the contingency plan involve the entire company and are periodically conducted jointly with outsourced contractors, etc.
- F. Whether off-site backup systems, etc. are introduced for important systems whose failure could seriously affect business operations, and that a control environment is in place to address disasters, system troubles, etc. so that normal business operations can be speedily brought back.

(x) System Integration Risk / Project Management

- A. Whether the Financial Instruments Business Operator has developed a control environment for managing system integration risk by ensuring that its officers and employees fully recognize the risk.
- B. Whether the Financial Instruments Business Operator has established arrangements and procedures for conducting tests. Whether its test plan is suited to the nature of the system development necessitated by the system integration.
- C. Whether the Financial Instruments Business Operator has established a control environment that enables itself to be proactively involved in the system integration when this task is outsourced.
- D. Whether the Financial Instruments Business Operator makes use of third-party evaluation, such as evaluation by a system auditor, when making judgment regarding important matters related to the system integration.
- E. Whether the Financial Instruments Business Operator has developed a contingency plan for dealing with an unexpected incident.

(Reference) As for supervisory viewpoints in examining system integration risk / project management, “Approach to and Viewpoints Concerning the Control Environment for Managing System Integration Risk (Detailed Description)” attached to the Discussion Paper on Dialogues and Practices Regarding Financial Institutions’ IT Governance (June 2019) could also serve as a reference.

(xi) Actions to System Troubles

- A. Whether the Financial Instruments Business Operator is prepared to implement appropriate measures to avoid causing unnecessary confusion among customers when system troubles, etc. occur and take actions to speedily recover the system or activate alternative measures.  
Also, whether it has developed a worst-case scenario in preparation for system troubles and is prepared to take necessary measures accordingly.
- B. Whether the Financial Instruments Business Operator has prepared procedures that also subjects outsourced contractors to reporting system troubles, and has a clearly defined system of command and supervision.
- C. Whether the Financial Instruments Business Operator is prepared to immediately notify the representative director and other directors when a system trouble that may significantly affect business operations occurs, and report the largest potential risk it poses under the worst-case scenario (for example, if there is a possibility that the failure could gravely affect customers, the reporting persons should not underestimate the risk but immediately report the biggest risk scenario).

In addition, whether it is prepared to launch a task force, have the representative director issue appropriate instructions and orders, and seek resolution of the issue in a swift manner.

D. When system trouble, etc. occurs, whether the Financial Instruments Business Operator publicizes the details of the trouble, the cause of occurrence, expectation of restoration, etc. as needed, and promptly establishes a call center to precisely respond to inquiries from customers.

In addition, whether the method and contents of information provision to related business divisions have been made clear to prepare for the occurrence of system trouble, etc.

E. Whether the Financial Instruments Business Operator precisely carries out investigation of the cause of the system trouble, etc., investigation of the impact the system trouble, etc. has until the restoration, improvement measures, measures to prevent recurrence, etc.

Also, whether it periodically analyzes tendencies of factors that have led to system trouble, etc. and introduces measures to address them.

F. Whether the Financial Instruments Business Operator has developed a systemic mechanism, such as circumventing the troubled part, in order to minimize the impact of system trouble, etc.

G. Whether the Financial Instruments Business Operator has established arrangements and procedures for immediately reporting system trouble, etc. to the authorities.

(Reference) Reference materials on information technology risk include “FISC Security Guidelines on Computer Systems for Banking and Related Financial Institutions” (compiled by the Center for Financial Industry Information Systems).

## (2) Supervisory Method and Actions

### (i) At the Time of Problem Recognition

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator’s control environment for managing information technology risk, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator, by holding in-depth hearings with the business operator and the outsourcing contractor and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement, etc., based on Article 51 and 52(1) of the FIEA.

### (ii) At the Time of System Integration

When Financial Instruments Business Operators have announced plans to integrate computer systems as part of planned mergers and other management restructuring moves, they shall be required, as necessary, to submit specific plans for smoothly implementing the system integration, including the schedules and timetables, and documents regarding the internal control environment for managing information technology risk (including internal audits) and other matters, as well as to continue periodically submitting reports based on Article 56-2(1) of the FIEA until the integration is completed.

## (3) In times of system trouble

- (i) Financial Instruments Business Operators shall be required to notify the authorities of the occurrence of any computer system trouble and cyber security incidents as soon as they have recognized it, and submit a “Report on Problem Occurrence, etc.” (in the format specified in Attached List of Formats III-1) to the authorities.

After the computer system operation has been restored to normal and the cause of the problem has been identified, they shall be required to report to the authorities again (It should be kept in mind that they shall be required to report to the authorities on the current state within one month even if the computer system operation has not been restored to normal or the cause of the problem has not been identified within the one-month period.)

It should be noted that when a Local Finance Bureau has received a report from a Financial Instruments Business Operator, it shall immediately notify the FSA division in charge.

(Note) Computer System Trouble Subject to Reporting to the Authorities

Problems that must be reported to the authorities are those which affect systems and equipment (including both hardware and software) used by Financial Instruments Business Operators and contractors undertaking business operations outsourced by Financial Instruments Business Operators, and which could affect the business operators’ abilities to identify and keep track of the status of financial instruments transactions, financial settlements, cash deposits and withdrawals, fund-raising and financial conditions, and undermine customer convenience in other ways.

However, the reporting requirement is not applicable to such system troubles in cases where a backup system has started up and effectively prevented adverse effects. (For example, when an order-taking system has broken down in off-market hours but a backup system has quickly started up to take orders in time for the start of market hours, a report is not necessary.)

It should be noted that even if any computer system troubles have not occurred, a report must be made in cases where customers and business operations are affected or the probability that these may be affected is deemed to be high, including cases where a Financial Instruments Business Operator has received a warning of a cyber attack on its computer system or where it has detected the possibility of such an attack.

- (ii) A Financial Instruments Business Operator who has reported computer system troubles to the authorities shall be required to submit an additional report based on Article 56-2(1) of the FIEA when necessary. When the business operator is deemed to have a serious problem from the viewpoint of protecting public interests and customers, the authorities shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious violation of law, the authorities shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

### III-2-9 Control Environment for Crisis Management

Given the increased diversity and complexity of risks faced by Financial Instruments Business Operators and changes in the business environment for them in recent years, such as the increasing use of information systems, the possibility cannot be denied that a crisis that cannot be dealt with by ordinary methods of risk management will occur, which means that crisis management has become more important than ever. It is desirable that if risk has



materialized at a Financial Instruments Business Operator, the business operator avoids causing unnecessary disruptions to market and social activities by maintaining its functions as much as possible. With this in mind, when supervising a Financial Instruments Business Operator, supervisors shall pay attention to the following points, for example, in light of the business operator's business profile.

(1) Major Supervisory Viewpoints

(i) Preparations to Be Made in Normal Times

- A. Whether the Financial Instruments Business Operator recognizes what constitutes an emergency and is striving as much as possible to prevent or guard against any emergency (prepare countermeasures against an emergency that may be unpreventable) by, for example, conducting inspections and anti-crisis practices periodically in normal times.
- B. Whether the Financial Instruments Business Operator has formulated a crisis management manual. Whether it has established a control environment that maintains the effectiveness of the crisis management manual by, for example, constantly reviewing and revising it in light of the actual state of its business operations and its risk environment. It should be noted that it is desirable that Financial Instruments Business Operators use objective benchmarks as a basis for the formulation of their crisis management manuals

(Reference) Examples of Conceivable Emergency

- Natural disasters (earthquakes, typhoons, abnormal weather, epidemics of infectious diseases)
  - Acts of terrorism and wars (including those that occur outside Japan)
  - Accidents (large-scale power failures, computer system breakdowns, etc.)
  - Unfounded rumors (word-of mouth rumors, Internet messages, e-mail messages, news articles based on speculation, etc.)
  - Crimes committed against Financial Instruments Business Operators (blackmail, intervention by anti-social forces, data theft and abduction of officers or employees)
  - Problems involved in business processes (inappropriate response to complaints and inquiries, errors in data entry, etc.)
  - Problems related to personnel management affairs (accidents and crimes involving officers and employees, internal disputes, sexual harassment cases, etc.)
  - Problems related to labor affairs (cases of whistle-blowing, deaths from excessive workloads, occupational diseases, drain of human resources, etc.)
- C. Whether the crisis management manual notes the importance of initial responses, such as accurate identification and objective judgment of the situation and dissemination of information in the period immediately after the occurrence of the emergency.
  - D. Whether the crisis management manual clarifies the allocation of responsibilities in the event of an emergency and specifies arrangements and procedures for reporting the occurrence of the emergency throughout the institution and to other parties concerned (including the relevant authorities). Whether the crisis management manual specifies arrangements and procedures for reporting the occurrence of an emergency to relevant overseas organizations, including overseas supervisory authorities,

depending on the extent of its possible impact abroad as well as its level and type. It is desirable that anti-crisis arrangements and procedures be established under the supervision of the crisis management headquarters that oversees institution-wide response in light of the levels and types of emergencies assumed for each division and branch.

- E. Whether the Financial Instruments Business Operator is striving to disseminate and gather information in normal times in a conscientious manner.

(ii) Actions to Emergencies

- A. When supervisors have recognized the occurrence of an emergency or the possibility of an emergency occurring, they shall hold hearings periodically and check the situation first-hand so that they can identify and keep track of how the relevant Financial Instruments Business Operator is responding to the emergency, including whether the response (status of the development of a control environment for crisis management, communications with relevant parties and dissemination of information) is sufficient in light of the level and type of the emergency, until the situation is stabilized. In addition, they shall require the submission of a report based on Article 56-2(1) of the FIEA when necessary.
- B. In the above case, supervisors shall make sure to maintain close cooperation with relevant departments and sections, by, for example, immediately reporting to the FSA division in charge.

(iii) Post-Crisis Actions

In cases where supervisors have concluded, after the emergency has been brought under control, that it is necessary to examine the Financial Instruments Business Operator's response to the emergency, they shall require the business operator, under Article 56-2 (1) of the FIEA, to submit a report regarding the outline of the emergency, its response, the analysis of the cause and measures to prevent a recurrence.

(iv) Control Environment for Crisis Management Regarding Reputational Risk

- A. Whether the Financial Instruments Business Operator has developed a control environment for managing reputational risk. Whether it has specified how the headquarters, divisions and sales offices should respond to the circulation of unfounded rumors. It is desirable that Financial Instruments Business Operators consider how to respond when unfounded rumors regarding other business operators or their business clients are circulated.
- B. Whether the Financial Instruments Business Operator regularly checks whether there are unfounded rumors circulating in each media category (e.g. Internet messages, news articles based on speculation).

(2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's control environment for crisis management, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions,

including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

### III-2-10 Measures to Prevent Violation of Law by Financial Instruments Intermediary Service Providers

#### (1) Points of Attention Regarding Prevention of Violation of Law by Financial Instruments Intermediary Service Providers

When Financial Instruments Business Operators entrust businesses to financial instruments intermediary service providers, it is important for them to give guidance on the development of a control environment for customer management that enables the intermediary service providers to precisely identify the attributes of customers and the actual state of transactions from the viewpoint of ensuring appropriate investment solicitation suited to the attributes. It is also important for Financial Instruments Business Operators to identify the actual state of investment solicitation by financial instruments intermediary service providers and urge them to ensure thorough legal compliance. In examining a Financial Instruments Business Operator's control environment for preventing violation of law by financial instruments intermediary service providers, supervisors shall pay attention to the following points in particular:

##### (i) Precise Identification of Customer Attributes and Thorough Management of Customer Information

- A. Whether the Financial Instruments Business Operator shares information regarding the attributes and investment experiences of customers with the entrusted financial instruments intermediary service provider only when it has obtained the customers' consent, and whether it gives the intermediary service provider guidance on how to identify customer attributes as necessary. Whether the Financial Instruments Business Operator has prescribed specific procedures for the intermediary service provider to solicit customers in an appropriate manner suited to the attributes of the customers, has communicated the procedures to the intermediary service provider, and strives to ensure compliance therewith.
- B. Whether the Financial Instruments Business Operator has prescribed specific guidelines for the financial intermediary service provider to manage customer information, such as customer attributes, based on careful deliberations made from the viewpoint of the confidentiality obligation, and has communicated the guidelines to the intermediary service provider and strives to ensure compliance therewith.
- C. Whether the division in charge of customer due diligence strives to keep track of the Financial Instruments Business Operator's status concerning the identification of customer attributes and the management of customer information, and also establish a control environment that ensures the effectiveness of customer information management by examining, as necessary, whether customer solicitation is conducted in an appropriate manner in light of the attributes of the relevant customers, and by requesting revisions of the method of customer information management, for example.

##### (ii) Identification of the Actual State of Financial Instruments Intermediary Service Provider's Solicitation for Investment and Efforts to Ensure Appropriate Solicitation

- A. Whether the manager of the division in charge of customer due diligence, for example, strives to identify and keep track of the actual state of the entrusted financial instruments intermediary service provider's solicitation for investment by directly holding interviews with customers and taking appropriate measures when necessary.

- B. Whether the division in charge of customer due diligence has prescribed a specific method for identifying and keeping track of the actual state of the financial instruments intermediary service provider's solicitation for investment and has communicated the method to them, and is striving to establish a control environment that ensures the effectiveness of the method by identifying and examining the implementation and reviewing and revising the method when necessary.
  - C. Whether the division in charge of customer due diligence checks whether the entrusted financial instruments intermediary service provider provides appropriate explanations, and requests improvement and takes other measures when necessary.
- (iii) Efforts to Foster and Maintain Sense of Compliance at Financial Instruments Intermediary Service Providers
- A. Whether the Financial Instruments Business Operator provides case study training, external training and other types of training with a view to enhancing the entrusted financial instruments intermediary service provider's sense of compliance.
  - B. Whether the division in charge of customer due diligence strives to enhance the effectiveness of training by, for example, identifying and examining the contents of training programs and the implementation thereof and reviewing and revising the contents when necessary.

## (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a Financial Instruments Business Operator's measures to prevent violation of law by an entrusted financial instruments intermediary service provider, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

## III-2-11 Prevention of Damage that May be Inflicted by Anti-Social Forces

### (1) Significance

Eliminating anti-social forces from society is a task critical to ensuring the order and safety of society, so it is necessary and important for corporations to promote efforts to ban any relations with anti-social forces from the viewpoint of fulfilling their social responsibility. In particular, as Financial Instruments Business Operators have a public nature and play an important economic role, they need to exclude anti-social forces from financial instruments transactions in order to prevent damage from being inflicted not only on their officers and employees but also on their customers and other stakeholders.

Needless to say, if Financial Instruments Business Operators are to retain public confidence and maintain the

soundness and appropriateness of their business operations, it is essential that they deal with anti-social forces in accordance with laws and regulations without bowing to pressure from them. Therefore, Financial Instruments Business Operators must strive, on a daily basis, to develop a control environment for banning any relations with anti-social forces in accordance with the purpose of the “Guideline for How Companies Prevent Damage from Anti-Social Forces” (agreed upon at a meeting on June 19, 2007 of cabinet ministers responsible for anti-crime measures).

In particular, anti-social forces have become increasingly sophisticated in their efforts to obtain funds, disguising their dealings as legitimate economic transactions through the use of affiliated companies in order to develop business relations with ordinary companies. In some cases, the relations thus developed eventually lead to problems. There are also cases in which anti-social forces such as “boryokudan” crime syndicates intervene in the financial instruments market through initial public offering in stock markets for emerging companies and through equity financing deals in markets for listed companies in an attempt to obtain funds. In order to deal with such cases properly, the management teams of Financial Instruments Business Operators need to take a resolute stance and implement specific countermeasures.

It should be noted that if a Financial Instruments Business Operator delays specific actions to resolve a problem involving anti-social forces on the grounds that unexpected situations, such as the safety of officers and employees being threatened, could otherwise arise, the delay could increase the extent of the damage that may be ultimately inflicted on the business operator.

(Reference) “Guideline for How Companies Prevent Damage from Anti-Social Forces” (agreed upon at a meeting on June 19, 2007 of cabinet ministers responsible for anti-crime measures)

(i) Basic principles on Prevention of Damage That May be Inflicted by Anti-Social Forces

- Institutional response
- Cooperation with external expert organizations
- Ban on any relations, including transactions, with anti-social forces
- Legal responses, both civil and criminal, in the event of an emergency
- Prohibition of engagement in secret transactions with and provision of funds to anti-social forces

(ii) Identification of anti-social forces

In judging whether specific groups or individuals constitute “anti-social forces,” which are defined as groups or individuals that pursue economic profits through the use of violence, threats and fraud, it is necessary not only to pay attention to whether they fit the definition in terms of their affiliation, such as whether they constitute or belong to “boryokudan” crime syndicates, “boryokudan” affiliated companies, “sokaiya” racketeer groups, groups engaging in criminal activities under the pretext of conducting social campaigns or political activities and crime groups specialized in intellectual crimes, but also to whether they fit the definition in terms of the nature of their conduct, such as whether they are making unreasonable demands that go beyond the limits of legal liability. (Refer to the “Key Points of Measures against Organized Crime,” a directive issued in the name of the Deputy Commissioner-General of the National Police Agency on December 22, 2011.)

(2) Major Supervisory Viewpoints

The Financial Instruments Business Operator should not have any relations with anti-social forces and, in cases

where it has established a relationship with an anti-social force unwittingly, supervisors, while also giving consideration to the characteristics of specific transactions, shall pay attention to such as the following points in order to examine its control environment for banning any relations with anti-social forces as soon as possible after the counterparty has been found to be an anti-social force and its control environment for dealing with unreasonable demands by anti-social forces appropriately.

(i) Institutional response

In light of the need and importance of an action to ban any relationship with anti-social forces organically, whether the responsibility of responding to the situation is not left solely to the relevant individuals or divisions but the management including directors are appropriately involved, and there is a policy for the entire organization to respond. In addition, whether there is a policy calling for the corporate group as a whole, not just the involved Financial Instruments Business Operator alone, to take on an effort to prevent any relationship with anti-social forces.

(ii) Developing of a Centralized Control Environment through anti-social forces response division

Whether the Financial Instruments Business Operator has established a division in charge of supervising responses to ban any relationship with anti-social forces (hereinafter referred to as the “anti-social forces response division”) so as to develop a centralized control environment for preventing anti-social forces from inflicting damage, and whether this division is properly functioning.

In particular, whether the Financial Instruments Business Operator pays sufficient attention to the following points in developing the centralized control environment.

- A. Whether the anti-social forces response division is actively collecting and analyzing information on anti-social forces and has developed a database to manage such information in a centralized manner and has a system to appropriately update it (i.e., addition, deletion or change of information in the database). Further, whether the division is making efforts to share information within the group in the process of collecting and analyzing such information, while making appropriate use of information provided by self-regulatory organizations, etc. Whether the anti-social forces response division has a system to take advantage of information on anti-social forces for screening counterparties of transactions and evaluating the attributes of shareholders of the Financial Instruments Business Operator.
- B. Whether the Financial Instruments Business Operator makes sure to maintain the effectiveness of measures to ban any relations with anti-social forces by, for example, having the anti-social forces response division develop a manual for dealing with anti-social forces, provide on-going training, foster cooperative relationships with external expert organizations such as the police, the National Center for the Elimination of Boryokudan and lawyers on an ongoing basis. In particular, whether the Financial Instruments Business Operator is prepared to report to the police immediately when it faces the imminent prospect of being threatened or becoming the target of an act of violence, by maintaining close communications with the police on a daily basis so as to develop a systematic reporting system and build a relationship that facilitates cooperation in the event of a problem.
- C. Whether the Financial Instruments Business Operator has a structure in which relevant information is swiftly and appropriately conveyed to the anti-social forces response division for consultation when transactions with anti-social forces are found or such forces have made unreasonable demands. Further,

whether the anti-social forces response division has a structure to swiftly and appropriately report relevant information to the management. In addition, whether the anti-social forces response division has a structure to ensure the safety of individuals encountering anti-social forces in person and to support divisions involved in dealing with them.

(iii) Execution of Appropriate Prior Screening

Whether the Financial Instruments Business Operator bans allowing anti-social forces to become a counterparty to a transaction by conducting appropriate advance screening using information on such forces in order to prevent transactions with anti-social forces, and makes sure provisions regarding the exclusion of “boryokudan” crime syndicates are introduced in all contracts and terms of transactions.

(iv) Execution of Appropriate Follow-up Review

Whether, for the purpose of making sure any relationships with anti-social forces are eliminated, there is a structure to conduct an appropriate follow-up review on existing contracts.

(v) Measures to Terminate Transactions with Anti-Social Forces

- A. Whether the Financial Instruments Business Operator has a system under which information confirming the existence of a transaction with anti-social forces is swiftly and appropriately reported to the management, including directors, etc., via the anti-social forces response division, and responds to the situation under appropriate directions and involvement by the management.
- B. Whether the Financial Instruments Business Operator regularly communicates with external expert organizations, including the police, the National Center for the Elimination of Boryokudan, lawyers and so forth, and promotes efforts to eliminate any transactions with anti-social forces.
- C. Whether the Financial Instruments Business Operator, when it has learned through a follow-up review after initiating a transaction that the counterparty is a member of an anti-social force, takes measures to prevent the provision of benefits to anti-social forces, such as terminating relationships with such forces.
- D. Whether the Financial Instruments Business Operator has a structure to prevent providing funds or engaging in inappropriate or unusual transactions for whatever reason if the counterparty has been found to be an anti-social force.

(vi) Dealing with Unreasonable Demands by Anti-Social Forces

- A. Whether the Financial Instruments Business Operator has a system under which the information that anti-social forces have made unreasonable demands is swiftly and appropriately reported to the management, including directors, etc., via the anti-social forces response division, and responds to the situation under appropriate directions and involvement by the management.
- B. Whether the Financial Instruments Business Operator actively consults external expert organizations such as the police, the National Center for the Elimination of Boryokudan, and lawyers, when anti-social forces make unreasonable demands, and responds to such unreasonable demands based on guidelines set by the National Center for the Elimination of Boryokudan and other organizations. In particular, whether the operator has a structure to report to the police immediately when there is an imminent prospect of a threat being made or an act of violence being committed.
- C. Whether the Financial Instruments Business Operator, in response to unreasonable demands by anti-social forces, has a policy to take every possible civil legal action and to avoid hesitating to seek the

initiation of criminal legal action by pro-actively reporting damage to the authorities.

- D. Whether the Financial Instruments Business Operator ensures that the division in charge of handling problematic conduct promptly conducts a fact-finding investigation upon request from the anti-social forces response division, in cases where unreasonable demands from anti-social forces are based on problematic conduct related to business activity or involving an officer or employee.

(vii) Management of Shareholder Information

Whether the Financial Instruments Business Operator manages shareholder information properly, through means such as checking the transaction status of its own shares and examining information regarding the attributes of its shareholders.

(3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a financial institution's control environment for banning any relations with anti-social forces, through inspection and daily supervisory administration, they shall identify and keep track of the status of voluntary improvement made by the business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the Financial Instruments Business Operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, because its internal control environment is extremely fragile, as shown by, for example, a failure to take appropriate steps toward dissolving relations with anti-social forces despite recognizing the provision of funds thereto and the presence of inappropriate business relations therewith, supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the Financial Instruments Business Operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider taking strict actions based on Article 52 (1) of the FIEA.

III-2-12 Information Disclosure Regarding Corporate Social Responsibility (CSR), etc.

(1) Significance

- (i) CSR is a concept generally interpreted to include the economic, environmental and social responsibilities a company recognizes in relation to its diverse range of stakeholders, and activities conducted on the basis of those responsibilities. CSR is significant in that the company can enhance its sustainability by fulfilling those responsibilities.
- (ii) It should be left to individual Financial Instruments Business Operators to decide, based on the principle of self-responsibility, not only whether to engage in CSR activity but also whether to make information disclosure regarding such activity. Evaluation of a Financial Instruments Business Operator's CSR activity should be made by users and other stakeholders under the principle of market discipline.
- (iii) However, if easy-to-understand information disclosure regarding CSR activity is made in a timely and appropriate manner, users are expected to more easily obtain information useful for judging the sustainability of business operators and their financial products and services when deciding which business operators to make transactions with. From this viewpoint, by clarifying supervisory viewpoints regarding CSR-related information disclosure by Financial Instruments Business Operators as a minimum standard, supervisors shall



promote information disclosure that is appropriate and useful for users.

## (2) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator makes information disclosure appropriate from the viewpoints of the following matters in order to enable a diverse range of stakeholders, including users, to properly evaluate its CSR and to contribute to the improvement of the convenience for users.

### (i) Suitability with Objective

Whether the Financial Instruments Business Operator's CSR report comprehensively covers the fields of economy, environment and society and whether its contents suit the objective of meeting the needs of a diverse range of stakeholders, including users, by using comprehensive descriptions and reflecting social backgrounds. Whether disclosure is made in a timely and effective manner.

### (ii) Reliability

Whether the Financial Instruments Business Operator compiles its CSR report through a transparent process and uses precise and objective data and information, thereby ensuring that the report is highly reliable and widely acceptable.

### (iii) Readability

Whether the Financial Instruments Business Operator strives to make its CSR report as easy-to-understand as possible so that a diverse range of stakeholders, including users, can understand it. Whether the Financial Instruments Business Operator pays sufficient attention to the need to enable comparison between recent and past reports by, for example, maintaining consistency.

## (3) Supervisory Method and Actions

A Financial Instruments Business Operator's CSR-oriented efforts and information disclosure are voluntary activities made in accordance with management decisions based on the principle of self-responsibility. Therefore, even if the business operator's CSR report fails to take account of the above supervisory viewpoints, supervisors do not need to take supervisory measures.

However, in cases where information disclosure is imprecise or inappropriate, the disclosure practice shall be examined from the viewpoint of the appropriateness of business operations.

## III-2-13 Response to Disabled Persons

(1) The Act Concerning the Promotion of Elimination of Discrimination on the Grounds of Disabilities (Law No. 65 of 2013; hereinafter referred to as the "Disabled Persons Anti-Discrimination Act") imposes prohibition of discriminatory treatment and best-effort obligations for reasonable accommodation of disabled persons on business operators.

With regard to Financial Instruments Business Operators, specific treatments are indicated in the "Guidelines for the Promotion of Elimination of Discrimination on the Grounds of Disabilities in Business Fields Under the Jurisdiction of the Financial Services Agency" (Notice No. 3 of 2016; hereinafter referred to as the "Disabled Persons Anti-Discrimination Guidelines").

Supervisors shall pay attention to matters such as whether, in responding to disabled persons, the business operator has developed an internal control environment such as making appropriate responses in accordance with the Disabled Persons Anti-Discrimination Act and the Disabled Persons Anti-Discrimination Guidelines, including customer protection and user convenience perspectives, as well as grasping and examining the status of the responses and reviewing response methods.

## (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding responses to disabled persons by Financial Instruments Business Operators, through daily supervisory administration or complaints from disabled persons, they shall check the status of the development of an internal control environment by holding in-depth hearings with the business operator. When there is doubt about the development status of the internal control environment at a Financial Instruments Business Operator, supervisors shall request reporting (including reports based on the provisions of Article 56-2(1) of the FIEA) and examine the situation as needed. If said development status is deemed problematic, the supervisor shall urge improvement.

## III-2-14 Points of Attention Regarding Crypto-and Other Assets

While the design and specifications of crypto-and other assets (meaning the crypto-and other assets prescribed in Article 2(24)(iii)-2 of the FIEA; the same shall apply hereinafter) are varied, some crypto-and other assets have a high risk of being exploited in cases of terrorism financing and money laundering, such as those of which the transactions are difficult to trace because the transfer records are not disclosed. Generally, crypto-and other assets have no assets, etc. to back up their value, so their intrinsic value is difficult to conceptualize. Given that their prices fluctuate substantially, it is necessary to carefully confirm the suitability of customers. In addition, the management of crypto-and other assets also involves information technology risks, such as computer system malfunction and cyberattacks.

In light of these aspects, supervisors shall conduct supervision on the handling of crypto-and other assets by Financial Instruments Business Operators, etc. in relation to purchase and sale or other transactions of securities, etc. by paying attention to the following points, for example.

Meanwhile, it should be kept in mind that in order for a Financial Instruments Business Operator, etc. to manage crypto-assets (meaning the crypto-assets prescribed in Article 2(14) of the Payment Services Act; the same shall apply hereinafter) deposited by customers in relation to financial instruments transactions, it needs the registration referred to in Article 63-2 of the Payment Services Act.

### (1) Identification, Assessment, and Reduction of Risks Based on the Specific Characteristics, etc. of Crypto-and Other Assets

Whether the Financial Instruments Business Operator, etc. takes the following measures, for example, in order to make crypto-and other assets, etc. (meaning the crypto-and other assets, etc. prescribed in Article 185-23(1) of the FIEA; the same shall apply hereinafter) not subject to transactions if they are deemed likely to compromise the protection of investors or proper and reliable performance of financial instruments business in light of the specific

characteristics of crypto-and other assets and its own business arrangements and procedures:

- (i) When making new crypto-and other assets, etc. subject to transactions, whether the Financial Instruments Business Operator, etc. identifies and assesses risks that may be caused by making the crypto-and other assets, etc. subject to transactions (hereinafter referred to as "transaction risks"), and has developed a control environment for precisely screening whether the crypto-and other assets, etc. should be made subject to transactions from the viewpoint of protection of investors and proper and reliable performance of business.
- (ii) Whether the Financial Instruments Business Operator, etc. periodically reviews the contents of transaction risks involved in crypto-and other assets, etc. that are already subject to transactions, and as necessary, re-screens whether the crypto-and other assets, etc. should be made subject to transactions.
- (iii) When newly making crypto-and other assets, etc. subject to transactions, whether the Financial Instruments Business Operator, etc. makes the decision in an organized manner, such as gaining the approval of the board of directors, based on the results of the screening as to whether the crypto-and other assets, etc. should be made subject to transactions.
- (iv) Whether the division that screens whether crypto-and other assets, etc. should be made subject to transactions has arrangements and procedures to be able to appropriately examine transaction risks, such as being independent from the sales division and staffed with personnel having expert knowledge.

## (2) Measures against Cases of Money Laundering and Terrorism Financing

Whether the Financial Instruments Business Operator, etc. carefully determines the scope of crypto-and other assets to be handled in light of the risk that the crypto-and other assets would be exploited in cases of money laundering and terrorism financing, and other factors. For example, it should be kept in mind that crypto-and other assets of which transfer records are extremely difficult to trace should not be received as consideration for purchase and sale or other transactions of securities, etc. and securities for which such crypto-and other assets are distributed as dividends, etc. should not be handled, as the risk of such crypto-and other assets becoming exploited in cases of money laundering and terrorism financing is particularly high.

In addition, in the case of conducting purchase and sale or other transactions of securities, etc. in consideration of crypto-and other assets, whether the Financial Instruments Business Operator, etc. has developed a control environment for effectively reducing the risk of money laundering and terrorism financing associated with the handling of crypto-and other assets based on III-2-6 and the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism, and whether it appropriately confirms that the transactions are unlikely to fall under the category of suspicious transactions. In particular, whether it has determined the need for the suspicious transaction reporting by appropriately considering whether there are any suspicious aspects about the counterparty to the transaction being the true holder of the crypto-and other assets in respect to the attributes of the counterparty to the transaction and the management method of the crypto-and other assets, etc.

Moreover, whether the Financial Instruments Business Operator, etc. has a control environment for appropriately confirming that the issuer and manager of and other persons concerned in the crypto-and other assets do not fall under the category of those subject to sanctions or anti-social forces, etc.

## (3) Control Environment for Customer Solicitation and Explanations

(i) Points of Attention Regarding Crypto-and Other Assets-Related Business

When a Financial Instruments Business Operator, etc. conducts the crypto-and other assets-related business prescribed in Article 43-6 of the FIEA and Article 146-3 of the FIB Cabinet Office Ordinance, supervisors shall pay attention to whether it appropriately explains the matters prescribed in Article 146-4 of the FIB Cabinet Office Ordinance by delivering a document or the like.

Of those matters, "the outline and specific characteristics of the crypto-and other assets" prescribed in Article 146-4(2)(iv) of the FIB Cabinet Office Ordinance and "matters which should be noted by the customer in relation to the nature of crypto-and other assets" prescribed in item (v) of that paragraph could include, for example, the following matters:

- A. Main uses of the crypto-and other assets
- B. Matters concerning the scheme of holding or transferring the crypto-and other assets
- C. Total volume of issuance of the crypto-and other assets, and if there is an upper limit to the issuable volume, the upper limit
- D. Status of distribution of the crypto-and other assets
- E. Inherent risks of the crypto-and other assets

In addition, "a representation that could cause the customer to have a misconception about the nature of the crypto-and other assets or other particulars specified by Cabinet Office Order" provided in Article 43-6(2) of the FIEA could include, for example, the following matters:

- A. A representation that could cause the customer to have a misconception regarding the fact that price fluctuations of the crypto-and other assets could generate a loss
- B. A representation that could cause the customer to have a misconception regarding the fact that transfer of the crypto-and other assets will be restricted for a specific period according to the scheme of the crypto-and other assets
- C. A representation that could cause the customer to have a misconception regarding the financial conditions of the issuer of the crypto-and other assets or the status of progress of business conducted by the issuer

(ii) If the customer is planned to receive crypto-and other assets as dividends or consideration in relation to purchase and sale or other transactions of securities, etc., supervisors shall pay attention to whether the Financial Instruments Business Operator, etc. confirms the suitability of the customer by checking the customer's knowledge and trading experience concerning crypto-and other assets, and whether it appropriately explains the scheme, nature, price fluctuation risk, etc. of the crypto-and other assets based on (i) above.

(4) Securing Financial Soundness

If a Type I Financial Instruments Business Operator holds crypto-and other assets, it is necessary to examine not only the points stated in (1) through (3) above, but also the effects that the price fluctuation risk, etc. of the crypto-and other assets have on its financial soundness. Therefore, whether the Type I Financial Instruments Business Operator has developed a control environment necessary for securing its financial soundness, such as identifying various risks involved in the holding of the crypto-and other assets in a timely and appropriate manner and appropriately managing those risks, based on IV-2, in light of the specific characteristics of the crypto-and other assets and the contents, specific characteristics, size, etc. of business relating to the holding of the crypto-and other

assets.

### III-2-15 Supervisory Response in Cases of Long-term Suspension of Business, etc.

(1) When it is found that the circumstance may fall under cases where a Financial Instruments Business Operator does not commence business (where a Financial Instruments Business Operator engages in two or more types of businesses, any one of those businesses; the same applies here in III-2-15) within three months of the day on which it is permitted to begin engaging in financial instruments business, or suspends business for three months or more continually, supervisors shall ascertain the cause therefor promptly by holding in-depth hearings with or requesting a report based on the provisions of Article 56-2(1) of the FIEA as needed from the Financial Instruments Business Operator regarding the justice in the relevant circumstance, while taking into account the actual conditions of the Financial Instruments Business Operator's business.

(2) For example, if any of the following situations is found as a result of the aforementioned examination, it is considered that "there is no just cause" (provided however, that the situation is not limited to the following, which are only examples).

(i) Where the Financial Instruments Business Operator has not prepared a business plan, etc. for commencing or resuming business based on reasonable grounds and it is found that there is no prospect that a business plan, etc. will be prepared

(ii) Where it is found that there is the possibility that the continuation of the suspension of business for three months or more may cause unpredictable damage to investors

(3) When it is found that a Financial Instruments Business Operator has not commenced business or has suspended business without just cause, supervisors shall take necessary actions, including a recommendation for notification of the suspension of business based on the provisions of Article 50(1)(i) of the FIEA or notification of the discontinuance of business based on the provisions of Article 50-2(1)(ii) of the FIEA (where a Financial Instruments Business Operator engages in two or more types of businesses, and discontinues any one of those businesses, a recommendation for registration of a change based on the provisions of Article 31(4) of the FIEA), and issuance of a business improvement order based on the provisions of Article 51 of the FIEA. When it is obvious that commencement or resumption of business is not expected or otherwise there is no just cause for not commencing or suspending business and no improvements are expected, supervisors shall consider actions such as issuance of a business suspension order based on the provisions of Article 52 of the FIEA or rescission of registration based on the provisions of Article 54 of the FIEA.

### III-3 Various Administrative Procedures (General)

#### III-3-1 Registration

##### (1) Trade Name

It shall be confirmed that a trade name given in the application for registration does not infringe Article 25(2) of the Amendment Act.

From the viewpoint of preventing misunderstandings by investors, etc., it shall be ensured that the use of the names of securities companies, financial futures transaction companies, investment trust management companies, and investment advisory service companies that existed in the past is avoided as much as possible, except for the case where a business operator, which is allowed to continue the business due to business transfer, etc., uses such a name.

##### (2) Business Site or Office

The business site or office to be listed in the application for registration shall refer not to representative offices, liaison offices or any other facilities devoted to work other than the financial instruments business, but to a certain facility or utility to be established for the purpose of conducting whole or part of the financial instruments business.

In the case of an unmanned business site or office, the number of stores located within the jurisdiction of each finance bureau and the name of the business site or office that controls such stores shall be entered.

It must be noted that it is necessary to post a sign at unmanned business sites or offices, pursuant to the provision of Article 36-2(1) of the FIEA.

##### (3) Name and Location of the Head Office, etc.

With regard to the “name and location of the head office, etc.” to be listed in the application for registration (Article 7(xii), Article 44(xiii) and Article 258(iv) of the FIB Cabinet Office Ordinance), when stating the “name and location of the head office and other business site or office (in the case of a foreign corporation: the head office and the principal business site or office or other business site or office in Japan)” (Appended Form 1 Attachment 6, Appended Form 9 Attachment 4 and Appended Form 24 Attachment 2 of the FIB Cabinet Office Ordinance), supervisors shall check that this is done by stating the head office, etc. first (in the case of a foreign corporation: by stating the head office first, followed by the principal business site or office in Japan).

In cases where the said head office and the principal business site or office are different, such as the head office listed on the certificate of registered matters not having the functions of a principal business site or office, it should be kept in mind that it is necessary to state the said principal business site or office first.

##### (4) Documents to be Attached to the Application for Registration

- (i) The abstract of residence certification to be submitted shall contain the following items:
  - A. address,
  - B. name, and
  - C. date of birth.

- (ii) A copy of the residence card or a copy of the special permanent resident certificate submitted by a foreign resident living in Japan, and a copy of residence certification of the home country submitted by a foreigner living outside Japan, or any other documents equivalent thereto (a Japanese translation shall be attached to all documents in English, etc.) shall fall under the “documents in lieu thereof” pursuant to the provisions of Article 9(ii)(B), (iii)(B) and (ix) (A)(1) of the FIB Cabinet Office Ordinance.

(5) Points to Consider before Granting Registration

- (i) Applicants shall be reminded to abstain from conducting any business activities until they are registered in a registry of Financial Instruments Business Operators.
- (ii) In the case where an applicant for registration is engaged in another business related to laws and regulations under the supervision of the Financial Services Agency and an administrative reprimand concerning the said business has been issued, the details of such a reprimand shall be confirmed and, when necessary, the progress of improvement measures shall be verified in a hearing session, etc.

In the case where the said disposition is related to legal compliance, attention shall also be paid to III-2-1.

(6) Handling of Registration Numbers

- (i) Each registration shall be identified by a serial number (however the following numbers shall not be used, 4, 9, 13, 42, 83, 103, and 893), which is assigned by each local finance bureau, and the registration number to be entered into the registry of Financial Instruments Business Operators shall be subject to the following rules: e.g., Director General of Finance Bureau ..... (Financial instruments business) No. ....
- (ii) When a registration is no longer valid, its registration number shall be retired and no new number shall be issued in its place.
- (iii) Registration numbers shall be managed by the registration number file of Financial Instruments Business Operators using appended form III-2.

(7) Notification to Applicants for Registration

When registration is made in the registry of Financial Instruments Business Operators, appended form III-3 shall be used to issue notification of registration to the applicant for registration.

(8) Refusal of Registration(Refer to II-5-6)

- (i) When registration is refused, appended form III-4 shall be used to issue notification of refusal of registration to the applicant. The notification shall include the grounds for refusal and state that the applicant is entitled to make a request to the Commissioner of the Financial Services Agency for an examination and file a claim against the government to rescind the decision, etc.
- (ii) The Director-General of the Financial Bureau shall enter the grounds for refusal and the corresponding numbers of items set out in Article 29-4(1) of the FIEA as grounds for refusal, or specifically indicate the part of the application for registration or attached documents that lists false information or has important facts missing, in the notification of refusal of registration.

### (9) Registry of Financial Instruments Business Operators

- (i) The registry of Financial Instruments Business Operators shall be prepared according to the section from page 2 to 11 of the copy of the application for registration.
- (ii) When a notification of change in items of application for registration is submitted, the relevant page of the registry for Financial Instruments Business Operators shall be replaced by the revised page of the application for registration attached to the said notification.

In addition, with respect to the notification of change in the amount of capital due to the issuing of a warrant by a Financial Instruments Business Operator that issues warrants or bonds with warrants, a declaration of the amount of capital at the end of every month shall be submitted by the 15th of the following month and the registry of the relevant Financial Instruments Business Operator shall be revised monthly.

- (iii) When Financial Instruments Business Operators under the supervision of the Agency submit notifications of change in the items in the application for registration, the Agency shall compile such notifications every month and send the revised pages of the application forms to the finance bureaus that registered the relevant Financial Instruments Business Operators, by the 20th of the following month.
- (iv) The date of inspection of the registry of a Financial Instruments Business Operator shall be a day other than a holiday as specified in Article 1 of the Act on Holidays of Administrative Organs, and the inspection period shall be within the duration designated by the Director-General of the Finance Bureau. However, when it is necessary to organize the registry of financial instruments business operations, etc., the inspection date or time may be changed.
- (v) The Inspector of the registry of financial instruments business operations shall use appended form III-5 to enter the necessary items into the inspection book of the registry of Financial Instruments Business Operators.
- (vi) The registry of Financial Instruments Business Operators shall not be taken out of the premises designated by the Director-General of the Finance Bureau.
- (vii) When any inspector falls under the following category, the inspection may be suspended or refused:
  - A. Any person who does not follow the items from (iv) to (vi) or the instructions of the bureau.
  - B. Any person who has defaced or damaged the registry of a Financial Instruments Business Operator, or who may do so.
  - C. Those who have caused trouble to other inspectors, or who may do so.
- (viii) When a request is made for the inspection of a Financial Instruments Business Operator that has been registered by the another Director-General of another Local Finance Bureau, the applicant for inspection shall be informed that such inspection can be supplied by the Local Finance Bureau that granted the registration.,However, under unavoidable circumstances the Local Finance Bureau that granted the registration is located in a remote area, an inspection shall be carried out by referring the registered items to the Director-General of the relevant Finance Bureau.

### III-3-2 Notification

When accepting and processing various notifications, etc., prescribed in the FIEA, the following points shall be considered:



(1) Change in the Location of Head Office, etc., to an Area Beyond the Jurisdiction of the Director-General of the Competent Finance Bureau

- (i) A Director-General of the Finance Bureau who has received a notification of change in the location of head office, etc., to an area beyond his/her jurisdiction shall send the necessary documents to a Director-General of the Finance Bureau who will process the new registration; such necessary documents include the relevant sections of the notification of change and the registry of Financial Instruments Business Operators prescribed in Article 20(2) of the FIB Cabinet Office Ordinance together with other documents, including the copy of the application for registration, other attached documents, and a report of the most recent inspection.
- (ii) A Director-General of the Finance Bureau who has received the above documents shall send a copy of notification of registration to the Director-General of the Finance Bureau who processed the previous registration, after completing the new registration for the Financial Instruments Business Operator concerned.
- (iii) A Director-General of the Finance Bureau who processed the previous registration of the said Financial Instruments Business Operator shall delete the previous registration upon receiving a copy of the notification of new registration.

(2) Points of Attention Regarding Submission of Notifications of Holding Subject Voting Rights

The abstract of residence certification (limited to that containing nationality, etc.), a copy of the residence card or a copy of the special permanent resident certificate submitted by a foreign resident living in Japan, and a copy of residence certification of the home country submitted by a foreigner living outside Japan, or any other documents equivalent thereto (a Japanese translation shall be attached to all documents in English, etc.) shall fall under the “documents in lieu thereof” pursuant to the provisions of Article 38(i) of the FIB Cabinet Office Ordinance.

(3) Points of Attention Regarding Notification of Discontinuation of Business, etc.

- (i) When a notification pursuant to Article 50(1)(vii) and Article 50-2(7) of the FIEA and Article 199(v) of the FIB Cabinet Office Ordinance, is received from a Financial Instruments Business Operator, the following points shall be verified by, for example, conducting inspections:
  - A. There are no grounds for rescission of the registration prescribed in the provision of Article 52(1) of the FIEA.
  - B. All liabilities to clients are expected to be paid in full.
  - C. It is confirmed that there are no unlisted liabilities in the form of an outstanding balance of claims/liabilities to clients.
- (ii) In the case where a Financial Instruments Business Operator submits a notification prescribed in the provision of Article 199(xi)(g) of the FIB Cabinet Office Ordinance, and when the reason for the termination of entrustment to a financial instruments intermediary services provider is that the said financial instruments intermediary services provider is to discontinue the financial instruments intermediary services, a confirmation shall be made at the time of the submission of the notification that the said Financial Instruments Business Operator has confirmed that there are no grounds for rescission of registration of the said financial instruments intermediary services provider pursuant to the provision of Article 66-20(1) of the FIEA.

### III-3-3 Books and Documents Related to Business Activities

The obligation to formulate and retain books and documents related to business activities (hereinafter referred to as “books and documents” [excluding in VI-3-2-4, VI-3-5-3, VII-2-3 and XI-2-3]) is stipulated in laws and regulations in order to contribute to the protection of investors, by means of making books and documents accurately reflect the status of operations and assets of Financial Instruments Business Operators and by examining the appropriateness of business activities and the financial soundness. Based on these principles, the following points shall be considered when examining books and documents.

#### (1) Basic Points to Consider

- (i) Books and documents may serve as other books and documents within a rational scope, part of the records may be listed in other books, and names other than those prescribed in Article 157 and Article 181 of the FIB Cabinet Office Ordinance, may be used, but only in cases where all the items to be listed are entered in accordance with the type of each business-related document.
- (ii) For foreign corporations to which III-3-3 is applicable, the term “head office” shall be replaced with “principal business site or office in Japan” and the term “branch office” shall be replaced with “other business site or office.”
- (iii) When creating order forms concerning self-transaction, the term “order received” in Article 158 of the FIB Cabinet Office Ordinance, shall be replaced with “order shipped.”
- (iv) The items directly corresponding to the relevant items among those to be listed in the books and documents shall be replaced with those of the compatible items and those with no applicable items may be omitted.
- (v) A copy of the document prescribed in Article 157(1)(i)(A)(4) of the FIB Cabinet Office Ordinance, (a document upon conclusion of the contract prescribed in Article 37-4(1) of the FIEA) shall be prepared by machine concurrently with the said original document, and may be substituted by another book and document which lists all the items to be listed in the said document.
- (vi) Individual books and documents may be substituted by the transaction contracts that list all the items to be listed in the respective books and documents, when creating: order forms; transaction records concerning intermediary or agency services; transaction records concerning public offering, secondary distribution or private offering; transaction records concerning the handling of public offering or secondary distribution or the handling of private offering; or transaction records concerning agency or intermediary services for concluding investment advisory contracts or discretionary investment contracts. The said transaction contracts shall be prepared separately.
- (vii) Items to be listed in the books and documents may be entered using codes, brevity codes or any other symbols that have been standardized by the said Financial Instruments Business Operator.
- (viii) In the cases where part of the items to be listed in books and documents is linked using the transaction contract that lists the appropriate items and the contract number, and they are managed and stored together, this package may be regarded as the relevant books and documents.
- (ix) The second sentence of both the proviso to Article 157(3) and the proviso to Article 181(4) of the FIB

Cabinet Office Ordinance permits to keep the books and documents specified in the items of paragraph (1) of those Articles outside Japan when they are prepared by means of an electronic or magnetic records and documents indicating matters recorded in the electronic or magnetic records is made available for inspection without delay at a business office or other office established in Japan, regardless of whether or not they are prepared in a business office or other office established in a foreign state; provided, however, that Financial Instruments Business Operators need to pay sufficient attention to Control Environment for the Management of Information Related to Customers, etc. (III-2-4) and Control Environment for Managing Information Technology Risk (III-2-8), etc. and need to properly take into consideration risks of information leaks to a third party, not limited to unauthorized access, and any hindrance to stable operation of systems in the relevant foreign state.

## (2) Formulation and Storage of Books and Documents on Microfilm

- (i) In the cases where books and documents are three or more years-old, and an inspection has been conducted on such books and documents by inspection departments during this period, such documents may be stored on microfilm that is prepared according to the generally accepted standards for formulation.
- (ii) Original books and documents may be created and stored on microfilm in the following cases:
  - A. When the books and documents in question correspond to the items listed in Article 157(1) items (i)(A)(4), (ix), (xi), (xvi) (limited to (B) and (C)), and (xvii) (excluding (A)) of the FIB Cabinet Office Ordinance;
  - B. When it is possible to prepare written books and documents within a reasonable period of time at each business site for the inspection, etc., by inspection departments; and
  - C. When personnel in charge of microfilm formulation and storage have been appointed and management procedures have been developed.

## (3) Centralized Storage of Books and Documents at the Head Office

- (i) In the cases where books and documents are three or more years-old, and an inspection has been conducted on such books and documents by inspection departments during this period, such books and documents may be stored in the head office (including the administrative center, etc., the same shall apply to (ii) below) in an integrated manner.
- (ii) Books and documents may be stored in an integrated manner, from the time of their creation, at the companies which are entrusted by a head office or a Financial Instruments Business Operator to create the books and documents, under the condition that the following requirements are met:
  - A. A system has been established to allow quick response to referrals from clients;
  - B. A system has been established to enable books and documents to be accessed at a head office within a reasonable period of time; and
  - C. It does not impede internal audits.

## (4) Creation of Forms for Receiving Orders by Direct Entry into a Computer

In the cases where a form for receiving orders is completed by directly entering data into a computer, the

following points shall be considered:

- (i) Details of orders received shall be entered into a computer when the orders are received (in the case of self-transaction, when orders are shipped).
- (ii) The system enables prompt response to referrals from clients.
- (iii) Backups of input data are made and stored.
- (iv) The system automatically records input time.
- (v) The system can track deleted/corrected records, if deletion/correction of input history is made.
- (vi) Handwritten forms for receiving orders shall be prepared, as was done previously, in the cases where the order form cannot be made by directly inputting data into a computer at the same time as receiving orders. Examples of such cases are when the details of orders are communicated to executing offices by telephone, where orders for the following day are received after the computer system is shut down for the day, or where computers are not usable due to a disaster, etc. However, a postscript may be omitted if a handwritten form for orders received, which has been created at the same time as orders were received, is stored together with the form for receiving orders that has been prepared by a computer that shows whether all order information agrees if the details of the orders received are input later.
- (vii) The system can respond to internal audits.

#### (5) Formulation of Form for Shipping Orders by Direct Entry into a Computer

In the cases where a form for shipping orders is created by directly entering data into a computer, the following points shall be considered:

- (i) Details of shipping orders shall be entered into a computer when orders are shipped.
- (ii) Handwritten forms for shipping orders shall be prepared in the cases where order forms cannot be formulated by direct entry of data into a computer at the same time as orders are shipped, such as when computers cannot be used due to a disaster, etc. However, a postscript may be omitted if a handwritten form for shipping orders, which has been created at the same time as orders were shipped are stored together with a form for shipping orders that has been prepared by a computer that shows whether all information agrees if the details of the orders shipped are input later.
- (iii) In addition to (i) and (ii) above, the cases corresponding to items (4) (iii) to (v) and (vii) above.

#### (6) Storage of Books and Documents Using Electronic Media

The following points shall be considered when using electronic media to store books and documents.

- (i) Handwritten books and documents shall be saved as image data.
- (ii) The electronic media for storage shall have sufficient durability to last for the storage period prescribed in Article 157(2) and Article 181(3) of the FIB Cabinet Office Ordinance.
- (iii) One of the electronic media used for data storage shall be designated as “original” and shall be clearly labeled to that effect (judgment on the condition of storage of books and documents shall be made in conformity with this “original”).
- (iv) A backup of the “original” mentioned above (iii) shall be created and stored as a “copy.”
- (v) The system enables prompt response to client referrals.

- (vi) The system allows hard copies of books stored as data to be created within a reasonable period of time
- (vii) The system can track deleted/corrected records, if deletion/correction of input history is made;
- (viii) The system can accommodate internal audits;
- (ix) Personnel in charge of formulation and storage have been appointed and in-house regulations on the said formulation and storage have been developed.
- (x) When a handwritten postscript or supplement to a hard copy of a book or document created electronically is made, a copy of the said hard copy shall be made and saved as image data. If it is not stored as image data, the said hard copy shall be stored as the original.

### III-3-4 Matters Related to the Industrial Competitiveness Enhancement Act

Matters related to the plans specified in the Enhancement Act, etc., concerning business reorganization, reorganization of specific businesses, and small-and-medium-enterprise succession and business turnaround shall be listed in compliance with the preparation method of financial statements, etc., of Financial Instruments Business Operators, with due consideration to the following points.

#### (1) Matters Regarding the Setting of Targets Concerning the Improvement of Productivity and Financial Soundness Through Business Reorganization in 1. of the Guidelines for the Implementation of Business Reorganization (Hereinafter Referred to as the “Implementation Guidelines”):

- (i) In 1.A.(2) of the Implementation Guidelines, “turnover ratio of tangible fixed assets” refers, for example, to operating revenue divided by the carrying amount of tangible fixed assets.
- (ii) In 1.A.(3) of the Implementation Guidelines, “the amount of added value per employee” refers, for example, to the sum of operating income, personnel expenses and depreciation per employee.
- (iii) In 1.B.(1) of the Implementation Guidelines, “total amount of interest-bearing debt” refers, for example, to all of debt financing means.
- (iv) In 1.B.(2) of the Implementation Guidelines, “current revenue” refers, for example, to the total amount of operating revenues and non-operating revenues, while “current expenditure” refers, for example, to the total amount of operating expenditures and non-operating expenditures.

#### (2) Matters Regarding the Definition of Business Reorganization in 2.A. of the Implementation Guidelines

- (i) In 2.A.(3) of the Implementation Guidelines, “net sales” refers, for example, to operating revenue.
- (ii) In 2.A.(5) of the Implementation Guidelines, “sales expenses on the provision of said product or service” refers, for example, to sales and general administrative expenses.

#### (3) Criteria for Industries or Business Fields with Excessive Supply in 2.B.(3) of the Implementation Guidelines

In 2.B.(3)(ii) of the Implementation Guidelines, “net sales” in “operating profit on sales” refers, for example, to operating revenue.

#### (4) Matters Regarding the Setting of Targets Concerning the Improvement of Productivity and Financial Soundness Through Reorganization of Specific Businesses in 3. of the Implementation Guidelines

(1) above shall be applied mutatis mutandis to 3.A.(2) and (3), and B.(1) of the Implementation Guidelines.

(5) Matters Regarding the Definition of Reorganization of Specific Businesses in 4.A. of the Implementation Guidelines

In 4.A.(4) and (5) of the Implementation Guidelines, “net sales” refers, for example, to operating revenue.

(6) Matters Regarding the Setting of Targets Concerning the Enhancement of Business Through Small-and-Medium-Enterprise Succession and Business Turnaround in 1. of the Guidelines for the Implementation of Small-and-Medium-Enterprise Succession and Business Turnaround (Hereinafter Referred to as the “Turnaround Implementation Guidelines”)

(i) In 1.A. of the Turnaround Implementation Guidelines, “total amount of interest-bearing debt” refers, for example, to all of debt financing means.

(ii) In 1.B. of the Turnaround Implementation Guidelines, “current revenue” refers, for example, to the total amount of operating revenues and non-operating revenues, while “current expenditure” refers, for example, to the total amount of operating expenditures and non-operating expenditures.

## **IV. Supervisory Evaluation Points and Various Administrative Procedures (Type I Financial Instruments Business)**

### IV-1 Governance (Type I Financial Instruments Business)

Supervisors shall pay attention to the following points when examining the governance of Financial Instruments Business Operators (limited to Type I Financial Instruments Business Operators; the same shall apply in IV).

It should be noted that in cases where the provisions of III-1 Governance (general) are applied to foreign corporations engaging in Type I financial instruments business, the “representative director” shall be replaced with the “representative in Japan” and “the Board of Directors, etc.” with “the highest decision-making organization of a sales branch or business office in Japan.”

#### IV-1-1 Officers of Financial Instruments Business Operators

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator appropriately takes into consideration the following eligibility requirements in the decision-making process regarding proposals for the appointment of officers (those who are subject to dismissal order under Article 52(2) of the FIEA; hereinafter referred to as “officers” in IV-1-1, V-1-1, VI-1-1 and VII-1-1).

- (i) A person who does not meet any of the ineligibility criteria (Article 29-4(1)(ii)(a) to (i) of the FIEA) and who did not meet any of them at the time of registration.
- (ii) A person who has not violated laws and regulations regarding financial instruments business or related business operations (excluding Article 46-6(2) of the FIEA), or a person who has not been subjected to administrative actions taken based on laws and regulations.
- (iii) A person who has not damaged the interests of investors in relation to the conduct of the investment advisory and agency business and the investment management business.
- (iv) A person who has not engaged in an illegal or markedly inappropriate act regarding financial instruments business under particularly grave circumstances.
- (v) A person who has not violated the conditions attached to authorization under Article 30(1) of the FIEA.

##### (2) Supervisory Method and Actions

In cases where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 29-4(1)(ii)(a) to (i) of the FIEA, or is found to have done so at the time when the business operator obtained registration under Article 29 of the FIEA, or where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 52 (1) (vii) and (ix) to (xi) of the FIEA, supervisors shall consider taking actions such as ordering the dismissal of the said officer based on Article 52(2) of the FIEA.

In addition, they shall hold an in-depth hearing regarding the decision-making process concerning the proposal for the appointment of the said officer and, when necessary, require the submission of a report based on Article 56-

2(1) of the FIEA. Furthermore, supervisors shall consider taking actions such as issuing an order for business improvement, if the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem and the action is deemed to be necessary and appropriate, from the viewpoint of protecting public interests and investors.

#### IV-1-2 Adequate Staffing for Properly Conducting Financial Instruments Business

##### (1) Major Supervisory Viewpoints

Supervisors shall examine whether Financial Instruments Business Operators are adequately staffed to properly conduct financial instruments business (limited to Type I financial instruments business; the same shall apply to IV), in light of IV-4-1, and whether Financial Instruments Business Operators, etc. have established operating structures/system necessary to operate financial instruments business appropriately.

##### (2) Supervisory Method and Actions

Provisions in IV-4-1 are part of a comprehensive set of elements that should be taken into consideration when supervisors examine whether a Financial Instruments Business Operator is adequately staffed to properly conduct financial instruments business, etc. Even if an officer or an employee is deemed to not meet the requirements, it should not automatically lead to the conclusion that the Financial Instruments Business Operator is not adequately staffed, etc. The important thing is, first and foremost, that Financial Instruments Business Operators strive to ensure on their own responsibility that they are adequately staffed, etc. in light of those requirements and other elements.

However, supervisors shall hold in-depth hearings regarding Financial Instruments Business Operators' view on their staffing, etc. and their decision-making process concerning the proposed appointments of officers and employees, in cases where a Financial Instruments Business Operator is deemed to have failed to take those elements into consideration sufficiently in the said decision-making process, and where it is deemed to be necessary and appropriate from the view point of protecting the public interest and investors to hold such hearings. In addition, they shall require the submission of reports based on Article 56-2(1) of the FIEA when necessary.

Supervisors shall consider taking actions such as issuing an order for business improvement under Article 51 of the FIEA, in cases where the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem as a result of the examination of the submitted report, and where the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

Furthermore, when the Financial Instruments Business Operator is deemed to not be adequately staffed to properly conduct financial instruments business, etc. as a result of the examination of the submitted report, supervisors shall consider taking necessary measures, including issuing an order for business suspension based on Article 52(1) of the FIEA.

#### IV-1-3 Development of Conflict of Interest Management Systems

##### (1) Basic Ideas for the Development of Conflict of Interest Management Systems

Along with the diversification of services provided by financial institutions and advances in the formation of



international groups across business types, multiple interests competing or conflicting with one another are created within each financial institution or financial group, posing a growing risk of conflict of interest. In view of such a situation, securities companies, etc. (referring to those engaging in Type 1 Financial Instruments Business (limited to such business related to securities); the same shall apply hereinafter) are required to manage transactions that are likely to cause a conflict of interest, depending on the contents, characteristics, scales, etc. of the businesses conducted by the securities companies, etc. and their group member companies, so as to ensure that such a conflict of interest will not unduly harm customers' interests.

From this perspective, it is important for securities companies, etc. to develop appropriate systems for the management of conflict of interest of their own and of their subsidiary financial institutions, etc. pursuant to Article 36(2) of the FIEA.

Securities companies, etc. are permitted to exchange non-disclosure information with their parent corporations, etc. or subsidiary corporations, etc. (hereinafter referred to as "parent/subsidiary corporations, etc.") under certain conditions. In line with this, it is recommended that securities companies, etc. conduct governance with due consideration to a conflict of interest that may occur in relation to all businesses carried out within the securities companies, etc. and their financial groups (including businesses other than financial instruments businesses). In such case, it is also recommended that they also pay attention to the likelihood of materialization of reputation risk (referring to the risk of damage to the reputation in society or confidence in financial markets; the same shall apply hereinafter) of the securities companies, etc. or their financial groups, in addition to the risk of directly harming customers' interests.

On the other hand, considering that some member companies within the groups of securities companies, etc. may engage in businesses irrelevant to the customers of the securities companies, etc., there is no necessity to require all securities companies, etc. to conduct conflict of interest management at the same level or to the same extent. Furthermore, if securities companies, etc. choose not to share non-disclosure information with their group member companies, they may be deemed to have taken necessary and sufficient measures to manage conflict of interest with such group member companies. Thus, it should be noted that when securities companies, etc. conduct conflict of interest management at different levels or to different extents within their groups, they are required to give sufficient explanation on such different treatment to external parties.

In addition, even in cases where conflict of interest management, which must be conducted by securities companies, etc., is actually conducted by their parent companies, etc., if the securities companies, etc. properly understand the management method and implementation status and participate in the management process as appropriate, they may be deemed to have taken necessary and sufficient measures.

With all these matters in mind, supervisors shall perform supervision, focusing on the following points.

## (2) Development of Systems for Identifying Transactions with the Risk of Conflict of Interest

- (i) Whether the securities company, etc. has identified and categorized (Note) transactions with the risk of conflict of interest in advance.

(Note) In 2022, deregulation (see IV-3-1-4(2)) was conducted and it was made possible to share non-disclosure information of listed companies, etc. between a securities company, etc. and its parent/subsidiary

corporations, etc. until the relevant listed companies, etc. undertake procedures for opting out. Accordingly, securities companies, etc. and their parent financial institutions, etc. or subsidiary financial institutions, etc. (referred to as “parent/subsidiary financial institutions, etc.”; hereinafter the same applies in (2)(Note)) are required to properly and strictly manage conflicts of interest in order to ensure that the interests of the customers are not unjustly impaired. In light of this point, concrete examples of “transactions with the risk of conflict of interest” are as follows; provided, however, that the following are only examples, and it should be noted that transactions with the risk of conflict of interest must be properly identified depending on the actual status of the business model of securities companies, etc. and business types of other financial institutions within financial groups to which individual securities companies, etc. belong.

(Reference) “Second Report by the Working Group on Capital Market Regulations – To Create an Attractive Capital Market toward the Post-COVID Era” (June 18, 2021)

[Related to M&A]

- A case where a securities company, etc. offers advisory services to a candidate purchaser in an M&A and the securities company, etc. or its parent/subsidiary financial institutions, etc. have provided loans to another competing candidate purchaser or have had any balance of loan receivables from the seller’s side (including the company subject to the M&A and its parent company and sponsors; the same shall apply hereinafter).
- A case where a securities company, etc. offers advisory services to the seller’s side in an M&A and the securities company, etc. or its parent/subsidiary financial institutions, etc. provides loans to a single or multiple candidate purchasers.
- A case where a securities company, etc. or its parent/subsidiary financial institutions, etc. offers advisory services to both candidate purchasers and the seller’s side in an M&A.

[Related to underwriting]

- A case where in procurement of funds in the capital markets by a non-financial company through the issuance of securities (including straight bonds, subordinated debts, share options, and bonds with share options), a securities company, etc. serves as the lead managing underwriter and the securities company, etc. or its parent/subsidiary financial institutions, etc. provides loans to said non-financial company.
- A case where a securities company, etc. or its parent/subsidiary financial institutions, etc. provides advice, etc. on underwriting and customers’ issuance of securities, and the securities company, etc. or its parent/subsidiary financial institutions, etc. recommends transactions of said securities to other customers.

[Other]

- A case where a securities company, etc. recommends or sells securities issued or composed by the securities company, or its parent/subsidiary financial institutions, etc. to customers.
- A case where a securities company, etc. or its parent/subsidiary financial institutions, etc. offers advisory services on M&A, such as conducting underwriting or providing advice, etc. in relation to fund procurement in the capital markets, or provides loans to a customer, and the securities company, etc. provides a research report on said customer to other customers.

(ii) Whether the securities company, etc. has developed a control environment wherein the contents, characteristics, scales, etc. of the securities company, etc. and its parent/subsidiary financial institution, etc. can be taken into consideration appropriately in the process of identifying transactions with the risk of conflict

of interest.

- (iii) Whether the securities company, etc. has developed a control environment for examining the appropriateness of the transactions that are found to involve the risk of conflict of interest, periodically, for example, upon starting new operations.

### (3) Methods of Conflict of Interest Management

- (i) Whether the securities company, etc. has developed a control environment wherein it can properly identify transactions with the risk of conflict of interest prior to conducting relevant transactions, and whether it has developed a control environment wherein it can choose or combine appropriate methods of conflict of interest management, depending on the characteristics of relevant transactions, while paying attention to the following points.

- A. In cases where the securities company, etc. conducts management separately for departments, whether a Chinese wall (see III-2-4(3)(i)) has been created between the departments.
- B. In cases where the securities company, etc. conducts management by changing terms or methods of transactions or suspending transactions of either party involved in the conflict, including cases where officers, etc. of its parent/subsidiary financial institutions, etc. participate in making decisions on such change or suspension, whether the authority and responsibility for making such decisions are clearly specified.
- C. In cases where the securities company, etc. conducts management by notifying the customer of the risk of conflict of interest, whether the customer is provided with appropriate explanation, depending on the customer's attributes, so that the customer can fully understand the content of the possible conflict of interest and the reasons for choosing the management method (including reasons for not choosing other methods), before the customer concludes a contract for the transaction.
- D. In cases where the securities company, etc. conducts management by supervising the parties who share information, whether an independent division or department appropriately supervises the transactions carried out by such parties.

- (ii) Whether the securities company, etc. has developed a control environment wherein it can confirm, when necessary, whether there is any transaction that may be in conflict with a new transaction to be conducted by the securities company, etc. or its subsidiary financial institution, etc.

- (iii) Whether the securities company, etc. has developed a control environment for examining the method of conflict of interest management periodically for the purpose of securing its effectiveness. Whether the securities company, etc. is creating and storing records appropriately to enable examinations ex post facto as to whether it is identifying transactions with the risk of conflict of interest and selecting and implementing the method of conflict of interest management in an appropriate manner.

### (4) Formulation of the Conflict of Interest Management Policy and Publication of its Summary

- (i) Whether the securities company, etc. has formulated a conflict of interest management policy (referring to the policy prescribed in Article 70-4(1)(iii) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter), while taking into consideration the contents, characteristics, scales, etc. of the securities company,

etc. and its parent/subsidiary financial institutions, and whether such policy specifies the following matters: the types of transactions with the risk of conflict of interest; major examples and the identification process of such transactions; the methods of conflict of interest management (if conflict of interest management is conducted at different levels and to different extents, the content of and reasons for such difference); the conflict of interest management system (the responsibility and independence of the person who controls the company-wide management system regarding the identification of the transactions involving the risk of conflict of interest and the conflict of interest management (hereinafter referred to as the “conflict of interest manager”), as well as the review system for the methods of identifying transactions involving the risk of conflict of interest and conducting conflict of interest management); and the scope of companies subject to conflict of interest management. Whether examples of such transactions and methods of conflict of interest management are specified for each type of transactions involving the risk of conflict of interest.

- (ii) Whether the securities company, etc. has prepared a summary of the conflict of interest management policy to be publicized, while taking into consideration the contents, characteristics, scales, etc. of the securities company, etc. and its parent/subsidiary financial institutions, and whether such summary specifies, in an easily understandable manner, the types of transactions involving the risk of conflict of interest, methods of conflict of interest management, conflict of interest management system, and scope of companies subject to conflict of interest management.
- (iii) Whether the securities company, etc. publicizes the summary of the conflict of interest management policy by appropriate means, such as posting or providing for inspection the summary at its branches or presenting the same on its website.

#### (5) Personnel Structure and Operational System

- (i) Whether the management team of the securities company, etc. and its subsidiary financial institution, etc. recognize the importance of conflict of interest management and sincerely take the lead in carrying out the management by such means as cooperating with other financial institutions within the financial group (including holding companies). Additionally, regarding operationally important cases such as those posing the possibility of exerting a material impact on customers, whether the management team appropriately gets involved in decision making concerning actions to be taken, such as the selection of the methods of conflict of interest management.
- (ii) Whether the operational procedures based on the conflict of interest management policy are clarified in writing; whether matters concerning conflict of interest management are communicated to officers and employees of the securities company, etc. and its subsidiary financial institution, etc., through training programs regarding the conflict of interest management policy and the said procedures.
- (iii) Whether the securities company, etc. has developed a centralized system for identifying transactions with the risk of conflict of interest and conducting conflict of interest management, for example by appointing a conflict of interest management, for example by appointing a conflict of interest manager in divisions engaging in conflict of interest management (hereinafter referred to as “conflict of interest management divisions”).
- (iv) Whether the conflict of interest manager, and conflict of interest management divisions and their staff members (hereinafter referred to as the “conflict of interest manager, etc.”) identifies transactions with the

risk of conflict of interest and conducts conflict of interest management properly in accordance with the conflict of interest management policy, and appropriately examines the effectiveness of the policy.

- (v) Whether the conflict of interest manager, etc. secures his/her independence from the sales division and fully checks the sales division. Whether the securities company, etc. has developed a control environment wherein the conflict of interest manager, etc. can make decisions independently when judging whether a transaction falls under a transaction with the risk of conflict of interest or deciding the methods of conflict of interest management even in cases where the sales division gets involved in conflict of interest management work.
- (vi) Whether the conflict of interest manager, etc. collects information necessary for conflict of interest management, including information on the transactions of its parent/subsidiary financial institutions, etc., thereby preparing a control environment for conducting conflict of interest management appropriately.
- (vii) Whether the securities company, etc. has developed a control environment wherein an independent internal audit division, etc. examines the personnel structure and operational system for conflict of interest management periodically. When conflict of interest management is conducted integrally by the entirety of a financial group, whether efforts are being made to ensure cooperation with the internal audit divisions, etc. of other financial institutions within the group (including holding companies).
- (viii) When the securities company, etc. has overseas offices or belongs to a financial group that operates internationally, whether it has developed an appropriate control environment for identifying and properly managing transactions with the risk of conflict of interest at a level commensurate to the details and size of its global business operations, by measures such as conducting conflict of interest management globally on a group-wide basis: not merely domestically, under organizational and integrated policies, procedures and systems, while observing laws and regulations of individual countries.

#### (6) Supervisory Method and Actions

Securities companies, etc. should develop a conflict of interest management system through their own efforts, depending on the contents, characteristics, scales, etc. of their businesses. The matters listed in (1) to (5) above provide a basic framework of such efforts. Securities companies, etc. are required to independently develop appropriate conflict of interest management systems, depending on the contents, characteristics, scales, etc. of the businesses of their own and of their subsidiary financial institutions, etc.

However, where there is likelihood that customers' interests would be unduly harmed, irrespective of the status of the development of a conflict of interest management system, supervisors shall hold an in-depth hearing if it seems necessary and appropriate to do so in order to protect public interests and investors, and shall require the submission of a report under Article 56-2(1) or (3) of the FIEA. Furthermore, supervisors shall consider taking actions such as issuing an order for business improvement under Article 51 of the FIEA or an order for business suspension under Article 51 of the FIEA in cases where the conflict of interest management system of the securities company, etc. is deemed to have a serious problem as a result of the examination of the submitted report, and where the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

#### IV-2 Soundness of Financial Condition (Type I Financial Instruments Business)

With due consideration of the susceptibility of the business of Financial Instruments Business Operators to changes in the market environment, regulation on the capital adequacy ratio aims to ensure the soundness of their financial conditions and the protection of investors, even if the business operators face a decline in their income due to rapid changes in the market conditions or a decline in the value of their asset holdings. Through efforts to maintain an adequate level of capital adequacy ratio, Financial Instruments Business Operators must identify and manage risks involved in their businesses in a comprehensive manner and keep liquid assets (non-fixed capital) in sufficient quantity and quality, to enable them to withstand losses that may be caused by the materialization of various risks. For their part, supervisors need to encourage Financial Instruments Business Operators to make voluntary efforts to maintain the soundness of their financial conditions through their offsite monitoring, which should complement the efforts the business operators make on their own responsibility to maintain an appropriate level of capital adequacy ratio.

##### IV-2-1 Preciseness of Capital Adequacy Ratio

Supervisors shall examine the preciseness of a Financial Instruments Business Operator's capital adequacy ratio by paying attention to the following points, with due consideration of Article 46-6(1) of the FIEA and the FIB Cabinet Office Ordinance.

##### (1) Eligibility of Subordinated Debts and Subordinated Bonds

- (i) Regarding the notification of the borrowing of a subordinated loan or the issuance of a subordinated bond, whether the terms of the contract give preference to senior creditors in accordance with Article 50(1) of the FIEA (Article 199 (xii) of the FIB Cabinet Office Ordinance.) by including a legal provision stipulating that when a condition for subordination, such as bankruptcy or court-administered corporate rehabilitation, arises, subordinate creditors' claims are voided temporarily and their claims become effective only after all payments to senior creditors have been made.
- (ii) Whether the subordinated loan/bond has all of the characteristics described in the individual items of Article 176(2) and (3) of the FIB Cabinet Office Ordinance.
- (iii) Whether the contract for the subordinated loan/bond stipulates that contractual revisions disadvantageous to senior creditors and payments made in violation of the special provision for subordination are deemed to be ineffective.
- (iv) In the following cases, whether the Financial Instruments Business Operator acknowledges the intentional provision of funds to the subordinated loan lender/the subordinated bond holder as specified under Article 176(4)(iii) of the FIB Cabinet Office Ordinance and accordingly deducts the amount of the said funds from the subordinated loan/bond amount.
  - A. The Financial Instruments Business Operator has provided a subordinated loan to the subordinated loan lender/the subordinated bond issuer, or holds a subordinate bond issued thereby (excluding cases where the Financial Instruments Business Operator acquired the subordinated bond as its underwriter and the holding period does not exceed six months, and cases where the business operator holds the subordinated

bond temporarily for market-making and other similar purposes).

- B. The Financial Instruments Business Operator has provided funds to the subordinated loan lender/subordinated bond issuer for the purpose of supporting business rehabilitation or recapitalization.
- C. The Financial Instruments Business Operator has underwritten new stocks and other securities issued by the subordinated loan lender/subordinated bond issuer for the purpose of supporting business rehabilitation or recapitalization (excluding the case where the Financial Instruments Business Operator has purchased the said stocks and securities in the secondary market and holds them purely for the investment purpose or for purposes other than supporting business rehabilitation or recapitalization, with the holding period not exceeding six months, and the case where it holds the stocks and securities temporarily for market-making and other similar purposes).

## (2) Collateral Deducted from Deductible Assets

In cases where a Financial Instruments Business Operator has deducted the appraisal value of land and buildings based on Article 177(2) and (3) of the FIB Cabinet Office Ordinance or where it has deducted the appraisal value of funds and assets pledged as collateral based on Article 177(5) of the same act and Article 2(5) of the Capital Regulation Notice, supervisors shall examine whether the deducted value is appropriate by paying attention to the following points:

- (i) In cases where the appraisal value of land and buildings is deducted, whether the appraisal value has been calculated in an appropriate manner.
- (ii) In cases where the appraisal value of collateral and other assets is deducted, whether the funds and other assets pledged as collateral are eligible as collateral, and whether the appraisal value and the value of the market risk equivalent that should be deducted therefrom have been calculated in an appropriate manner.

## (3) Identification of Value of Market Risk Equivalent

Based on Article 178(2) of the FIB Cabinet Office Ordinance supervisors shall check, with due consideration of the following points, whether a Financial Instruments Business Operator identifies and keeps track of the values of the market risk equivalent and the counterparty risk equivalent on a daily basis with a rational method suited to the characteristics of their business.

- (i) Whether the Financial Instruments Business Operator properly identifies the market risk equivalent based on the appraisal values of all securities that it holds (the appraisal values verified for objectivity at the end of each month). It should be noted that except for at the end of each month, a rough estimate is permissible with regard to items of little relevance, such as those regarding which the Financial Instruments Business Operator's position is usually small relative to the amount of its non-fixed capital.
- (ii) Whether the Financial Instruments Business Operator properly identifies the value of the counterparty risk equivalent based on the total value of the credit equivalent, including all relevant transactions and assets. It should be noted that except for at the end of each month, accounts receivable and accrued income that concerns financial income and those which are booked on the execution dates on a provisional basis (excluding those regarding which the payment was not made on the delivery date) may be excluded.

(iii) Whether the director in charge of risk management keeps track of the values of the market risk equivalent and the counterparty risk equivalent on a daily basis.

In the case of a Financial Instruments Business Operator who accepts margin deposits from customers in amounts corresponding to a certain proportion of the contracted principal amount, and conducts foreign exchange transactions through net settlements (so-called foreign exchange margin transactions) in particular, whether it has developed a risk management and internal control environment that enables the precise and appropriate identification of the impact that rapid movements in the foreign exchange market could have on the soundness of its financial condition and its capital.

#### (4) Checkpoints Regarding Loaned Securities

Regarding securities lent to other entities, whether the Financial Instruments Business Operator has calculated the value not only of the counterpart risk equivalent but also of the market risk equivalent.

#### (5) Basic Risk Equivalent Related to Crypto-and Other Assets and Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

In holding or managing crypto-and other assets and electronically recorded transferable rights that must be indicated on securities, etc., it is not only necessary to identify the points stated in (3)(i) through (iii) above, but given that crypto-and other assets and electronically recorded transferable rights that must be indicated on securities, etc. for which private keys are managed in a state connected to the internet in particular have a risk of leakage, it is also necessary to appropriately identify the basic risk equivalent relating to such risk. Therefore, whether the Financial Instruments Business Operator identifies and keeps track of the values of such basic risk equivalent on a daily basis.

### IV-2-2 Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level

As the "early corrective action" based on the capital adequacy requirement is prescribed under Article 46-6(1) of the FIEA as a means to ensure the soundness of Financial Instruments Business Operators' management, such business operators need to make continuous efforts to improve their management so that they can maintain and enhance the soundness of the management.

Therefore, when a Financial Instruments Business Operator's capital adequacy ratio falls below a legally prescribed level, supervisors shall take the following measures in order to urge the business operator to make improvement quickly.

(1) When supervisors have received a notification based on Article 179(3) of the FIB Cabinet Office Ordinance from a Financial Instruments Business Operator, they shall check the contents of the Plan Regarding Specific Voluntary Measures to Be Taken in Order to Maintain the Capital Adequacy Ratio attached to the notification. In addition, they shall check the future outlook on the business operator's capital adequacy ratio through hearings and urge it to make voluntary improvement efforts.



It should be noted that in cases where the capital adequacy ratio stays below 140% for a long period of time or where the ratio repeatedly falls below 140%, supervisors shall strive to identify and keep track of the Financial Instruments Business Operator's capital adequacy ratio by, for example, requiring the submission of a report based on Article 56-2(1) of the FIEA.

In addition, over the period until a notification based on Article 179(5) of the FIB Cabinet Office Ordinance is submitted, they shall strive to identify and keep track of the Financial Instruments Business Operator's capital adequacy ratio and the status of its management of various risks by, for example, checking a notification regarding the capital adequacy ratio on a daily basis and holding hearings.

(2) When the above notification shows that the Financial Instruments Business Operator's capital adequacy ratio is below 120%, supervisors shall check the contents of the Plan Regarding Specific Voluntary Measures to Be Taken in Order to Improve the Capital Adequacy Ratio" attached to the notification and, when necessary, identify the specific method with which to bring the capital adequacy ratio back above the prescribed level and the estimated date of the recovery, as well as the status of segregated management of customer assets and fund-raising by, for example, requiring the submission of a report based on Article 56-2(1) of the FIEA.

(3) Regarding the above capital adequacy shortfall, supervisors shall issue an order for the implementation of the following measures, for example, based on Article 53(1) of the FIEA when it is deemed to be necessary and appropriate to do so from the viewpoint of protecting public interests and investors, in light of the Financial Instruments Business Operator's conditions that have been identified through the submitted report and hearings.

- (i) To draft and implement measures (including the drafting of specifics and the implementation schedule) to bring the capital adequacy ratio back above the legally prescribed level and maintain the ratio above that level on a permanent basis.
- (ii) To implement measures to ensure the protection of investors in preparation for an unexpected event, through appropriate management of securities and cash and careful management of fund-raising.
- (iii) To avoid activities that could lead to wasteful use of corporate assets.
- (iv) To compile the projections of the balance sheet and fund-raising status on a daily basis and the projection of capital adequacy ratio in ways to reflect the specific measures to be implemented, in order to bring the capital adequacy ratio back above the legally prescribed level.

#### IV-2-3 Control Environment for Managing Market Risks

Market risks include the risk of a Financial Instruments Business Operator incurring losses due to fluctuations in prices of its asset holdings (including positions related to off-balance transactions) caused by changes in various market-related risk factors, such as prices of securities and other financial instruments, interest rates and exchange rates, as well as credit and other risks associated therewith. It is important for Financial Instruments Business Operators to properly manage market risks.

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly manages market risks by developing a comprehensive control environment for risk management, properly recognizing and evaluating the risks, properly setting and managing position limits and establishing a system of checks and balances based on the clear allocation of roles and responsibilities.

## (2) Supervisory Method and Actions

Supervisors shall strive to identify and keep track of the status of a Financial Instruments Business Operator's market risk and its risk management through monthly offsite monitoring reports and hearings based thereon and, when necessary, require it to submit a report based on Article 56-2(1) of the FIEA and urge it to make improvement efforts.

## (3) Specific Procedures

### (i) Risk Management Regarding Proprietary Trading

When identifying and managing market risks regarding proprietary trading, a Financial Instruments Business Operator must pay attention to the following points, in addition to identifying the value of the market risk equivalent on a daily basis, based on Article 178(2) of the FIB Cabinet Office Ordinance.

#### A. Appropriate Risk Management Regarding Proprietary Stock Trading

- a. A Financial Instruments Business Operator should set the maximum allowable value of market risks that may be allotted to proprietary stock trading or reasonable limits and risks equivalent thereto (hereinafter referred to as the "allowable market risk value, etc."), based on an appropriate capital adequacy ratio target set with due consideration of its own financial condition and other factors.
- b. A Financial Instruments Business Operator should monitor on a daily basis whether its proprietary stock trading operations are conducted properly within the allowable market risk value, etc.
- c. From the viewpoint of maintaining the capital adequacy ratio above the target level, a Financial Instruments Business Operator should take necessary measures regarding the allowable market risk value, etc., such as reviewing and revising it in a timely manner, in light of changes in its own financial condition, including profits/losses from proprietary stock trading.

#### B. Appropriate Management of Proprietary Trade Operations during Daytime

- a. A Financial Instruments Business Operator should develop a control environment for managing proprietary stock trading operations so as to keep them within the allowable market risk value, etc.
- b. Instead of using the management method described in A. above, a Financial Instruments Business Operator may manage proprietary stock trading operations so as to keep them within the allowable market risk value, etc., during the daytime with similar methods using the position amount, as described below:
  - i) To make sure that the value obtained by multiplying the total amount of positions at specific points during the daytime with the internally prescribed volatility margin for loss cutting does not exceed the allowable market risk value, etc.

- ii) To make sure that the value obtained by multiplying the value of positions accumulated by specific points during the daytime with the internally prescribed volatility margin for loss cutting does not exceed the allowable market risk value, etc.
    - iii) To allocate position limits set in light of the allowable market risk value, etc., as specified in
      - A. above by trader and unit, and check the status of compliance with the allocated position limits as necessary.
  - C. A Financial Instruments Business Operator should develop a control environment that ensures the implementation of appropriate measures when it has recognized a situation that could have a significant impact on the soundness of its financial condition.
- (ii) Checkpoints regarding Rational Reason for Selecting Calculation Method of Market Risks
 

In cases where a Financial Instruments Business Operator selects the standard approach or the internal control model-based approach by either risk category or business type for the calculation of the value of the market risk equivalent based on Article 3(4) of the Capital Adequacy Notice, supervisors shall examine whether there is a rational reason for the selection, by paying attention to the following points:

  - A. When the calculation method of market risks is selected by risk category
    - a. Whether the Financial Instruments Business Operator can better identify market risks by selecting different calculation methods for different risk categories.
    - b. Whether the division in charge of comprehensively identifying the overall market risks is independent from other divisions.
  - B. When the calculation method of market risks is selected by business type
    - a. Whether the Financial Instruments Business Operator can better identify market risks by selecting different calculation methods for different business types.
    - b. Whether the Financial Instruments Business Operator has developed a control environment that ensures that the division in charge of comprehensively identifying the overall market risks identifies the value of the market equivalent by risk category.
- (iii) Representative Stock Price Indexes of Designated Countries
 

In cases where a Financial Instruments Business Operator calculates the stock risk equivalent based on the standard approach, and has selected stock price indexes other than those listed below as the representative stock price indexes of the designated countries, supervisors shall examine whether the selected indexes are suited to be treated as the representative stock price indexes of the relevant countries, in light of the transaction status and other factors.

  - A. Japan: Nikkei Stock Average, Nikkei 300 Stock Index, TOPIX Index
  - B. United States: S&P500
  - C. Italy: MIB 30
  - D. Australia: ASX200
  - E. Netherlands: AEX
  - F. Canada: S&P Toronto Composite Index
  - G. United Kingdom: FTSE100

- H. Switzerland: SMI
- I. Sweden: OMX
- J. Spain IBEX35
- K. Germany: DAX
- L. France: CAC40
- M. Belgium: BEL20
- N. Hong Kong: Hang Seng

(iv) International Organizations

In cases where a Financial Instruments Business Operator calculates the value of the interest rate risk equivalent based on the standard approach, the following shall be deemed to fall under the category of international organizations:

- International Bank for Reconstruction and Development
- International Finance Corp.
- Multilateral Investment Guarantee Agency
- Asian Development Bank
- Inter-American Development Bank
- African Development Bank
- European Investment Bank
- European Investment Fund
- Nordic Investment Bank
- European Bank for Reconstruction and Development
- Caribbean Development Bank
- Islamic Development Bank
- International Finance Facility for Immunisation
- Council of Europe Development Bank

(v) Checkpoints Regarding External Audits of Internal Control Model

Regarding a Financial Instruments Business Operator using an internal control model-based approach, supervisors shall annually check the results of external audits of the risk measurement process and the risk measurement model used in the previous year.

(vi) Pre-Auction Trading of Government Bonds

It should be kept in mind that in cases where a Financial Instruments Business Operator engages in pre-auction trading of government bonds, the calculation of the capital adequacy ratio prior to the announcement of the coupon rate and other items should be made according to the following procedures:

- A. In calculating the value of the risk equivalent, the Financial Instruments Business Operator should use a coupon rate calculated in a reasonable manner in light of the prevailing rate in the secondary market at the time of the calculation, or use the coupon rate on the most recent government bond with the same maturity and the same issuance format with the relevant government bond (in the case of a government bond whose coupon rate is determined through the formula “standard interest rate –  $\alpha$  of the previous

bond,” “the most recent standard interest rate –  $\alpha$ ”) as a provisional coupon rate, and the same calculation method should continue to be used.

- B. After the auction of the relevant government bond has been conducted and the issue name, coupon rate and other details have been announced, the Financial Instruments Business Operator should recalculate the value of the risk equivalent based on the actual coupon rate without any delay, and use it for the calculation of the capital adequacy ratio on and after the announcement date of the said coupon rate.

(vii) Risk Management of Credit Investments Such as Securitization Products

In the case of investments in marketable credit products such as securitization products, whether the Financial Instruments Business Operator conducts risk management with due regard to the following points. It should be noted that similar consideration is required for marketable loans (regardless of whether the operator originates them or acquires them in the secondary market) and transactions of CDS.

A. Proper price evaluation of products

Whether the Financial Instruments Business Operator evaluates the price of marketable credit products (including marketable loans and CDS transactions) with due consideration to the following points.

- a. Whether the Financial Instruments Business Operator evaluates price in as objective a manner as possible through such measures as evaluating the price by referencing the frequently-traded price when such a price is available, and, in cases where such a price does not exist, by referencing the price of similar products. In addition, in cases where a price evaluation model is used, whether the operator understands that such a model is based on certain assumptions and verifies the appropriateness of the model by reviewing the assumptions and reasoning behind it.
- b. In cases where a product price calculated by the front-end divisions is used as the market value for risk management purposes, whether such price is independently verified by the risk management divisions, etc.
- c. In cases where a price evaluation is obtained from brokers and external vendors, whether the operator is seeking as much information as possible regarding the methods of price evaluation and making efforts to verify the appropriateness of the relevant price evaluation. Furthermore, in cases where a price appraisal model provided by external vendors is used, whether the operator requests these vendors to provide as detailed information as possible and makes efforts to understand the assumptions, characteristics and limitations of such a model.
- d. In cases where a price evaluation model is used and the liquidity risk or uncertainty risk of the price evaluation model is deemed to be significant, whether the operator gives due consideration to such risks.

B. Proper understanding of product details in the investment of securitization products, etc.

- a. Whether the Financial Instruments Business Operator has established a control environment in order to avoid relying excessively on external credit ratings for investments in securitization products, etc. and for its intra-term management by, for example, precisely understanding the rating methods used by the credit rating agencies and the meaning of such ratings before using them.
- b. Whether the operator, when investing in securitization products, makes efforts to understand the

nature of the securitization products, etc., such as by understanding the contents of underlying assets; analyzing their structures by looking into the priority-subordinate structure (extent of leverage) and the status of liquidity support, credit enhancement, and details of credit events; and understanding the situation of price fluctuations.

- c. Whether the operator investing in securitization products makes efforts to understand and monitor the skills and qualifications of the relevant parties and the organizational structure, as the operation and management of the portfolio of underlying assets rely on relevant parties such as the originators and managers.
- d. When the originator, in structuring the underlying assets, intends to transfer the entirety of the underlying assets to vehicles of securitization for securitization products at the initial stage, the risks of the interests in the relevant securitization products may be heightened as a result of inappropriate structuring of the underlying assets due to, for example, inadequate analysis of the investments. As such, it is desirable that the originator continuously retain the part of the risks associated with such securitization products.

In view of this, whether the operator checks if the originator continuously retains the part of the risks associated with the securitization products.

In cases where the originator does not retain such risks, whether the operator thoroughly analyzes the status of the originator's involvement in the underlying assets, and the quality of such assets.

#### C. Management of market liquidity risk

- a. Whether the Financial Instruments Business Operator properly verifies the market liquidity for investments in securitization products and for their intra-term management. It should be noted that the following methods can be considered for verifying market liquidity.
  - i) Check whether the operator's invested amount represents an excessive share relative to the overall market size
  - ii) Assess the bid-offer spread in the market, and the price level at which the products can actually be sold, through hearings etc.
  - iii) Monitor changes in market conditions through analysis of available indices (such as those of securitization products)
  - iv) Design stress scenarios regarding the market liquidity drying up, and assess the profit/loss etc. of the securitization portfolio
- b. Whether the operator has a control environment in order to promptly consider measures to address risks related to the market liquidity of securitization products, etc. when concerns regarding the market liquidity are observed

#### D. Management of risks associated with the structuring of securitization products, etc.

- a. Whether the Financial Instruments Business Operator has taken into consideration the possibility that risks attributable to the underlying assets (or the risk associated with relevant loans) might become difficult to transfer to investors due to changes in market conditions (pipeline risk) during the process from the structuring of the securitization products to their sale (or the sale of marketable loans). Also,

whether the operator has considered measures to be taken after the buy-back (measures such as securing new investors, the inclusion of the product in the proprietary portfolio, etc.) when it buys back a securitization product, as well as the risk that it may retake the risks associated with the underlying assets after their sale as a result of, for example, clauses such as a buy-back clause in the sale contract. Whether the operator judges the relevant risks and returns in the provision of securitization (syndication) services, taking the above risks into consideration.

- b. Even if the risks associated with the underlying assets are transferred to investors by structuring and selling securitization products through unconsolidated special purpose companies, etc., the operator may retake the risks associated with underlying assets due to, for example, reputational risk, depending on the changes in market conditions.

As such, whether the operator has previously considered the above possibility through measures such as reflecting this possibility in its stress tests.

Whether the operator judges the relevant risks and returns in providing securitization (syndication) services, taking the above risks into consideration.

#### IV-2-4 Counterparty Risk Management Framework

Counterparty risk refers to risk arising from holding the obligations of a counterparty, namely the risk that a Financial Instruments Business Operator will incur losses due to a failure by the counterparty to fulfill its contractual obligations. It is important for Financial Instruments Business Operators to properly manage counterparty risk.

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly manages counterparty risk by developing a comprehensive control environment for risk management, properly recognizing and evaluating the risks, conducting internal screening when a new product or a new business is introduced and establishing a system of checks and balances based on the clear allocation of roles and responsibilities.

##### (2) Supervisory Method and Actions

Supervisors shall strive to identify and keep track of the status of a Financial Instruments Business Operator's counterparty risk and its risk management, through monthly offsite monitoring reports and hearings based thereon and, when necessary, require it to submit a report based on Article 56-2(1) of the FIEA and urge it to make improvement efforts.

##### (3) Specific Procedures

###### (i) Checkpoints Regarding Collateral Deducted from Value of Credit Equivalent

In cases where a Financial Instruments Business Operator has deducted the appraisal value of funds and other assets pledged as collateral based on Article 15 (5) and (6) of the Capital Adequacy Notice, supervisors shall examine whether the deducted value is appropriate by paying attention to the following points:

- A. Whether the relevant funds and other assets pledged as collateral are eligible as collateral.

B. Whether the appraisal value of the relevant funds and other assets and the value of the market risk equivalent that should be deducted therefrom have been calculated in an appropriate manner.

(ii) Checkpoints Regarding Legally Valid Bilateral Netting Contract

In cases where a Financial Instruments Business Operator calculates the value of the credit equivalent regarding a transaction made under a legally valid bilateral netting contract based on the netted value and uses it for the calculation of the value of the counterparty risk equivalent, supervisors shall check the following points:

A. Whether the Financial Instruments Business Operator has obtained a confirmation, in writing when necessary, of a legal opinion that indicates that if the counterparty to the transaction goes bankrupt or a dispute with the counterparty arises, the rational judgment of the court of jurisdiction or the authorities concerned will be that the business operator's provision of credit should be limited to the netted value under the relevant netting contract in light of the relevant laws.

B. Regarding the relevant laws, whether the Financial Instruments Business Operator has checked, at the minimum, the following ones:

a. The laws of the country that has granted an establishment license or authorization to the counterparty to the transaction and the laws of the countries where the counterparty's overseas sales branches and business offices are located.

b. The laws related to the specific transactions covered by the netting arrangement and the legal basis for the netting

c. The laws related to the contracts necessary for the netting and the legal basis for the netting

(iii) Checkpoints Regarding Commitment to Guarantee

Supervisors shall check whether the Financial Instruments Business Operator recognizes a contract assuring a future conclusion of a loan guarantee contract as a commitment to guarantee, regardless of in what form or name the contract is made, and includes it in the calculation of the value of the counterparty risk. A document made in the name of a "management guidance promise note" (which is submitted by a parent company to a financial institution that provides a loan to its subsidiary in order to acknowledge its responsibility for supervising the subsidiary and providing management guidance) shall be deemed to fall under the category of commitments to guarantee, if its contents are deemed to have a legal force similar to that of a loan guarantee or a commitment to guarantee, and if it needs to be noted in the balance sheet under Article 58 of the Rules on the Terminology, Formats and Compilation Method of Financial Statements (hereinafter referred to as the "Rules on Financial Statements, etc.").

(iv) Checkpoints Regarding Corporations Deemed to Be Insolvent

A corporation deemed to be insolvent as a result of inspection by an inspection department or through an external audit shall be deemed to fall under the category of the "corporations deemed to be insolvent from an objective standpoint" as specified under Article 15(3)(iii) Table (Note 3)(4) of the Capital Adequacy Notice.

(v) Checkpoints Regarding Consolidated Financial Statement-Submitting Companies

Supervisors shall keep in mind that consolidated subsidiaries for which a consolidated-financial statement-submitting company, as specified under Article 15(3)(iii)(refer to Note 1), is allowed to calculate the value of



the counterparty risk equivalent based on a eligible rating assigned to itself, are companies which are covered by the said company's consolidated financial results and which are subject to appropriate external audits regarding the relevant consolidated financial results, and supervisors shall check on this point as necessary, based on audit reports. In addition, supervisors shall monitor, as necessary, a consolidated-financial-statement-submitting company's calculation of the values of the credit equivalent and the counterparty risk equivalent related to its transactions with affiliated companies in order to make sure, in reference to contracts, audit reports and other documents and materials, that the calculation is appropriate.

(vi) International Organizations

In cases where a Financial Instruments Business Operator calculates the value of the counterparty risk equivalent based on the standard approach, the following shall be deemed to fall under the category of international organizations:

International Bank for Reconstruction and Development

International Finance Corp.

Multilateral Investment Guarantee Agency

Asian Development Bank

Inter-American Development Bank

African Development Bank

European Investment Bank

European Investment Fund

Nordic Investment Bank

European Bank for Reconstruction and Development

Caribbean Development Bank

Islamic Development Bank

International Finance Facility for Immunisation

Council of Europe Development Bank

(4) Non-Cleared Over-The-Counter Derivative Transactions

(i) Variation Margin

Whether a Financial Instruments Business Operator (including Financial Instruments Business Operators whose average total notional amount of outstanding over-the-counter derivative transactions falling under Article 123, paragraph(11), item(iv)B of the FIB Cabinet Office Ordinance is less than 300 billion yen) has made effort to develop a framework for the appropriate management of variation margin for non-cleared over-the-counter derivative transactions with financial institutions, in accordance with Article 123, paragraph(1), item(xxi-viii) of the FIB Cabinet Office Ordinance and other related provisions, as well as with the "Final Report on Margin Requirements for Non-Centrally Cleared Derivatives" published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (March 2015), and taking into consideration, for example, the following:

A. Conclusion of an appropriate agreement with counterparties pertaining to variation margin (for instance,

an ISDA Master Agreement and a CSA Agreement).

- B. Consideration of relevant foreign exchange risks when variation margin is collected in cash in a currency other than a major currency (such as Japanese yen, U.S. dollars, or Euro) and such currency differs from any currencies previously agreed upon by the parties, given that Article 123, paragraph (10), item (i) of the FIB Cabinet Office Ordinance does not require a haircut for foreign exchange risk in connection with variation margin posted in cash.

Whether a Financial Instruments Business Operator with an average total notional amount of outstanding non-cleared over-the-counter derivative transactions of less than 300 billion yen that falls under Article 123, paragraph (11), item (iv)B of the FIB Cabinet Office Ordinance has made efforts to develop a framework for calculating the mark-to-market value of its non-cleared over-the-counter derivative transactions and exchanging variation margin with sufficient frequency, as well as for exchanging variation margin in response to ad-hoc calls (ad-hoc margin demands), taking into consideration the volume of its transactions and its risk profile.

(ii) Initial Margin

Whether a Financial Instruments Business Operator subject to the provisions of Article 123, paragraph (1), item (xxi-ix) (initial margin) of the FIB Cabinet Office Ordinance has made efforts to develop a framework for the appropriate management of initial margin for non-cleared over-the-counter derivative transactions subject to that provision, in accordance with that provision and other related provisions, as well as the “Final Report on Margin Requirements for Non-Centrally Cleared Derivatives” published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (March 2015), and taking into consideration, for example the following:

- A. Conclusion of an appropriate agreement with counterparties pertaining to initial margin (for instance, an ISDA Master Agreement and a CSA Agreement as well as an agreement pertaining to the initial margin management (such as an agreement for the establishment of a trust)).
- B. Proper ensuring of the safety of any initial margin collected in the form of cash places into trust that is managed as permitted in Article 123, paragraph (1), item (xxi-ix)E of the FIB Cabinet Office Ordinance.
- C. Calculation of Initial Margin
- a. Calculation of potential future exposure using transaction categories that are capable of appropriately capturing risks associated with the transactions using either a quantitative calculation model or the standardized margin schedule as provided in Article 1 of the “Calculation Method of Potential Future Exposure Designated by the Commissioner of the Financial Services Agency in accordance with the Provision of Article 123, paragraph (1), item (xxi-ix) of the Cabinet Office Ordinance Concerning Financial Instrument Businesses” (hereinafter referred to as the “Notice on Calculation of Potential Future Exposure”).
- b. When a quantitative calculation model is used, development and implementation of appropriate management procedures and verification through back testing or other means by the model control unit in accordance with items (ii) through (v) of Article 6 of the Notice on Calculation of Potential Future Exposure.

- c. When a quantitative calculation model is used, implementation of proper internal audits in accordance with Article 6, item(vi) of the Notice on Calculation of Potential Future Exposure.

(iii) Initial Margin and Variation Margin

Whether the Financial Instruments Business Operator with respect to (i) and (ii), above, has made efforts to develop a framework for appropriate management of initial margin and variation margin, taking into consideration, for example, the following.

- A. Appropriate diversification of assets used as margin, such as by imposing certain limits on, for example, the use of illiquid securities
- B. Establishment in advance of a dispute resolution mechanism, implementation of appropriate responses to disputes that arise, and recording and preservation of the details of any such disputes.
- C. Appropriate risk management related to non-cleared over-the-counter derivative transactions, for which the exchange of margin is not required because the transactions involve counterparties that are financial institutions in a foreign jurisdiction where the validity of close-out netting arrangements has not been confirmed.

#### IV-2-5 Control Environment for Managing Liquidity Risk

Liquidity risk refers to the risk that because of deterioration in business performance or other factors, a Financial Instruments Business Operator will face a credit crunch as it fails to raise necessary funds, or incurs losses as it is forced to obtain funds at markedly higher interest rates than under normal circumstances (funding risk). It also refers to the risk that a financial institution will incur losses because it is unable to conduct market transactions or is forced to conduct transactions at far more unfavorable prices than under normal circumstances, because of market turmoil and other emergency market developments (market-liquidity risk). It is important for Financial Instruments Business Operators to properly manage liquidity risks.

(1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly manages liquidity risk by taking measures such as the following, depending on the contents and scale of its business, with the aim of developing a comprehensive control environment for risk management, properly recognizing and evaluating the risks and establishing a system of checks and balances based on the clear allocation of roles and responsibilities.

- (i) Managing fund-raising on a daily basis, and compiling projections and managing fund-raising on a medium and long-term basis
- (ii) Establishing and controlling the limits for asset management
- (iii) Comprehensively managing transactions in yen or foreign currency, and domestic or overseas transactions
- (iv) Securing financing methods (cash reserves) in preparation for a sudden change in the nature of the business or market climate
- (v) Vesting the person in charge of liquidity risk management with the authority to collect information and control operations

## (2) Supervisory Method and Actions

Supervisors shall strive to identify and keep track of the status of a Financial Instruments Business Operator's liquidity risk and its risk management through monthly offsite monitoring reports and hearings based thereon and, when necessary, require it to submit a report based on Article 56-2(1) of the FIEA and urge it to make improvement efforts.

### IV-2-6 Early Warning System

As a means to maintain the soundness of the management of Financial Instruments Business Operators, the scheme for "prompt corrective actions" has been established under Article 46-6(1) of the FIEA. As well as Financial Instruments Business Operators to which the scheme is applicable, those to which it is not applicable need to make continuous efforts to improve their management so as to maintain and enhance the soundness of the management.

Therefore, in cases where a Financial Instruments Business Operator meets the prescribed criteria regarding changes in the capital adequacy ratio and in prices of securities listed below, supervisors shall strive to quickly identify risks by, for example, holding a hearing and requiring the submission of a report based on the early warning system.

(Note) Although supervisors shall take supervisory actions, including holding hearings, against Financial Instruments Business Operators which meet the said criteria under the early warning system, the management of such business operators should not automatically be deemed to be unsound, or supervisors shall not necessarily urge them to make management improvement efforts.

Also, from the viewpoint of reducing the cost to be imposed on Financial Instruments Business Operators and increasing the efficiency of supervisory processes, the early warning system shall be flexibly operated in a manner suited to the size and the risk profiles of individual business operators.

#### (1) Change in Capital Adequacy Ratio

Supervisors shall identify the margin and rate of change in Financial Instruments Business Operators' capital adequacy ratios each month, based on offsite monitoring data, and analyze the risks that have materialized.

#### (2) Change in Prices of Securities

Supervisors shall identify the amount of Financial Instruments Business Operators' securities holdings, based on offsite monitoring data, and analyze market risks through stress testing that assumes a prescribed level of price change.

#### (3) Impact of Change in Foreign Exchange Rates

Supervisors shall identify the impact of changes in foreign exchange rates on Financial Instruments Business Operators engaging in over-the-counter financial futures transactions, based on offsite monitoring data, and analyze the risk of the business operators' capital being eroded by changes in foreign exchange rates, in light of their method of segregated management, their leverage ratio and the characteristics of their transactions.

#### (4) Supervisory Method and Actions

In cases where a Financial Instruments Business Operator is deemed to meet the prescribed criteria regarding (1) to (3) above, based on the analysis of the relevant data, supervisors shall strive to quickly identify risks by, for example, holding a hearing with it and requiring it to submit a report under the early warning system.

In addition, supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA, when the action is deemed to be necessary in order to ensure the implementation of improvement measures.

## IV-3 Appropriateness of Business Operations (Type I Financial Instruments Business)

### IV-3-1 Appropriateness of Business Operations Related to Securities Businesses

#### IV-3-1-1 Control Environment for Legal Compliance

Securities companies, etc., act as market intermediaries that enable individual investors, institutional investors and securities-issuing companies to make transactions smoothly in the financial instruments market. As their business operations have a highly public nature, securities companies, etc., must exercise their market intermediary function in an efficient and stable manner by executing business operations in a highly reliable way while properly protecting investors. To this end, they must also manage their business operations in a sound and appropriate manner in their capacity as market players, while maintaining a high level of self-discipline.

Their control environment for legal compliance shall basically be examined based on the supervisory viewpoints and method specified in III-2-1. However, it shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary rules adopted from the viewpoint of ensuring an appropriate exercise of the market intermediary function.

#### IV-3-1-2 Control Environment for Customer Solicitation and Explanations

##### (1) Points of Attention Regarding Explanation Documents

“The Key Points of the Status of Internal Control” in the Explanation Documents as specified under Article 46-4 of the FIEA (Article 174(iv) of the FIB Cabinet Office Ordinance) shall describe specific arrangements and procedures for handling complaints and inquiries from customers and for conducting internal audits.

##### (2) Points of Attention Regarding Notification of Necessary Information Related to Delivery of Securities and Other Matters

In cases where a securities company, etc., has failed to properly notify customers of the following items (including cases where the securities company, etc., has failed to notify customers of (iv) below through the method agreed to by the relevant customers), the situation shall be deemed to fall under the category of “situations in which information necessary for customers with regard to the status of delivery and other items regarding the customers’ securities transactions is deemed not to have been properly provided,” as specified under Article 123(1)(viii) of the FIB Cabinet Office Ordinance.

- (i) Items that must be specified in writing when a contract is signed under Article 37-4(1) of the FIEA must be notified to the customer.
- (ii) In cases where a customer has made a pre-auction government bond transaction, the issue name and price of the government bond, the transaction amount and items notified in the transaction report at the time of the execution of the relevant transaction (excluding the scheduled redemption date and the contracted yield) must be notified to the customer after the auction of the relevant government bond.
- (iii) In cases where a customer has made a pre-auction government bond transaction and where the condition

precedent regarding the transaction has not been met, the fact of the condition being unmet and items regarding the execution or non-execution of the relevant transaction (excluding cases where the customer has agreed to these items not being notified) must be notified to the customer.

- (iv) In addition to the items described in (i) to (iii) above, items related to the delivery of cash and securities (excluding cases where the transaction does not involve the direct delivery of cash and securities between the customer and the Financial Instruments Business Operator, such as when the delivery of cash is made through a financial institution and when the delivery of securities is made through a transfer settlement.) must be notified to the customer.

### (3) Points of Attention Regarding Solicitation Targeting Elderly Customers

Even when they have ample investment experience, elderly customers can be physically weak and their ability to make investment decisions may change quickly. As such, solicitation of investment targeting elderly customers calls for, based on the Principle of Suitability, securing a discreet solicitation and sales structure and having a monitoring system to discover problematic solicitation or sales activities. It is necessary to follow up carefully such customers also after sale of products by a Financial Instruments Business Operator. In light of the above, supervisor shall perform supervision, focusing on the following points.

- (i) Whether the operator has internal rules on solicitation and sales activities targeting elderly customers and a system to monitor the status of compliance with such internal rules, based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members,” and “How to Interpret Article 5(3) of Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members,” (guidelines on sales through solicitation targeting elderly customers).
- (ii) Whether the operator follows up elderly customers in a careful manner even after the sale of the product, for example by trying to understand their issues from their viewpoint, advising them on their issues in every minor detail and assisting them with their investment judgment.

### (4) Points of Attention Regarding Solicitation of Investment Trusts

Given that investment trusts are instruments that are solicited and sold to a broad range of customer groups, including ordinary customers who do not have sufficient expert knowledge and experiences, it is important to correctly grasp customer needs taking into consideration their stages of life, status of their assets, purpose of their investment, etc. and provide products that meet such needs, and conduct solicitation that is appropriate according to the customer’s knowledge, experience and investment intention.

In addition, building an organizational structure for solicitation and sales that supports customers' stable asset building while expanding investment trust assets under management is likely to help securities companies, etc. build a stable profit structure that is not vulnerable to market fluctuations.

Therefore, supervisors shall, regarding solicitation of investment trust products, conduct supervision by paying particular attention to the following points, for example.

- (i) Whether the following points are explained in an easy-to-understand manner at the time of solicitation of

investment trust products in relation to costs incurred by customers (excluding specified investors; ; hereinafter the same shall apply in (ii)-(iii) ), such as commission on sales of investment trusts.

- A. The rates of commission on sales, and the amounts of commission on sales that varies in accordance with the amount being purchased, of the investment trusts to be solicited (a rough estimate shall be provided if the exact figure is not available at the time of solicitation.).
  - B. Costs incurred by customers after purchasing the investment trusts under solicitation (including, for instance, trust fees (real contribution rates including the asset management costs of the destination funds of investment in cases of investment trusts using a fund-of-funds strategy), the value of assets retained in the trust, etc.)
- (ii) With respect to dividends on investment trusts, whether it is explained to customers in an easily understandable manner, that all or part of the dividends may correspond to a partial repayment of principal.
  - (iii) Given that multi-currency funds involve not only a risk that the price of the invested asset will fluctuate but also the complex risk of currency fluctuation, when entering a contract with a customer that has no experience in investing in multi-currency funds, whether the securities company, etc. takes measures, such as receiving a written confirmation from the customer to the effect that he/she has understood the product characteristics and risk profile, and keeping it.

#### (5) Points of Attention Regarding Explanation of Important Items Related to Investment Trust Switching

Solicitation of frequent switches to other investment trusts may not necessarily lead to the customer's stable and effective asset building due to such factors as increased costs arising from additional commissions on sales and, in terms of asset management, and potential declines in investment results arising from an increase in cancellations shortly after establishing a new fund that lead to failure to efficiently manage the assets. In light of this, it is necessary to provide detailed explanations to customers on the characteristics of investment trusts related to switching between them and the advantages and disadvantages associated with the relevant switching even when there is rationale for switching in light of customers' investment goals, market trends, etc., to enable customers to judge whether there is the need to make such switching after they have fully understood these points.

Reflecting these considerations, in cases where a securities company, etc. has failed to provide explanations regarding the information necessary for customers to make a judgment as to whether there is a rationale for the switching of investment trusts or investment corporations (hereinafter referred to as "investment trusts, etc."), including the consistency of the switching and customers' investment purposes, in accordance with each customer's depth of understanding, and when it is found that it has failed to establish an internal control system for conducting effective verification, the situation shall be deemed to fall under the category of "situations in which explanations regarding important items related to switching have not been provided to customers in the solicitation for switching of investment trust beneficiary certificates, etc.," as specified under Article 123(1)(ix) of the FIB Cabinet Office Ordinance. The information necessary for customers to make a judgment as to whether there is a rationale for switching may include roughly calculated profit and loss of the investment trust, etc. to be cancelled and comparisons of merchantability and expenses between the investment trust, etc. to be cancelled and that to be newly acquired, in addition to general items to be explained in relation to sale of investment trusts, etc., but it shall be noted that



explanations may vary by case depending on each customer's knowledge, experience, status of assets, investment purposes, and the characteristics of relevant investment trusts, etc.

(6) Points of Attention Regarding Secondary Offering of Bonds

(i) Cases in which a securities company, etc., has failed to provide explanations regarding the following situations when soliciting individual customers (excluding specified investors) to acquire bonds (securities as specified under Article 123(1)(xi) of the FIB Cabinet Office Ordinance; hereinafter the same shall apply in (6)) or selling bonds to them in a secondary offering, under Article 2(8)(viii) or (ix) (excluding the provision regarding private placement of securities) shall be deemed to fall under the category of “cases in which explanations regarding important incidents that have occurred during the application period for the acquisition or purchase of the relevant securities and could affect investment decisions have not been individual customers (excluding specified investors),” as specified under Article 123(1)(xi) of the FIB Cabinet Office Ordinance.

- A. When the yield on the relevant bond has become markedly disadvantageous to the customer compared with the yield on a similar bond already issued by the same issuer, the situation must be explained.
- B. When the redemption terms of the relevant bond are determined by the market condition and other benchmarks (hereinafter referred to as “benchmarks, etc.”), and the condition of benchmarks, etc., regarding the bond at the time when the securities company, etc., is soliciting customers to buy the bond or selling the bond to them is disadvantageous to the customer compared with the condition of the benchmarks, etc., that were used as a reference when the issuance terms or sales terms were determined, the situation must be explained.

(ii) Regarding (i) A. above, the following points shall be taken into consideration:

- A. The “relevant bond” is a bond that falls under the category of corporate bonds, etc., intended for individuals (referring to corporate bonds, etc. intended for individuals as specified under Article 2(1) of the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Rules on Publication of Over-the-Counter Quotations Regarding Corporate Bonds, etc. Intended for Individuals”; the same shall apply hereinafter).
- B. The “similar bond” is a corporate bond intended for individuals which matures in less than six months after the maturity date of the relevant bond (newly issued bond) and whose maturity date is the closest to that of the relevant bond (when there are two or more such bonds, the one that was issued most recently).
- C. Whether or not a certain situation should be deemed as a “situation markedly disadvantageous to the customer” shall be judged with due consideration of the interest rate level at the time of the offer (secondary offer) and other circumstances. For example, the value  $\alpha$  obtained through the following formula may be used as a basis for the judgment.

$$\alpha = X \text{ (credit spread equivalent of a similar bond)} - Y \text{ (credit spread equivalent of the relevant bond (newly issued bond))}$$

X = (average (refer to Note) of reported values, as specified under the “System for Publication of Over-the-Counter Quotations Regarding Corporate Bonds, etc., Intended for Individuals” (values

published on the day before the offer date) regarding the similar bond) – (average simple yield (the value published on the same day as the offer date), calculated on the basis of reference bond trading statistics published by the Japan Securities Dealers Association, of the government bond whose maturity date is closest to that of the similar bond)

$Y = (\text{subscribers' yield (average simple yield) of the relevant bond (newly issued bond)}) - (\text{average simple yield (the value published one day after the terms-setting date), calculated on the basis of reference bond trading statistics published by the Japan Securities Dealers Association, of the government bond whose maturity date is closest to that of the relevant bond (newly issued bond)})$

(Note) The “average of reported values as specified under the ‘System for Publication of Over-the-Counter Quotations Regarding Corporate Bonds, etc. Intended for Individuals’ regarding the similar bond” shall be a simple average of values (simple yields) that are reported by reporting members to and published by the Japan Securities Dealers Association under this system.

(iii) Regarding (i) B. above, the following points shall be taken into consideration:

- A. A “situation disadvantageous to the customer” refers to a case in which the theoretical price of the relevant bond at the time of the solicitation (or the theoretical price based on the closing price of the relevant bond on the previous day) has fallen below the bottom of the range set in advance by the securities companies, etc., in relation to the offer price (secondary offer price).
- B. The theoretical price in A. above shall be calculated through the calculation formula which was used as a basis for determining the issuance (secondary offer) terms of the bond, and the price range shall be determined in light of the levels prescribed under internal rules regarding sales after the offer and secondary offer periods. In addition, records on the calculation formula for the theoretical price shall be organized and recorded, and appropriate arrangements and procedures, including the establishment of internal rules, regarding the handling of such records shall be established.
- C. Regarding bonds whose redemption terms depend on the stock market condition, such as bonds exchangeable with stocks of other companies and Nikkei Average-linked bonds with a special redemption provision (hereinafter referred to “EBs, etc.”), the definition of a “situation disadvantageous to the customer” may be changed from A. above to “a case in which the price of the relevant stock at the time when the securities companies, etc., solicit customers to acquire or sell EBs, etc., in a secondary offer to them (or the closing price of the stock on the previous day) has fallen more than 7% below the initial price (the price of the relevant stock used as a basis for determining the issuance terms or the price regarded by individual companies as equivalent thereto).(Limited to cases where the use of this definition was decided before the offer (secondary offer) period.)
- D. Regardless of which of the above definitions in (A) and (C) is used during the offer/ secondary offer periods, cases in which, after the offer/secondary offer periods, appropriate prices calculated based on internal rules are not offered in the sale of EBs, etc., may be deemed to constitute a violation of Article 117(1)(ii) of the FIB Cabinet Office Ordinance.

(iv) In cases where securities companies, etc., are to conduct solicitation for acquisition under brokerage contracts, they shall provide explanations specified under Article 123(1)(xi) of the FIB Cabinet Office

Ordinance.

(7) Points of Attention Regarding Sale of Securitization Products (Assurance of Traceability of Securitization Products)

Some securitization products have a complex structure and involve several parties in the origination to sales processes. Therefore, if the originator of the underlying assets fails to properly provide information regarding the contents of the underlying assets and the risks involved therein to the parties involved in the processes, such as the originator of securitization products, the seller and investors, it may become difficult for investors to identify risks precisely.

As transactions involving securitization products are basically made between professional investors (e.g., securities companies, etc., and qualified institutional investors), they are unlikely to be subject to the legal regulation on disclosure and the legal obligation for explanations. However, regarding the sale of securitization products, supervisors shall pay attention to the following with due consideration of the viewpoint described above as well as the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning the Distribution, etc. of Securitized Products.”

Even if securities companies, etc., play only a limited role in transactions, such as acting as a sales agent, it is desirable that they provide support where possible, as long as they deal with investors.

- (i) Whether before selling securitization products, the securities company, etc., collects information regarding the contents of the underlying assets, the status of the originators’ continuous retention of the risks and the risks involved therein and conducts sufficient analysis to provide appropriate explanations.
- (ii) Whether the securities companies, etc., has established the internal procedures and rules necessary to avoid relying exclusively on credit ratings, and provides information regarding the risks involved in the underlying assets and liquidity risks not reflected in credit ratings when they sell securitization products.
- (iii) Whether the securities company, etc., has established the internal procedures and rules necessary for providing information, in ways that enable customers investing in securitization products to trace information regarding the contents of the underlying assets and the risks involved therein, if requested to do so by the investors.
- (iv) Whether the securities company, etc., has developed a control environment for evaluating and calculating theoretical prices and quickly informs customers of them, even when it is difficult to determine market prices. Whether the securities company, etc., avoids evaluating and calculating theoretical prices in an arbitrary manner so as to refrain from giving priority to promoting arbitrary use of the information for specific purposes.

(8) Points of Attention Regarding Solicitation of Transactions That Use Tax Exemption for Small-Amount Investments

Tax exempt small-amount investment scheme “Nippon Individual Savings Account” which was introduced in January 2014 (hereinafter referred to as the "NISA Program"), was fundamentally expanded and was renewed as a permanent program in January 2024 from the perspective of accelerating a shift of household financial assets from savings to investment and developing an environment that enables households, particularly the middle class, to

enjoy the benefits of growth through broad participation in the capital market. More specifically, the period of tax-exempt holding was made indefinite and the account valid period was made permanent to enable people to build assets continuously from early in life to later in life through long-term, installment and diversified investment. In addition, the annual investment quota was expanded to respond to individuals' needs for making investments intensively during a short term when they have surplus funds in accordance with their life stages. Furthermore, from the perspective of further strongly backing up a fund flow from households to the capital market, which will lead to companies' growth investment, the growth investment quota to enable investment in listed stocks was newly introduced and it was made possible to use this quota concurrently with the quota for long-term, installment and diversified investment in certain investment trusts (the "installment investment quota").

Supervisors, mindful of the above considerations, shall especially take note of the following points, while taking into consideration the "Points of Attention upon the Opening of Account, Solicitation or Sale, etc. of the NISA Program (Guideline)" (NISA Promotion and Liaison Association), (hereinafter referred to as the "Guideline" in this paragraph (8)), in conducting their supervision work on solicitation, etc. for transactions that use the NISA Program, so that the NISA Program can be used appropriately in accordance with the design and purpose of the system.

(i) Development of Control Environment for Customer Explanations

A. Efforts to Improve Financial Literacy among Customers

Considering that the NISA Program is expected to be used by customers who lack ample knowledge or experience of investment, such as novice investors and young people, whether the operator embraces the view that helping improve such customers' financial (and investment) literacy and encouraging them to build their assets, instead of only complying with the Principle of Suitability dictated by law, are beneficial to both customers and securities companies, etc., and is committed to providing basic knowledge of investment, such as the benefits of medium- to long-term investment and diversified investment, in an appropriate manner, in conjunction with the initiatives for financial and economic education being implemented by the national government and other entities.

B. Explanation of the NISA Program

Whether the operator, when soliciting, or receiving application, etc. for, opening tax-exempt accounts related to the NISA Program(hereinafter referred to as "NISA accounts"), provides explanation based on the Principle of Suitability, for example, simple and accurate explanation of matters required by the Guideline as necessary, so that the customer may not have wrong understanding.

(ii) Provision of Financial Instruments in Ways That Take into Consideration the Design and Purpose, etc. of the System

Whether the operator takes into account the purpose of the NISA Program, which is to encourage steady asset building by households, and the customers' purpose for using the NISA Program, and provides financial instruments, etc. that can truly contribute to stable asset building of customers based on the Principle of Suitability, etc.

When determining the effectiveness of contribution to stable asset building, it is necessary to pay attention to not only the characteristics of the investment products but also the balance of customers' overall investment

portfolios. In light of the purpose, etc. of the NISA Program, solicitation of unreasonable short-term rollovers using the growth investment quota does not lead to the stable asset building of customers. Therefore, supervisors shall also conduct supervision while paying attention to such solicitation activities.

(iii) Points of Attention regarding the Junior NISA

Regarding the tax exempt small-amount investment scheme for minors, which was introduced in April 2016 (hereinafter referred to as the "Junior NISA"), opening of new accounts and new purchases were terminated in December 2023. However, minors' accounts for the Junior NISA (hereinafter referred to as "Junior NISA accounts") remain eligible for tax exemptions until account holders become 18 years old. It should be noted that those accounts are not used as accounts under fictitious names by people with parental authority, etc.

From this point of view, it is necessary to check whether Financial Instruments Business Operators, etc. manage Junior NISA accounts properly by, for example, sending account activity statements, etc. addressed to the account holders themselves based on their age, etc. and confirming that the funds belong to account holders and are intended to be used for the benefit of the account holders themselves upon withdrawals from Junior NISA accounts.

(9) Points of Attention Regarding Sale of Investment Trusts, etc. Whose Investment Targets Include Assets Other Than Specified Assets

Under the Act on Investment Trusts and Investment Corporations, investment trusts and investment corporations are used for the purpose of investing mainly in specified assets, and are given special institutional positions as the people's long-term and stable asset formation means. As it is inappropriate to sell the following products in light of such purpose of the investment trust and investment corporation systems, supervisors shall conduct supervision by paying attention to whether those products are being sold:

(i) Products whose investment targets include assets other than specified assets (hereinafter referred to as "non-specified assets" in this paragraph (9)) and specified assets that practically have the same nature as non-specified assets, such as equity in investment in a fund for which non-specified assets are investment targets, (hereinafter referred to as "non-specified assets, etc." in this paragraph (9)) (however, this shall not apply if the non-specified assets, etc. have a public nature, such as the "public facility, etc." prescribed in the Act on Promotion of Private Finance Initiative)

(ii) Products which, when investing in assets other than the fund's investment targets, invest in non-specified assets, etc. with higher risk of price fluctuation, liquidity, etc. compared to the specified assets that are the original investment targets

Even for products which, when investing in assets other than the fund's investment targets, invest in non-specified assets, etc. with low risk of price fluctuation, liquidity, etc., particular attention shall be paid to whether the following acts of sale are conducted, in light of the purpose of the investment trust and investment corporation systems:

A. Act of selling a product that is given a name that evokes non-specified assets

- B. Act of soliciting for and selling a product by emphasizing investment in non-specified assets
- C. Act of selling a product to a customer having insufficient understanding, without providing sufficient explanation on the risks involved and confirming the customer's understanding despite the fact that the investor bears risks in holding non-specified assets, etc.

(10) Points of Attention Regarding Development of the Operational Control System Provided in Article 70-2(7) of the FIB Cabinet Office Ordinance

In the case where a securities company, etc. provides the brokerage service prescribed in Article 70-2(7) of the FIB Cabinet Office Ordinance by using an internal trading system (meaning the internal trading system prescribed in the same paragraph; the same applies in IV-3-1-2), attention shall be paid to whether the securities company, etc. explains the following points to the customer in an easy-to-understand manner from the viewpoint of investor protection:

- (i) Information on the person operating the internal trading system (including an outline of the company and the presence or absence of proprietary trading using the internal trading system) and an outline of other trading participants
- (ii) In the case of providing the brokerage service prescribed in Article 70-2(7) of the FIB Cabinet Office Ordinance by using the internal trading system at a price equivalent to or more favorable than the price (including the matter equivalent to the price) on a financial instruments exchange market, etc. (meaning a financial instruments exchange market or the Proprietary Trading System prescribed in Article 26-2-2(7) of the FIEA Enforcement Order), details of the structure thereof
- (iii) The trading rules (including the standards for trading participation, grounds for refusal, and the method for the customer to exclude the method of forwarding the order to the internal trading system from order execution options)
- (iv) The fact that the matching price at the time of forwarding the order does not necessarily guarantee a favorable price at the time of contract and that an order will not be intentionally executed under transaction conditions disadvantageous to the customer
- (v) In the case of conducting transactions using the internal trading system mainly for the purpose of enabling the customer to conduct transactions at more favorable prices, the situation of the price improvement effects in individual transactions generated by using the internal trading system (if the prices did not improve, including the reasons why)
- (vi) The method by which the customer requests disclosure of the items to be specified under Article 158(5) of the FIB Cabinet Office Ordinance concerning the customer's own orders agreed by using the internal transaction system

(11) Points of Attention Regarding Evaluation of Sales Staff

In light of the purpose of developing a system for solicitation and sales that support customers' asset building over the medium- to long-term, supervisor shall perform supervision by paying attention to whether the operational-level evaluation of sales staff is not focused too much on revenues, such as commission on sales of investment trusts,

but appropriately assesses aspects of customer base expansion, as reflected, for example, in increases in assets under management.

#### (12) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the control environment for customer solicitation and explanations of a securities company, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities company, etc., by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the securities company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### IV-3-1-3 Discretionary Trading Contracts

##### (1) Points of Attention Regarding Discretionary Trading Contracts with Foreign Securities Companies

When supervisors have received a notification regarding the signing of a contract based on Article 16(1)(viii)(b) of the Cabinet Office Ordinance Regarding the Definitions Specified under Article 2 of the Financial Instruments and Exchange Act (hereinafter referred to as “Cabinet Office Ordinance Regarding Definitions”), they shall pay attention to the following points:

- (i) Whether the division that executes transactions regarding the said agreement is clearly separated from the divisions that receive and execute orders for other brokerage transactions.
- (ii) Whether it is ensured that account books are compiled in ways to enable the identification of transactions related to the said agreement.

##### (2) Scope of Specified Agreements by Securities Companies, etc.

Specified agreements as prescribed under Article 123(1)(xiii)(b) and (c) of the FIB Cabinet Office Ordinance include the following agreements:

- (i) Agreements regarding prices higher (in the case of sell orders) or lower (in the case of buy orders) than the specified prices (including prices determined with a prescribed method)
- (ii) An appropriate range determined with a specified price as a base point
- (iii) Agreements regarding the determination of prices at the discretion of securities companies, etc., on the condition that they follow the best execution practice (so-called CD order) in daily trading.
- (iv) Targeting of prices determined through a prescribed method such as volume weighted averaging (so-called VWAP target order)

##### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the transactions specified under Article 123(1)(xiii)(a) to (e) of the FIB Cabinet Office Ordinance through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities company, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the securities company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider taking necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

#### IV-3-1-4 Exchange of Non-Disclosure Information with Parent/Subsidiary Corporations, etc.

##### (1) Providing Corporate Customers with the Opportunity to Opt Out

Under Article 153(1)(vii) and (viii) and (2) of the FIB Cabinet Office Ordinance, if securities companies, etc. provide the corporate customers with the opportunity to opt out (meaning that the customer who has been notified of the sharing of non-disclosure information can request the securities company, etc. to stop providing the non-disclosure information to its parent/subsidiary corporations, etc. if the customer does not consent to such sharing; the same shall apply hereinafter), the corporate customers are deemed to have given consent to the exchange of their non-disclosure information between the securities companies, etc. and their parent/subsidiary corporations, etc. until the corporate customers undertake procedures for opting out. Whether a securities company, etc. appropriately provides corporate customers with the opportunity to opt out shall be examined, focusing on the following points.

- (i) Whether the securities company, etc. has, in advance, notified corporate customers of the scope of non-disclosure information to be exchanged with its parent/subsidiary corporations, etc., the scope of the parent/subsidiary corporations, etc. with which it will exchange non-disclosure information, the method of exchange of non-disclosure information, the method of management of non-disclosure information employed by the recipients of the information, the purpose of use of non-disclosure information by the recipients, and the method of management of non-disclosure information in the event of suspension of exchange of the information. If the securities company, etc. has made arrangements to provide corporate customers with easy access to necessary information, such as clearly stating, in the notification made to corporate customers, the fact that detailed information on the matters mentioned above are posted or provided for inspection at its branches or presented on its website, together with the contact point on this issue, the securities company, etc. may be deemed to have made an appropriate notification even when the said notification does not contain such detailed information.
- (ii) It is not necessary to make a notification to corporate customers each time there is a minor change to the matters of which the customers have previously been notified; whether the securities company, etc. has taken measures to enable corporate customers to acquire necessary information, such as presenting the latest information on its website at all times and giving an appropriate explanation of this arrangement to corporate



customers.

(iii) Whether the securities company, etc. notifies corporate customers of the opportunity to opt out by such means that enable them to clearly understand the opportunity to opt out, e.g. making a notification in writing upon concluding a contract.

In addition, whether the securities company, etc. has clearly announced that the opportunity to opt out is always available to corporate customers, by taking measures such as, posting or providing for inspection the information on the opportunity to opt out at its branches or presenting the same on its website, as well as making arrangements so that corporate customers can opt out via the website at any time, or establishing a permanent contact point for corporate customers' opt-out within the internal control division.

(iv) Whether the securities company, etc. secures a necessary period of time, after notifying a corporate customer of the opportunity to opt out and before commencing the exchange with its parent/subsidiary corporation, etc. of non-disclosure information on the corporate customer, so that the corporate customer can make a decision within such period regarding whether or not to opt out.

(v) In cases where the securities company, etc. applies, to some corporate customers, a scheme wherein it exchanges non-disclosure information with its parent/subsidiary corporations, etc. only when the corporate customers opt in (meaning that the customer voluntarily gives consent to the sharing of non-disclosure information; the same shall apply hereinafter), without providing the opportunity to opt out, whether the securities company, etc. posts or provides for inspection at its branches the information regarding the types of corporate customers to which it provides (or does not provide) the opportunity to opt out, so that each corporate customer can easily find if it is eligible to receive the opportunity to opt out.

(vi) Whether the securities company, etc. has prepared procedures for opting out in consideration of the convenience of corporate customers, by measures such as adopting procedures utilizing email and input of intentions in a format on the website using tablet terminals, etc., in addition to procedures in writing.

(vii) Whether the securities company, etc. has developed an environment for responding to corporate customers' requests to opt out promptly and appropriately to the extent possible.

(2) Disseminating Information on the Opportunity to Opt Out among Listed Companies, etc.

Under Article 153(1)(vii) and (viii) of the FIB Cabinet Office Ordinance, if listed companies, etc.(Note) are placed in a situation where they can easily know the fact that the provision of non-disclosure information is to be discontinued in response to their request to opt out, securities companies, etc. are not required to obtain consent from said listed companies, etc. and are permitted to exchange non-disclosure information pertaining to said listed companies with their parent/subsidiary corporations, etc. until the listed companies, etc. undertake procedures for opting out. The appropriateness of such responses should be examined, focusing on the following points.

(Note) Listed companies, etc. are those falling under any of 1. to 4. of Article 123(1)(xviii)g. of the FIB Cabinet Office Ordinance. Whether a company falls under a stock company intending to list its shares as set forth in 2. of the same subitem, out of all listed companies, etc., cannot be necessarily judged based only on disclosed information. Therefore, when exchanging non-disclosure information pertaining to a stock company intending to list its shares, it should be noted that the securities company, etc. is required to appropriately confirm the conformity of said company (including the confirmation whether the company that fell under a stock company

intending to list its shares still continues to fall under as such), and in cases where the securities company, etc. recognizes changes in the conformity of listed companies, etc. including those other than the above, it is to take appropriate responses as promptly as possible.

(i) Whether the securities company, etc. has placed listed companies, etc. in advance in a situation where they can easily know the scope of non-disclosure information that the securities company, etc. will exchange with its parent/subsidiary corporations, etc., the scope of its parent/subsidiary corporations, etc. with which it will exchange non-disclosure information, methods of exchanging non-disclosure information, methods of managing non-disclosure information at the corporations, etc. to which the information is provided, the purpose of use of non-disclosure information by the corporations, etc. to which the information is provided, required procedures and contact information for opting out, and methods of managing non-disclosure information when it discontinued exchange of non-disclosure information with its parent/subsidiary corporations, etc. The situation where listed companies, etc. can easily know the information refers to the situation where listed companies, etc. can know the information based on their own volition with ease in terms of both required time and procedures. For example, when the securities company, etc. displays at its branches or posts on its website the information on the aforementioned matters on a steady basis, it is considered to fall under the relevant situation.

(ii) Whether the procedures for opting out are easy-to-understand for listed companies, etc.

(iii) Whether the securities company, etc. secures time for a listed company, etc. to decide whether or not to opt out during the period from the time when the listed company, etc. is placed in advance in a situation where it can easily know the fact that the provision of non-disclosure information is to be discontinued in response to its request to opt out until the time when exchange of non-disclosure information between the securities company, etc. and its parent/subsidiary corporations, etc. commences.

(iv) Whether the securities company, etc. updates the details of the information it displays at its branches or posts on its website on a steady basis whenever there is any change in the matters set forth in (i) above.

(v) Whether the securities company, etc. has prepared procedures for opting out in consideration of the convenience of listed companies, etc., by measures such as adopting procedures utilizing email and input of intentions in a format on the website using tablet terminals, etc., in addition to procedures in writing. In cases where a company at a top position of listed companies, etc. represents all companies belonging to the relevant group and requests to opt out, whether the securities company, etc. takes appropriate responses from the perspective of giving due consideration to the intentions and burdens of individual listed companies, etc., through measures such as handling procedures for opting out collectively.

(vi) Whether the securities company, etc. has developed an environment for responding to requests to opt out filed by listed companies, etc. promptly and appropriately to the extent possible.

### (3) Obtaining Opt-in Consents (Consents to the Sharing of Non-Disclosure Information)

Under Article 153(1)(vii)a. of the FIB Cabinet Office Ordinance, securities companies, etc. that have obtained opt-in consents from issuers, etc. are permitted to exchange non-disclosure information pertaining to said issuers, etc. who have given opt-in consents with its parent/subsidiary corporations, etc. The appropriateness of the method of obtaining opt-in consents should be examined, focusing on the following points. The same shall apply in cases

where a securities company, etc. intends to obtain opt-in consents anew from issuers, etc. who have opted out as explained in (1) or (2) of IV-3-1-4 (Exchange of Non-Disclosure Information with Parent/Subsidiary Corporations, etc.) for the purpose of exchanging non-disclosure information pertaining to said issuers, etc. with its parent/subsidiary corporations, etc.

- (i) Whether the securities company, etc. has prepared procedures for withdrawing opt-in consents in consideration of the convenience of issuers, etc., by measures such as adopting procedures utilizing email and input of intentions in a format on the website using tablet terminals, etc., in addition to procedures in writing.
  - (ii) Whether the securities company, etc. has developed an environment for responding to withdrawals of opt-in consents promptly and appropriately to the extent possible.
- (4) Points of Attention Regarding Exchange of Non-Disclosure Information with Parent/Subsidiary Corporations, etc.

When a securities company, etc. exchanges with its parent/subsidiary corporations, etc. non-disclosure information on its customers under Article 153(1)(vii) and (viii) and (2) of the FIEA, it should pay attention to the following matters, in addition to the matters mentioned in III-2-4.

- (i) Whether the scope of non-disclosure information to be exchanged with the parent/subsidiary corporations, etc. has been defined in advance.
- (ii) Whether sufficient measures for information control are implemented regarding the non-disclosure information to be exchanged with the parent/subsidiary corporations, etc., such as thorough access control, measures to prevent the misappropriation by the parties concerned, and prevention of illegal access from outside.
- (iii) Whether the securities company, etc. and its parent/subsidiary corporations, etc., with which the former exchanges non-disclosure information, have developed centralized systems for management of non-disclosure information, including appointing a person responsible for management of non-disclosure information within their internal control divisions; whether they manage non-disclosure information regarding customers who have opted out or who have not opted in (hereinafter referred to as “non-shared information”) separately from other non-disclosure information; whether they have developed a control environment for examining the status of management of non-disclosure information and non-shared information periodically.
- (iv) Whether the securities company, etc. has taken measures, such as the following, so that the person responsible for the management of non-disclosure information, assigned within the internal control division, can fully check the sales division, etc.
  - A. Employees of the internal control division are prohibited from concurrently holding office at the sales division or other divisions using non-disclosure information for their operations, and vice versa.
  - B. The internal control division is vested with proper authority to check the sales division, in such manner that the former’s decision should always prevail over the latter’s decision with regard to the matters concerning the management of non-disclosure information.
  - C. The internal control division is free from the command and control of the sales division, etc. (excluding executive officers).
- (v) Whether the authority of the person responsible for the management of non-disclosure information and

the procedure for handling non-disclosure information are clarified in writing, and in particular, whether the procedure for handling non-shared information within the sales division is specified; whether these procedures are communicated to officers and employees of the securities company, etc. and its parent/subsidiary financial institutions, etc., through training programs.

- (vi) Whether the securities company, etc. has taken measures to ensure that the officers and employees of the sales divisions and other divisions who use non-disclosure information for their operations of the securities company, etc. or its parent/subsidiary corporations, etc. with which the former exchanges non-disclosure information would not conduct solicitation, etc. to customers, while using non-shared information that can be accessed only by any single corporation, etc. (limited to information regarding which corporations, etc. other than the single corporation, etc. do not have similar information), as officers or employees of a corporation, etc. other than said single corporation.

Incidentally, when an employee who concurrently holds positions at the securities company, etc. and its parent/subsidiary corporations, etc. provides non-shared information held by any of the corporations where he/she concurrently holds positions (limited to information regarding which other corporations, etc. where he/she concurrently holds positions do not have similar information) to a customer, officer, or employee, etc. (excluding officers and employees, etc. who concurrently hold positions at multiple corporations, etc. in the same manner as the employee) in relation to business operations at other corporations where he/she concurrently holds positions, such act of the employee concurrently holding positions falls under an exchange of non-shared information among these corporations. In addition, it is also necessary to note whether the securities company, etc. has developed an environment for ensuring that: based on the Need-to-Know Principle (see III-2-4(1)(i)), employees concurrently holding positions do not access information unnecessary for the execution of business operations and do not use such information between them in the first place.

Furthermore, when an employee concurrently holding positions has newly obtained non-disclosure information, the securities company, etc. should make a determination properly as to at which corporation, etc. the employee obtained the relevant non-disclosure information and handle the information as such, in light of the developments leading to the acquisition of said information and customers' recognition.

The securities company, etc. should also provide training to employees concurrently holding positions regarding these procedures to ensure that all such employees are aware of and comply with the relevant procedures.

- (vii) Whether measures have been taken to prevent non-disclosure information from leaking between the divisions dealing with non-disclosure information and the divisions dealing with no such information; whether the same measures have been taken by the sales division dealing with non-shared information and other divisions using non-disclosure information for their operations within the securities company, etc., and by the sales divisions and other divisions using non-disclosure information for their operations within the parent/subsidiary corporations, etc. Additionally, whether the securities company, etc. has developed an environment for appropriately examining any incidents wherein leakage of non-disclosure information or an illegal act utilizing non-disclosure information is suspected.
- (viii) In cases where the securities company, etc. outsources its operations, whether the following measures have been taken in addition to those mentioned in III-2-7(2), so that non-shared information will not be

provided for its parent/subsidiary corporations, etc. via the outsourcing contractor.

- A. The outsourcing contractor has taken measures to prevent non-shared information from being provided for the parent/subsidiary corporations, etc., such as managing non-shared information separately from other customer information.
- B. In cases where the securities company, etc. provides customers with its services via the outsourcing contractor, it has taken measures to prevent customers from mistakenly believing that the services are provided by the parent or subsidiary corporation, etc. of the securities company, etc.
- C. The securities company, etc. appropriately supervises the outsourcing contractor so that the measures mentioned in A and B above are taken as appropriate.

#### (5) Points of Attention Regarding Exchange of Non-Disclosure Information Necessary for Conducting Internal Control Operations

In cases where a securities company, etc. and its parent/subsidiary corporations, etc. have properly taken measures to prevent the leakage of non-disclosure information from the divisions engaged in conducting operations concerning the maintenance and management of electronic data processing systems or internal control and operation (such operations shall hereinafter be referred to as “internal control operations, etc.” in (5) and such divisions shall hereinafter be referred to as “internal control divisions, etc.” in (5)), they may exchange non-disclosure information (including non-shared information) necessary for conducting internal control operations, etc. under Article 153(1)(vii)(g) or (i) of the FIB Cabinet Office Ordinance (with regard to operations concerning internal control and operations, excluding cases where the securities company, etc. provides non-disclosure information to its parent/subsidiary corporations, etc. other than parties in specified relationships; with regard to business management concerning subsidiary corporations, etc., limited to reception from subsidiary corporations of the securities company, etc., or provision to the parent corporations). In such case, they should pay attention to the following points.

- (i) The following operations conducted by the securities company, etc. may fall under the category of “operations concerning legal compliance” prescribed in Article 153(3)(i) of the FIB Cabinet Office Ordinance.
  - A. Study of legal issues relating to the products and services handled
  - B. Response to complaints, inquiries, etc. from customers, etc. and settlement of disputes with customers, etc.
  - C. Conflict of interest management and management of non-disclosure information
  - D. Response to the supervisory authorities
  - E. Control of violation of laws and regulations committed by the sales division in carrying out transactions (including decisions on internal actions)
  - F. Management and monitoring of corporate-related information for the purpose of preventing insider trading and other illegal acts
  - G. Review of operations from the perspective of reputation risk and corporate ethics
  - H. Other operations necessary for fulfilling legal obligations
- (ii) The following operations conducted by the securities company, etc. may fall under the category of “operations concerning management of risk of loss” prescribed in Article 153(3)(ii) of the FIB Cabinet Office

Ordinance.

- A. Management of market risk (possible risk of loss arising from the fluctuation of prices of the securities held)
- B. Management of credit risk (possible risk of loss arising from the business partner's default or other reasons)
- C. Management of operational risk (possible risk of loss arising during the process of daily operations, such as errors in clerical work)
- D. Management of liquidity risk
- E. Business Continuity Management (BCM) and implementation thereof in the event of disasters

(iii) Whether the internal control division, etc. has properly taken the following measures so as to prevent the leakage of non-disclosure information.

- A. Employees of the internal control division, etc. are prohibited from concurrently holding office at the sales division or other divisions using non-disclosure information for their operations, and vice versa.

(Note)

(Note) Operations concerning measures for anti-money laundering and countering the financing of terrorism and other operations concerning compliance with laws and regulations related to the prevention of financial crimes fall under the "affairs related to compliance management" (Article 153(3)(i), etc. of the FIB Cabinet Office Ordinance). In cases where employees in charge of those operations are appointed at the sales division, such employees are deemed to belong to the internal control division, etc. as long as they deal with non-disclosure information for those operations, and concurrent holding of office between the internal control division, etc. and the sales division is not prohibited.

However, it should be noted that the securities company, etc. needs to take measures to ensure that those employees will not leak any non-disclosure information that they are not originally permitted to access for operations other than those falling under the affairs related to compliance management to other officers or employees of divisions other than the internal control division, etc. (e.g. front-line personnel of the sales division) and will not use such non-disclosure information for any purpose other than the relevant operations (e.g. sales purpose) (see IV-3-1-4(4)(vi) and (vii)).

- B. The internal control division, etc. has taken measures to prevent non-disclosure information (development of confidential regulations and information management, etc.) from leaking at the time of personnel reshuffles between the internal control division, etc. and other divisions.
- C. In cases where there are employees of the internal control division, etc. who also work for another division that does not handle non-disclosure information, the latter division has taken measures equivalent to those mentioned in A and B above.

(iv) If an officer, etc. (referring to an officer or person who has sufficient knowledge and experience in legal compliance control and holds the position to instruct or supervise other employees; hereinafter the same shall apply in (iv)) receives non-shared information, other than the non-shared information that is under management by any one corporation, etc. where he/she works, for the purpose of conducting operations concerning

governance or internal control and operation, such case does not constitute the leakage of non-shared information; in this case, however, whether the following measures have been taken.

- A. The officer, etc. is restricted from leaking the non-shared information.
  - B. The officer, etc. is restricted from using the non-shared information for purposes other than conducting operations concerning governance or internal control and operation (e.g. sales purpose)
- (v) Whether in-house regulations have been developed regarding the measures mentioned in (iii) and (iv) above, and a control environment has also been developed for ensuring the examination of compliance of such regulations.

#### (6) Prevention of Abuse of Superior Position of Employees Belonging to Two or More Divisions

In cases where a securities company, etc. has a parent bank, etc. or subsidiary bank, etc. (hereinafter referred to as “parent/subsidiary bank, etc.” in (6)), Article 153(1)(x) of the FIB Cabinet Office Ordinance prohibits abuse of the superior bargaining position of the parent/subsidiary bank, etc. In 2022, deregulation (see IV-3-1-4(2)) was conducted and it was made possible for a securities company, etc. and its parent/subsidiary corporations, etc. to share non-disclosure information of listed companies, etc. until relevant listed companies, etc. undertake procedures for opting out. Accordingly, securities companies, etc. are required to properly and strictly take measures in order to prevent abuse of the superior bargaining position of their parent/subsidiary banks, etc.(Note)

In light of this, supervision is to be performed, focusing on the following points.

(Note) “Abuse of the superior bargaining position of the parent/subsidiary bank, etc.” refers to the following, for example, but is not limited thereto. It should be noted that forms of abuse may vary depending on business models of individual securities companies, etc. and business types of other financial institutions within financial groups to which individual securities companies, etc. belong.

- Cases where an officer or employee of a securities company, etc. solicits transactions with the company while implying orally, in writing, or by any other means, or explicitly or implicitly, a possibility of giving unfavorable treatment to customers, for example, by saying that if customers do not use the company or increase the company’s market share in underwriting of securities or other financial transactions, they may be subject to some influence regarding loan activity by its parent/subsidiary bank, etc. in the future.
- (i) Whether the management team recognizes the importance of preventing abuse of the superior bargaining position of the parent/subsidiary bank, etc. and sincerely takes the lead in carrying out preventive measures by such means as cooperating with other financial institutions within the financial group (including holding companies). Additionally, regarding operationally important cases such as those posing the possibility of exerting a material impact on customers, out of cases wherein abuse of superior position is suspected, whether an environment has been developed so that such cases are reported to the management team appropriately on a timely basis and the management team appropriately gets involved in the development of the environment for preventing abuse of superior position.
  - (ii) Whether or not an officer or employee of the sales division of the securities company, etc., in effect, forces customers to sign contracts under which they make financial instruments transactions (hereinafter referred to as “financial instruments transaction contracts”) by implying that he/she will suspend transactions relating to

loans or give unfavorable treatment to them unless they sign the contracts.

- (iii) In cases where customers intend to sign contracts with competitors (other financial instruments business operators, etc.), whether or not an officer or employee tries to prevent the conclusion of said contracts with competitors by implying that he/she will suspend transactions that are available only at the parent/subsidiary bank, etc. where he/she works, or give unfavorable treatment to the customers in connection with such transactions.
- (iv) Whether or not the evaluation of operational performance of officers and employees works to provide an incentive to them to resort to abuse of superior position. Whether or not a parent/subsidiary bank, etc. has the earnings structure that may induce abuse of superior position, such as that loans are often provided with interest rates that are supposed to be possible on the premise that the securities company, etc. concludes financial instruments transaction contracts with the same customers, or profit management in the operations of a parent/subsidiary bank, etc. extremely lacks reasonableness.
- (v) Whether the securities company, etc. has established a division responsible for the implementation of measures to prevent abuse of superior position or appointed a person responsible therefor, and developed an internal control environment for examining whether said division or person is properly implementing the preventive measures.

Additionally, when developing said internal control environment, whether the securities company, etc. evaluates risks of abuse of superior position for each counterparty and transaction form depending on the contents of business and status of transactions with customers of the securities company, etc. and other financial institutions within the financial group, and takes preventive measures as follows, for example, in accordance with the evaluated risks.

- A measure to provide customers with clear explanations that even if they do not accept a solicitation for transactions with the company, this will not exert any influence on their transactions with its parent/subsidiary bank, etc.
- A measure to appropriately create and store records of dialogues with customers to enable examinations ex post facto as to whether there was any abuse of the superior position of the parent/subsidiary bank, etc.

- (vi) Whether the securities company, etc. provides training periodically and as necessary, using persons with knowledge and practical experience in banking business as trainers, in order to prevent abuse of a superior position.
- (vii) Whether the securities company, etc. has established arrangements and procedures for responding to complaints, such as specifying the contact point for customer complaints regarding abuse of a superior position, establishing a division in charge of processing complaints and prescribing procedures for processing complaints.
- (viii) Whether the securities company, etc. has established a sufficient system of checks and balances for the prevention of abuse of superior position by, for example, ensuring independence of the division or the person mentioned in (v) above. Additionally, whether said division appropriately gets involved in or manages examinations as to whether the effectiveness of the preventive measures mentioned in (v) above is being secured, depending on the significance of individual cases.



(ix) Whether the internal audit division is adequately staffed and equipped with regard to the aforementioned points of attention. Whether integrated management on a group-wide basis is conducted, in such a manner as conducting audits cooperatively among the group.

(7) Interpretation of Article 32 of the FIB Cabinet Office Ordinance

(i) "Operations for the execution of financial instruments business, etc., financial instruments intermediary services, or securities, etc. intermediary business" as prescribed in Article 32(i) of the FIB Cabinet Office Ordinance refers to the operations that do not entail governance decisions in relation to financial instruments business, etc., financial instruments intermediary services, or securities, etc. intermediary business, and the following operations fall under that category, for example:

- A. Acquisition, possession, lease, maintenance, security and management operations of real estate and facilities, such as sales offices, etc.
- B. Management operations of maintenance/operation of automatic teller machines (ATMs).
- C. Formulation, organization, storing, issuing and delivery operations of accounts, statements, and slips, etc.
- D. Computer-related operations (system development, electronic processing, maintenance/management, etc.).
- E. Calculation operations (including accounting work such as salary calculation and calculation of monthly settlements, etc.).
- F. Operations related to the management and organization of securities.
- G. Brokerage for name transfer.
- H. Requests for the payment of principal and interest of bonds and investment trusts.
- I. Delivery and settlement of securities among financial instruments exchanges/Financial Instruments Business Operators, etc.
- J. Welfare packages for officers and employees, such as employee counseling and bulk purchase and management of goods and services contributing to clerical work.
- K. Supplementary clerical work, such as formulation of personnel-related documents (including operations related to the dispatch of workers to Financial Instruments Business Operators or financial instruments intermediary service providers).
- L. Operations related to the education/training of officers and employees.
- M. PR and advertisement.
- N. Management operations such as use, maintenance and inspection, etc., of vehicles.
- O. Formulation of documents for statistical purposes.
- P. Providing public information, such as publications.
- Q. Printing, binding, issuing and delivery of documents.

(ii) "Operations for the purpose of conducting the business of any of the following persons exclusively" prescribed in Article 32(ii) of the FIB Cabinet Office Ordinance refers to the operations listed in (i) above (excluding C.) that do not entail governance decisions.

In this case, (i) above shall be applied by replacing D. with "Computer-related operations (management of hardware and software and computerized processing, etc. for system development, electronic processing, and data maintenance/management)," F. with "Operations related to the management and organization of securities (limited to those possessed as the own assets of a parent/subsidiary corporation, etc.)," G. with "Brokerage for name transfer (limited to those possessed as the own assets of a parent/subsidiary corporation, etc.)," and K. with "Supplementary clerical work, such as the formulation of personnel-related documents (including operations related to the dispatch of workers to Financial Instruments Business Operators, etc., financial instruments intermediary service providers, etc., or a parent/subsidiary corporation, etc.)."

(iii) The operations listed in (i) C. above (excluding issuing and delivery services), data storage and management in (i) D., and those from (i) F. to (i) I. are closely related for the purpose of implementing the operations of said financial instruments business, etc., financial instruments intermediary services, securities, etc. intermediary business operations, and the banking business, etc. Therefore, it should be noted that said operations shall not, in principle, be outsourced to any enterprise other than a parent/subsidiary corporation, etc. of said Financial Instruments Business Operator, etc. or financial instruments intermediary service provider, etc., or any company prescribed in Article 32(i) and (ii) of the FIB Cabinet Office Ordinance, and that the process of implementation of said operations is to be monitored in a timely manner.

In the cases where a Financial Instruments Business Operator (limited to those engaged in Type I Financial Instruments Business or Investment Management Business) is entrusted with the operations listed in (ii) above, it should be noted that the operations listed in (i) A., B., E., and J. through Q. above need to be approved as the other operations prescribed in Article 35(4) of the FIEA.

(iv) It should be noted that the Financial Instruments Business Operator, etc. or financial business intermediary service provider, etc. is not exempt from the responsibility to clients for the operations listed in (i) and (ii) above nor the administrative responsibilities even if they outsource said operations.

#### (8) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the exchange of non-disclosure information between securities companies, etc. and their parent/subsidiary corporations, etc. or abuse of the superior bargaining position of the parent/subsidiary banks, etc. by securities companies, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities companies, etc. by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the securities company, etc. is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities company, etc. is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

With regard to abuse of the superior bargaining position of the parent/subsidiary banks, etc. by securities companies, etc., supervisors shall analyze external information, including financial services users' opinions gathered through various channels, such as information collected at the information gathering contact for prevention to abuse

of advantageous position and results of the hearings of borrowers' opinions conducted by supervisory departments of the parent/subsidiary banks, etc., as well as media reports and external inquiries, and shall intensively conduct monitoring. Parent/subsidiary banks, etc. are also prohibited from imposing disadvantages on customers in deciding terms of transactions or conducting transactions by abusing their superior bargaining position under Article 14-11-3(iii) of the Regulation for Enforcement of the Banking Act and this has the same effect as Article 153(1)(x) of the FIB Cabinet Office Ordinance. Accordingly, it is necessary to conduct inspections and supervision from the same viewpoint and it should be noted that the supervisors need to sufficiently cooperate with supervisory departments of the parent/subsidiary banks, etc. and the Securities and Exchange Surveillance Commission. Furthermore, in light of the prohibition of the abuse of superior position prescribed in the Antimonopoly Act, the supervisors shall exchange opinions regarding viewpoints and means for inspections and supervision periodically with the Fair Trade Commission.

#### IV-3-1-5 Measures to Prevent Misrecognition

##### (1) Points of Attention Regarding Measures to Prevent Securities Companies, etc., from Being Misrecognized as Other Financial Institutions

Supervisors shall pay attention to the following points from the viewpoint of preventing customers from misrecognizing securities company, etc., as other financial institution.

- (i) In cases where the securities company, etc. conducts business operations, with its headquarters or sales branches located in a building also occupied by another financial institution, whether the securities company, etc. provides sufficient explanations regarding the following matters to customers:
  - A. The securities company, etc. and the financial institution sharing the building or its parent/subsidiary corporations, etc. are different corporations.
  - B. Products and services provided by the securities company, etc. are different from those provided by the said financial institution or its parent/subsidiary corporations, etc.
- (ii) In cases where an employee of the sales division of the securities company, etc. concurrently holds office at the sales division of its parent/subsidiary corporation, etc., whether the following measures have been taken appropriately:
  - A. The contents of the products or services handled by the employee at each branch where he/she works, and the name of the corporation that is the provider of such products or services, should be posted at the said branches, so that customers visiting the branches can easily understand these matters.
  - B. The employee should clearly show the customers the scope of the parent/subsidiary corporations, etc. where he/she concurrently holds office. In particular, if the employee is engaged in receiving an unspecified number of customers, such as in counter operations, it is recommended that information such as the scope of the major products or services that the employee deals with and the status of his/her holding of multiple offices should always be clearly shown to customers, by posting it at the counter at all times.
  - C. In particular, when the employee solicits new customers or solicits existing customers for new products

or services, he/she should give sufficient explanations on the status of his/her holding of multiple offices and the scope of the products and services that he/she deals with.

- D. When concluding contracts with customers, the employee should secure the opportunity for the customers to properly recognize the name of the corporation with which they are to conclude the contracts, for example by making confirmation in writing.

## (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding misrecognition prevention measures taken by a securities company, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities company, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the securities company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52 (1) of the FIEA.

## IV-3-1-6 Business Continuity Management (BCM)

### (1) Significance and Response

As securities companies, etc., play an important role as intermediaries in the financial instruments market, it is extremely important for the people's lives and the economy that they act in an appropriate manner in the event of an emergency, by, for example, taking recovery measures quickly and ensuring that the minimum necessary operations and services are maintained. Therefore, securities companies, etc., need to make appropriate preparations in normal times, such as establishing business continuity management (BCM) systems and creating crisis management manuals. From this viewpoint, supervisors shall examine the appropriateness of the BCMs of securities companies, etc., in light of the characteristics of their business, by paying attention to the following points, for example.

### (2) Major Supervisory Viewpoints

Whether the business continuity plan (BCP) ensures quick recovery from damage caused by acts of terrorism, large-scale disasters, etc., as well as continuance of the minimum necessary business operations and services for the maintenance of the functions of the financial system. Whether arrangements and procedures are in place for ensuring response coordinated with Financial Instruments Firms' Associations, other securities companies, etc., and relevant organizations based on the results of deliberations conducted at the Securities Market BCP Forum and other forums. Whether the BCP enables the securities company, etc, to deal with international disruptions of business operations in a manner suited to the actual state of its own business operations.

For example, attention shall be paid to:

- (i) Whether measures to secure the safety of customer data in the event of disasters, etc., have been taken (storing information printed on paper in electronic media, creating back-ups of electronic data files and programs, etc.).
- (ii) Whether measures to secure the safety of computer system centers, etc., have been taken (allocating suitable back-up centers, securing staff and communication lines, etc.).
- (iii) Whether the above back-up measures have been taken in ways to avoid geographic concentration.
- (iv) Whether a specific target period has been set for the recovery of operations vital for the maintenance of the lives of customers, economic activities and the functions of the financial instruments markets (e.g., cash withdrawals by customers, cancellation of MRFs and MMFs, sell orders for stocks in custody, orders for the settlement of margin transactions and futures and options transactions and the settlement of executed transactions for which delivery has not been made) through provisional measures such as manual operations and processing by back-up centers.
- (v) Whether the securities company, etc., obtains the approval of the board of directors when it adopts the BCM and makes important revisions. Whether the BCM is subjected to examination by independent entities, such as internal and external audits.

(Reference)

“Development of BCM at Financial Institutions” (BOJ, July 2003)

“Basic Principles on Business Continuity” (Joint Forum, August 2006)

In addition, examination of the BCM and BCP shall basically be conducted in reference to III-2-9.

### (3) Points of Attention Regarding BCPs Utilizing Overseas Offices

In cases where securities companies, etc. plan to develop their BCPs embedding a program that they operate financial business operations from overseas when it becomes difficult to maintain business continuity in Japan due to such reasons as a large scale disaster, attention shall be paid to the following points, in addition to the points set forth in (2) above.

- (i) Whether the following points are specified in a BCP: a description /nature of crises for which business operations from overseas are supposed, the scope and scale of supposed business operations, and its place and period.

In particular, in cases where front line of business (e.g. sales business, trading business) will operate from overseas, whether compliance with Article 58-2 and Article 64, etc. of the FIEA is ensured.

- (ii) Whether the scope and scale of business operations to be conducted from overseas and the period therefor are limited to the extent necessary in accordance with each crisis, and are specified taking into account the seriousness of each crisis and their impact on business operations.

Additionally, in cases where a part of the internal control and back office business operations are entrusted to the overseas offices of the company's group in normal times, whether the impact on the Japanese business operations is examined.

- (iii) In cases where the accessibility to customer information stored in Japan from overseas is described in a BCP, whether the control governance in the securities companies is ensured robust enough to comply with the

Personal Information Protection Act and other laws and regulations, in such ways as limiting the officers granted access rights and the scope of accessible customer information to the minimum necessary.

- (iv) Whether a control environment is ensured for verification/monitoring governance/procedures by the internal control division to examine whether financial institution violates any Japanese law or regulation or cause a problem from the perspective of public interest or investor protections during the period of executing BCP plan. In addition, whether the locus of responsibility is clarified in the event that any such act/behaviors was committed from overseas.
- (v) Whether reporting/communication systems/governance to the FSA and relevant bodies are developed appropriately for all business operations to be conducted from overseas.

(Note) In cases where securities companies, etc. conduct business operations of their group's overseas offices in accordance with their BCPs, it shall be noted that it is necessary to comply with local and Japanese laws and regulations.

#### IV-3-1-7 Measures Regarding Financial Services Support in Event of Disasters

##### (1) Financial Services Support Measures for Disaster-Stricken Areas

The FSA disaster prevention/mitigation plan based on Article 36(1) of the Disaster Countermeasures Basic Act and the FSA plan for the protection of the people based on Article 33(1) and Article 182(2) of the Act on the Protection of the People in Event of Armed Attacks (hereinafter referred to as the “People Protection Act”) provides for measures regarding financial services support in the event of disasters and other emergencies. In light of this, when a disaster (including a disaster as specified under Article 2(i) of the Disaster Countermeasures Basic Act, an armed attack specified under Article 2(4) of the People Protection Act and an emergency as specified under Article 183 of the People Protection Act) has occurred or may occur, supervisors shall, while maintaining close contact with relevant organizations, ensure that securities companies, etc., quickly implement the following measures in an appropriate manner within limits deemed necessary, in light of the extent of damage and other circumstances of the affected areas and the demand for funds in such areas.

- (i) To provide as much convenience as possible for customers who have lost registered seals.
- (ii) To support the re-issuance of lost securities.
- (iii) To provide as much convenience as possible for disaster victims who have requested the immediate payment against the sale and cancellation of securities in custody.
- (iv) In cases where a securities company, etc., has suspended over-the-counter services, to ensure that all customers know at which branches the said operations have been suspended through means such as notices indicated at branches, newspaper advertisement and notices posted on the Internet.
- (v) To take due care in dealing with customers regarding other matters.

##### (2) Various Financial Services Support Measures in Areas subject to prior evacuation for Nankai Trough Earthquake

Based on the Basic Plan for Promotion of Disaster Prevention Measures for the Nankai Trough Earthquake, the Government Guidance Policy, etc. shall be established for measures about Refund of deposits and savings and

Actions to be taken by Normal closed hours sales, etc. financial institutions when Contents of Nankai Trough Earthquake Temporary Information (Major Earthquake Warning) and other related information (hereinafter referred to as "Major Earthquake Warning") being published.

However, it is difficult to manage administrative processes related to financial instruments business on an area-by-area basis, given the advanced automation and the expansion of networks of unmanned services operations, therefore, regarding the possible Nankai Trough Earthquake, supervisors shall ensure that securities companies, etc., take the following measures in an appropriate manner in light of the fund demand in the affected areas, while maintaining close contact with relevant organizations.

(i) Response to Nankai Trough Earthquake by Securities Companies, etc., with Sales Branches and Business Offices in Areas subject to prior evacuation Prevention/Mitigation Measures Regarding Nankai Trough Earthquake

- A. In cases where Major Earthquake Warning being published during business hours, supervisors shall request the securities companies, etc., to suspend over-the-counter services and shall request to make traders fully aware that it has taken measures to suspend business.
- B. Supervisors shall request the securities companies, etc., to ensure that all customers know at which branches services have been suspended, through means such as notices indicated at branches, newspaper advertisements and notices posted on the Internet.
- C. In cases where Major Earthquake Warning being published on a holiday or before or after the business hours of sales branches, supervisors shall request the securities companies, etc., to refrain from resuming over-the-counter services so as to enable the smooth implementation of anti-disaster measures, in case the earthquake actually occurs.
- D. Others
  - a. In cases where Measures for Evacuation Orders in Preparation for a Major Earthquake is removed, supervisors shall request securities companies, etc., to resume normal operations and services as soon as possible.
  - b. Supervisors shall request the securities companies, etc., to take appropriate emergency measures based on IV-3-1-7 if the earthquake actually occurs.

(ii) Response to Major Earthquake Warning by Securities Companies, etc., with Sales Branches and Business Offices Outside of Areas subject to prior evacuation

Even if securities companies, etc., have suspended business operations and services at sales branches and business offices in Areas subject to prior evacuation, supervisors shall request them to conduct business and provide services as usual at sales branches and offices in other areas.

(3) Administrative Report

In cases where the above measures have been taken, supervisors shall immediately report them to the Director-General of the Supervisory Bureau.

#### IV-3-2 Appropriate Exercise of Market Intermediary Function of Securities Companies, etc.

The central role of securities companies, etc., in the financial instruments market is to exercise their market intermediary function, which has a highly public nature. In addition, securities companies, etc., participate in the financial instruments market as market players.

While institutional reforms implemented since the financial “Big Bang” have brought about benefits, a series of incidents involving problematic conduct occurred, including placement of large-scale erroneous orders in the financial instruments market, system troubles at securities companies, etc., insider trading cases, illegal transactions by investors, such as those aimed at market manipulation, and inappropriate practices by issuer companies, such as including false representations in financial statements. In light of this situation, a study group on securities companies’ market intermediary function was established under the FSA’s Supervisory Bureau in March 2006, and this group adopted and announced a summary of issues in June of the same year.

The summary included recommendations regarding four issues, namely (1) improvement in the reliability of the operations of securities companies as market intermediaries, (2) securities companies’ exercise of the function of acting as a check against issuers, (3) securities companies’ exercise of the function of acting as a check against investors and (4) maintenance of the self-discipline of securities companies as market players. Basically, these recommendations should be used as a basis for voluntary rules formulated by self-regulatory organizations, such as the Japan Securities Dealers Association. However, it is also important from the viewpoint of improving the reliability of the financial instruments market through an appropriate exercise of the market intermediary function of securities companies, etc., that the supervisory authorities take necessary actions based on the following viewpoints and with the following supervisory methods, while giving consideration to voluntary rules.

##### IV-3-2-1 Improvement of Reliability of Operations of Securities Companies, etc., as Market Intermediaries

###### (1) Points of Attention Regarding Order Management

- (i) Whether the securities company, etc., has developed appropriate internal rules based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Rules Regarding Development of Order Management Systems at Members,” and strives to ensure that all officers and employees are aware of and comply with them.
- (ii) Whether the securities company, etc., has implemented sufficient measures regarding computer systems to prevent the placement of erroneous orders, such as incorporating the settings of order limits regarding trading orders, including both hard limits and soft limits, into its systems.
- (iii) Whether the securities company, etc., has enhanced the order management system and maintained its functions, for example through periodic inspections, and through an appropriate allocation of personnel, including the appointment of a chief information officer (CIO), who is in charge of supervising the trading system.
- (iv) Whether the securities company, etc., has arrangements and procedures for ensuring an appropriate involvement of the relevant manager in the limitation of orders and the removal of alerts against inappropriate orders. In particular, whether appropriate handling of the said matters is ensured in the wholesale division.



- (v) Whether the securities company, etc., has developed an emergency response policy for dealing with large-scale erroneous orders and strives to ensure that all officers and employees are aware of and comply with them.
- (vi) Whether the securities company, etc., has developed a control environment that ensures the implementation of appropriate measures to prevent failure to meet the settlement deadlines in the event of an erroneous order.

## (2) Points of Attention Regarding Assessment Rates for Substitute Securities Used in Margin Trading

Whether the securities company, etc., in accordance with the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Rules Regarding Treatment of Changes in Assessment Rates for Cash Margin Deposit Substitute Securities Related to Margin Trading,” implements appropriate measures such as the provision of prior explanations regarding incidents which may lead to changes in the assessment rates, so as to ensure that all customers are aware of the changes, the notification of changes, the setting of the notification periods and the establishment of relevant internal rules.

## (3) Points of Attention Regarding Computer System Management by Securities Companies, etc.

Cases where the facts that fit the following descriptions are recognized with regard to computer system management by securities companies, etc., shall be deemed to fall under the category of “situations in which computer system management is not adequate” as specified under Article 123(1)(xiv) of the FIB Cabinet Office Ordinance. Supervisors shall also refer to supervisory viewpoints under Section III-2-1-2 of the “Guidelines for Supervision of High Speed Traders” for securities companies, etc. engaged in high-frequency trading as part of their financial instruments business.

- (i) Cases in which the securities company, etc., does not periodically conduct appropriate checks on its computer systems, such as system audits by computer system experts.
- (ii) Cases in which the securities company, etc., has failed to take sufficient measures regarding computer systems to prevent the placement of erroneous orders, such as incorporating the settings of order limits regarding trading orders, including both hard limits and soft limits, into their systems.
- (iii) Cases in which the securities company, etc., is deemed to have failed to develop an appropriate control environment in light of the viewpoints specified in III-2-8.

## IV-3-2-2 Exercise of Checking Function against Issuers

### (1) Points of Attention Regarding Screening Related to Underwriting

- (i) Whether the securities company, etc., has established appropriate rules regarding the screening of matters used for judgment as to the appropriateness of underwriting, such as the financial condition and business performance of issuers based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Underwriting, etc. of Securities,” and whether it conducts effective screening in an appropriate manner. Whether it has established arrangements and procedures for ensuring the

verification of the screening results.

- (ii) Whether the securities company, etc., relies on the screening conducted by other securities companies, etc., that act as joint lead underwriters and neglects to conduct its own screening.
- (iii) Whether the securities company, etc., has established arrangements and procedures for appropriately conducting screening, such as ensuring the independence of the screening division from the sales divisions, in terms of both function and effect.
- (iv) Whether the securities company, etc., has the function of examining and evaluating possible conflicts of interest between the underwriting division and other divisions. Whether it has developed a control environment for properly preventing conflicts of interest through the exercise of the said function.
- (v) Whether the securities company, etc., has established appropriate rules, regarding the calculation of prices based on laws and regulations as well as the self-regulatory regulations, in order to prevent underwriting under terms, such as volume and price, deemed to be markedly inappropriate. Furthermore, whether it has developed a control environment that ensures an appropriate determination of underwriting terms.

(2) Points of Attention Regarding Underwriting of Share Certificates, etc. Issued by Parent/Subsidiary Corporations, etc.

In cases where a securities company, etc. acts as a lead underwriter of share certificates, etc. issued by its parent/subsidiary corporations, etc. under Article 153(1)(iv)(c) of the FIB Cabinet Office Ordinance, whether the following measures have been taken to ensure that other securities companies, etc. can appropriately participate in the process of determining the issue price for such underwriting.

- (i) The following points are clearly prescribed in the written contract of screening for underwriting to be exchanged between the securities company, etc. (the lead underwriter) and the issuer:
    - A. Other securities companies, etc. participating in the determination of the issue price (hereinafter referred to as “independent underwriters” in (2)) have an authority equal to that of the lead underwriter.
    - B. Independent underwriters can express their opinions on the validity of the content of the screening for underwriting to the issuer or external parties.
  - (ii) Independent underwriters are selected from among the securities companies, etc. that have sufficient experience in underwriting services and satisfy the following requirements:
    - A. Having engaged in underwriting services for five years or more.
    - B. Having acted as lead underwriters within the past two years. In the case of share certificates, warrants or bonds with share options, it is recommended that the securities companies, etc. have experience in acting as lead underwriters for share certificates, warrants or bonds with share options issued by business operators in the same line of business as the issuer of the relevant share certificates, warrants or bonds with share options. Furthermore, in the case of corporate bonds it is recommended that the securities companies, etc. have experience in acting as lead underwriters for corporate bonds issued by business operators in the same line of business as the issuer of the relevant corporate bonds.
- (Note) The line of business of issuers may be classified based on, for example, the Major Categorization created and publicized by the Securities Identification Code Committee.

### (3) Points of Attention Regarding Underwriting and Purchases of Privately Placed CBs

While capital increases through third-party allotment and private placement of convertible bonds (CBs) (including moving-strike CBs (MSCBs)) are seen as effective fund-raising means for corporate rehabilitation and other measures, they involve the risk that the interests of existing shareholders may be undermined through the dilution of the value of their shareholdings, depending on the issuance terms and the usage method. In light of this risk, supervisors shall pay attention to whether securities companies, etc., handling such deals (i) properly design products with due consideration of possible effects on existing shareholders, (ii) provide issuers (senior managers of issuers) with sufficient product explanations suited to their level of understanding and (iii) ensure that issuers make appropriate information disclosure.

### (4) Points of Attention Regarding Issuers Affiliated with Anti-Social Forces

From the viewpoint of preventing the listing of stocks issued by antisocial forces or by companies affiliated therewith, it is desirable that securities companies, etc., make sure to properly identify attempts to list such stocks in their screening for underwriting, through cooperation with relevant authorities, the Japan Securities Dealers Association and other organizations. and that they refuse to underwrite such stocks in some cases.

## IV-3-2-3 Exercise of Checking Function against Investors

### (1) Points of Attention Regarding Trading Management System for Prevention of Illegal Trading

Securities companies, etc., need to exercise the function of acting as a check against investors by preventing the trading of securities on behalf of customers, while understanding that such trading could constitute an illegal activity, such as market manipulation and insider trading. Therefore, in examining the management of trading by securities companies, etc., conducted to prevent illegal trading by customers, supervisors shall pay attention to the following points with due consideration of the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Rules Regarding Development of Trading Management System for Prevention of Illegal Trading.” (Careful attention shall be paid to Internet transactions, in particular, in light of the absence of face-to-face contact therein.)

#### (i) Precise Identification of Customers’ Trading Patterns and Thorough Management

- A. Whether the securities company, etc., has established specific procedures for identifying customers’ trading patterns as represented by features such as the types of products they trade and the method and characteristics of their trading, and precisely identifies their trading motives by monitoring its trading activity as necessary in accordance with the procedures.
- B. Whether the internal control division makes sure that all officers and employees are aware of and follow the above procedures, and ensures the effectiveness thereof by revising them as necessary, for example.
- C. From the viewpoint of ensuring the preciseness of insider registration, whether the securities company, etc., based on the “Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members,” the self-regulatory rules of the Japan Securities Dealers Association, strives to improve the contents of insider registration cards by requesting customers who conduct buy and sell

transaction, etc. related to specified securities, etc. of listed companies, etc. stipulated in Article 166 of the Financial Instruments and Exchange Act for the first time to notify whether or not they fall under officers, etc. of listed companies, etc. and prepare an insider registration card for those who do before they carry out the buy and sell transaction, etc. related to specified securities, etc. of listed companies, etc., as well as updating the contents of the insider registration card without delay when a customer notifies change, checking the name, date of birth and address of customers on a regular basis against J-IRISS (Insider Registration & Identification Support System of the Japan Securities Dealers Association) and checking against other information concerning officers, etc. of listed companies, etc. as necessary.

- D. From the viewpoint of preventing illegal practices such as market manipulation and insider trading, whether the securities company, etc., strives to identify the original customers and the end-investors, with regard to transactions with investment business associations and orders placed from abroad.
- E. In cases where the securities company, etc., has recognized the possibility of customers using accounts opened under fictitious names, whether they investigate the true identity of the customers and monitor transactions involving the said accounts with special care.

(ii) Establishment of Trading Screening Criteria and Efficient Utilization Thereof

- A. Whether the securities company, etc., has established the criteria for selecting individual issues for screening, in light of factors such as the advancers-to-losers ratio, the own market involvement ratio and the trading status of specified customers, in order to ensure the fairness of customers' transactions and make appropriate selection based on the said criteria.
- B. Whether the securities company, etc., conducts appropriate trading management regarding selected issues by, for example, establishing specific screening criteria and taking measures necessary (e.g., inquiries with customers, issuing alerts and suspending trading) for preventing illegal trading practices, such as market manipulation.
- C. Whether the internal control division has developed a control environment for examining the consistency of the selection and screening criteria and the implemented measures with the actual status in a timely manner, and is ensuring the effectiveness of the measures and criteria by making revisions as necessary, for example.

(iii) Others

- A. Whether the securities company, etc., ensures that all customers are aware of the purpose of restrictions on short-selling by, for example, reminding them that new sell orders for margin trading deemed to have been repeatedly placed by a customer in a short period of time for the purpose of exceeding price limits do not fall under the category of transactions specified by Article 15 (1)(ii) of the cabinet office ordinance regarding regulations on securities transactions.
- B. Whether the securities company, etc., conducts appropriate trading management by taking appropriate measures, such as checking the contents of orders in a timely manner, making inquiries to customers, issuing alerts and suspending trading as necessary, in order to avoid taking orders intended to exceed price limits.

- C. Whether the securities company, etc., makes sure to immediately report suspected cases of insider trading to the supervisory authorities based on Article 9 of the Anti-Criminal Proceeds Act.

(2) Points of Attention Regarding Pre-Hearing

In cases where a securities company, etc., holds pre-hearings or entrusts third-party entities to do so, whether it makes sure to either implement or entrust third-party entities with the implementation of (i) approval by the legal compliance division, (ii) signing of an agreement with the surveyed entity to not provide information regarding transactions related to the relevant securities and the relevant corporation and (iii) compilation and storage of written records based on the FIB Cabinet Office Ordinance and the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Rules Regarding Appropriate Treatment of Pre-Hearings by Members.”

(3) Points of Attention Regarding Investors Affiliated with Anti-Social Forces

It is desirable that securities companies, etc., conduct sufficient trading management and screening with regard to investors who may be affiliated with antisocial forces, in cooperation with relevant authorities, the Japan Securities Dealers Association and other organizations.

(4) Points of Attention regarding High Speed Traders

When examining as to Article 38(viii) of the FIEA and Article 116-4 of the FIB Cabinet Office Ordinance, supervisors shall check whether securities companies, etc. perform the following.

- (i) Whether securities companies, etc., prior to starting business with and receive trade orders from investors who intend to execute trades considered High Speed Trading (HST), confirm with the investors that they are not non-authorized High Speed Traders under Article 38(viii) of the FIEA, nor High Speed Traders specified under Article 116-4(i) and (ii) of the FIB Cabinet Office Ordinance (hereinafter referred to as “non-registered entities, etc.” in this paragraph (4)); noting that the cases described below are deemed equivalent to the status defined under Article 116-4(ii) “High Speed Traders who are not confirmed to have taken appropriate measures to adequately manage electronic information processing systems or other systems for HST.”
  - A. When starting to transact with a High Speed Trader, it cannot be verified via documents, etc. that the trader has taken measures to adequately manage trading systems as required for properly managing HST business operations.
  - B. After starting to transact with a High Speed Trader, the trader cannot provide appropriate report and explanation via documents, etc. upon failure/error of trading system.
- (ii) Whether measures are in place by securities companies, etc. to stop taking orders from any High Speed Traders in the case where they become non-registered entities, etc. after starting to take HST-related orders, etc. (e.g., insertion of a clause in contracts that requires notification by High Speed Traders immediately when they become non-registered entities, etc.)

IV-3-2-4 Maintenance of Self-Discipline of Securities Companies, etc., as Market Players

Against the background of the increasing diversity and complexity of the business operations of securities

companies, etc., as market players, such as principal investments, M&A advisory services, proposals for fundraising through complex schemes and trading of securitization products, the number of incidents involving potential conflicts of interest and ethical problems related to their business operations is increasing.

In light of this situation, supervisors shall pay attention to the following points when examining the maintenance of the self-discipline of securities companies, etc., as market players.

- (i) Whether the securities company, etc., has formulated internal policies and rules and established an appropriate internal control environment (including a control environment for internal audits) from the viewpoint of preventing conflicts of interest and ensuring compliance with a code of ethics. Whether they have developed an appropriate control environment for legal compliance by ensuring all officers and employees are aware of and comply with those policies and rules through the provision of training, for example.
- (ii) Whether the securities company, etc., has identified transactions with a high risk of conflicts of interest.
- (iii) Whether the securities company, etc., has established an appropriate control environment for prior screening (for judging whether or not to allow the screened transactions to be made) by a division independent from the sales division, as necessary, from the viewpoint of preventing conflicts of interest.
- (iv) Whether the securities company, etc., provides appropriate explanations and makes appropriate disclosure to customers and investors, as necessary, with regard to the status of conflicts of interest.

(Reference) Examples of (Potential) Cases of Conflicts of Interest

- Cases where a securities company, etc., purchases stocks offered for sale through erroneous orders while knowing the orders are erroneous.
- Cases where a securities company, etc., (or companies belonging to the same groups therewith) acts as the lead manager of initial public offerings of stocks in unlisted companies in which it has made investment and where it sell the stocks after the IPO.
- Cases where a securities company, etc., (or companies belonging to the same groups therewith) originates securitization products based on assets it has acquired as a result of principal investments and sells the products to investors without providing sufficient explanations (transfer of risk).
- Cases in which a securities company, etc., proposes or considers securitization schemes aimed at accounting manipulation and tax evasion, through the use of special-purpose companies, for example.

#### IV-3-2-5 Supervisory Method and Actions

With due consideration of the above viewpoints, supervisors shall encourage an appropriate exercise of the market intermediary function of securities companies, etc., in cooperation with relevant organizations, including Financial Instruments Firms' Associations. In addition, they shall identify and keep track of the status of voluntary improvement made by securities companies, etc., when it is deemed necessary to do so from the viewpoint of protecting public interests and investors, by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When a securities company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When a securities company

is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52 (1) of the FIEA.

#### IV-3-3 Appropriateness of Business Operations Related to Over-the-Counter Derivatives Transactions

##### IV-3-3-1 Control Environment for Legal Compliance

If over-the-counter derivatives business operators (Type 1 Financial Instruments Business Operators engaging in the business specified under Article 2(8)(iv) of the FIEA; the same shall apply hereinafter) are to gain the trust of investors, it is important that they strive to manage their business operations in an appropriate manner, while strictly complying with laws, regulations and various business rules, and fully recognizing their roles as undertakers of over-the-counter derivatives business.

Basically, supervisors shall examine an over-the-counter derivative business operator's control environment for legal compliance, based on the viewpoints and the supervisory method specified in III-2-1. However, they shall also examine it in relation to a broad range of matters, including the status of compliance with voluntary rules set by self-regulatory organizations.

##### (1) Points of Attention Regarding Segregated Management of Currency-Related Over-The-Counter Derivatives Business Operators

In cases where the over-the-counter derivatives business operator manages cash margins or other deposits pertaining to currency-related over-the-counter derivative transactions and so forth (activities specified in Article 143(3)(ii) of the FIB Cabinet Office Ordinance; the same shall apply hereafter), it shall perform supervision, focusing on the following points:

- (i) Whether the over-the-counter derivatives business operator has clearly separated the management of trusts prescribed in Article 143(1)(i) of the FIB Cabinet Office Ordinance (trust for the segregated management of cash margin and other deposits) with the management of trusts prescribed in Article 141(1) of the FIB Cabinet Office Ordinance (trusts for the separate management of money and securities);
- (ii) Whether the over-the-counter derivatives business operator has properly calculated the individual amounts for separate management (amounts of the money or security deposits deposited by each customer) and the required amount for separate management (total of the individual amounts for separate management) prescribed in Article 143-2(1)(vi) of the FIB Cabinet Office Ordinance; and whether, in calculating the required amount for separate management, the over-the-counter derivatives business operator has added or subtracted the amounts listed in the following items A through C to or from the money or security deposits deposited by the customer:
  - A. Realized gains and losses
  - B. Valuation gains and losses
  - C. Swap gains and losses;
- (iii) Whether the decision in Article 143-2(1)(vi) of the FIB Cabinet Office Ordinance, on whether the appraised value of the principal of the trust assets will be less than the required amount for separate

management, has been made using as a reference day the day, in Japanese time, on which the point in time that serves as the basis for calculating the required amount for separate management falls. For instance, for transactions from seven o'clock in the morning, Japanese time, on a specified date to seven o'clock in the morning on the following day (hereinafter referred to as the "date of calculation" in IV-3-3-1), in cases where the over-the-counter derivatives business operator calculates the required amount for separate management using seven o'clock in the morning on the date of calculation as the base point in time, whether it adds the shortfall within two business days from the day following the date of calculation;

- (iv) In cases where a letter of guarantee or the like (hereinafter referred to as "LG") is provided to a counterparty to a cover transaction by a financial institution, etc., which is the trustee of a trust for the segregated management of cash margin and other deposits, whether the trust assets always exceed the required amount for separate management, even in cases where payment based on the LG has been made. Furthermore, in cases where a trust for the segregated management of cash margin and other deposits is terminated such as by way of a petition for commencement of bankruptcy proceedings, rehabilitation proceedings or reorganization proceedings, whether the terms of the contract give preference to the repayment of money or security deposits to the customer over the payment to the counterparties to the cover transaction; and
- (v) Whether the over-the-counter derivatives business operator properly manages segregated management such as, for instance, by periodically undergoing an external audit or an internal audit by an independent division.

## (2) Points of Attention Regarding the Segregated Management by Securities-Related Over-The-Counter Derivatives Business Operators

IV-3-3-1 shall be applied mutatis mutandis to the points of attention for when an over-the-counter derivatives business operator manages cash margin and other deposits pertaining to securities-related over-the-counter derivative transactions (refers to transactions specified in Article 117(1)(xxix) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter). In addition, it should be kept in mind that, when calculating the required amount in IV-3-3-1(1)(ii), the interest adjustment and dividend adjustment should be added or subtracted.

## (3) Points of Attention Regarding Segregated Management by Business Operators Handling Crypto-Assets, etc.-Related Over-The-Counter Derivatives Transactions, etc.

IV-3-3-1(1) shall be applied mutatis mutandis to the points of attention for when an over-the-counter derivatives business operator manages cash margin and other deposits pertaining to crypto-assets, etc.-related over-the-counter derivative transactions, etc. (refers to acts specified in Article 143(4)(ii) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter). In addition, it should be kept in mind that, when crypto-and other assets are used as substitute (hereinafter referred to as "substitute crypto-and other assets") for the whole or part of a customer margin or any other security deposit, the crypto-and other assets should be valued at market prices and their collateral value should be appropriately calculated on a daily basis in accordance with the rules of a Financial Instruments Firms Association.

(Note 1) Even a person that conducts crypto-assets, etc.-related over-the-counter derivatives transactions



(meaning the transactions prescribed in Article 123 (1)(xxxv) of the FIB Cabinet Office Ordinance) on a regular basis with a person that conducts such transactions on a regular basis as the counterparty is required to obtain registration for engaging in Type I Financial Instruments Business, in principle. Indeed, it should be kept in mind that the registration is not required in the case where a person that engages in crypto-and other assets-related over-the-counter derivatives business in a foreign country in accordance with laws and regulations of the foreign country conducts crypto-and other assets-related over-the-counter derivatives transactions from the foreign country and where that person engages in cover transactions with a Financial Instruments Business Operator that conducts crypto-and other assets-related over-the-counter derivatives transactions on a regular basis.

(Note 2) It should be kept in mind that, in the case where crypto-assets are used as a substitute for the whole or part of a customer margin or any other security deposit, an act of receiving deposit of the crypto-assets from the customer could constitute the "management of crypto-assets on behalf of others" prescribed in Article 2(15)(iv) of the Payment Services Act and could require the registration to provide crypto-assets exchange service.

#### (4) Supervisory Method and Actions

- (i) In order to check the appropriateness of the management of cash margin and other deposits pertaining to currency-related over-the-counter derivatives transactions, etc., securities-related over-the-counter derivatives transactions, and crypto-assets, etc.-related over-the-counter derivatives transactions, etc. that are intended for individuals, supervisors shall require over-the-counter derivatives business operators to submit, in principle, once a week, prima facie evidence of the balance of trusts, such as certificates of deposit balance issued by trust banks, as well as a written document in which the required amount for management has been calculated for the corresponding date of calculation, and other materials with which the status of management of security deposits can be confirmed.
- (ii) In order to check the appropriateness of the management of cash margin and other deposits pertaining to currency-related over-the-counter derivatives transactions, etc., securities-related over-the-counter derivatives transactions, and crypto-assets, etc.-related over-the-counter derivatives transactions, etc. that are intended for individuals, supervisors shall require over-the-counter derivatives business operators to submit, periodically or as necessary, reports on external audits or internal audits.
- (iii) When supervisors have, through daily supervisory processes, recognized an issue regarding an over-the-counter derivatives business operator's control environment for legal compliance, they shall identify and keep track of the status of voluntary improvement made by the over-the-counter derivatives business operator by holding in-depth hearings, and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the over-the-counter derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

#### IV-3-3-2 Control Environment for Customer Solicitation and Explanations

##### (1) Points of Attention Regarding Advertisements, etc.

- (i) In cases where losses exceeding the amount of cash margin and other deposits may arise due to rapid market movements, despite a contract provision for making automatic settlements through reversing trades in the event of the loss exceeding a prescribed ratio (hereinafter referred to as the “Loss-Cutting Rule”), whether the over-the-counter derivative business operator properly indicates this risk in the advertisement.
- (ii) Whether the over-the-counter derivative business operator has forced customers to continue attending seminars and similar events despite their expression of unwillingness to do so (including cases where it has effectively forced them to do so). It should be kept in mind that this kind of practice shall be deemed to meet the provision of Article 38(vi) of the FIEA (known as “prohibition of re-solicitation”).

##### (2) Points of Attention Regarding Over-the-Counter Derivative Business Operators’ Responsibility for Explanation

“The Key Points of the Status of Internal Control” in the Explanation Documents, as specified under Article 46-4 of the FIEA, shall describe specific arrangements and procedures for handling complaints and inquiries from customers and for conducting internal audits.

##### (3) Points of Attention Regarding the Distribution of Notices of Warning Concerning the Solicitation Methods, etc. for Over-the-Counter Derivative Transactions

When conducting over-the-counter derivative transactions, whether, based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members” and on the Financial Futures Association of Japan’s “Regulations on Financial Futures Trading,” and other rules of Financial Instruments Firms Associations, the over-the-counter derivatives business operator alerts customers appropriately by distributing clear and concise documents (Notice of Warning) which specify in large print and in an easily understandable manner: (i) the relationship with the application of the regulations on uninvited solicitations; (ii) an alert to the associated risks; and (iii) the contact details of the designated ADR body in the event of a problem arising, etc. and by giving explanations suited to the customer attributes. Whether there is a control environment in place in which the implementation status of this can be appropriately identified.

- (Note) Even in cases where a Financial Instruments Business Operator sells complex structured bonds and investment trusts that are similar to market derivatives transactions or over-the-counter derivative transactions, it should be kept in mind whether the business operator is treating them correspondingly.

##### (4) Points of Attention Regarding Over-the-Counter Financial Futures Business Operators’ Responsibility for Explanation

###### (i) Offer of Prices Indicated at Time of Transaction

- A. Regarding Article 123(1)(xxi) of the FIB Cabinet Office Ordinance, in cases where an over-the-counter

financial futures business operator offers the price of a financial instruments, a financial index or an option concerning over-the-counter financial futures trading to a customer requesting the offer of the price indicated at the time of the transaction, the price offered by the business operator may be either the opening price, the intraday high, the intraday low or the closing price of the relevant transaction date.

- B. Over-the-counter financial futures business operators shall record the prices of financial instruments, financial indexes and options indicated at the time of the transaction and store them for at least three years.

(ii) Hedging

- A. Whether the over-the-counter financial futures business operator solicits customers to do transactions intended to offset possible losses involved in the transactions made by them (so-called hedging) or engage in similar practices with regard to over-the-counter financial futures business (limited to transactions involving cash margin and other deposits)
- B. Cases where an over-the-counter financial futures business operator confirms the possibility of a customer making hedging transactions, when the customer has expressed willingness to make such transactions or when the customer inquired about the possibility of making such transactions shall not automatically be deemed to fit the provision of Article 117(1)(xxvi) of the FIB Cabinet Office Ordinance. However, if the business operator indicates that possibility without explaining that hedging may lack economic rationality in some cases, as the customer must pay double fees and may incur losses depending on the interest rate differential between currencies (hereinafter referred to as the “Swap Point”) and must bear an additional burden regarding the price difference (what is known as “the spread received by over-the-counter financial futures business operators) between the sale and purchase prices with the median price as a base point, the business operator’s act shall be deemed to fall under the category of “other similar practices” specified under Article 117(1)(xxvi) of the FIB Cabinet Office Ordinance.

(iii) Transactions with Customers and Counterparties to Cover Transactions

Whether the over-the-counter financial futures business operator provides appropriate explanations regarding the following points when requested to do so by customers:

- A. Order placement method of cover transactions
- B. Criteria for the execution of cover transactions
- C. Response to the occurrence of system troubles in relation to the counterparties to cover transactions

(iv) Response to Rapid Market Movements

Whether the over-the-counter financial futures business operator provides appropriate explanations regarding how it responds to rapid market movements, when requested to do so by customers.

(v) Internal Control Environment for Proprietary Trading

Whether the over-the-counter financial futures business operator provides appropriate explanations regarding whether it engages in proprietary trading and, if it does so, regarding its control environment for risk management, when requested by customers to provide such explanations.

(vi) Status of Segregated Management

Whether the over-the-counter financial futures business operator provides customers with appropriate explanations, when requested by them to do so, regarding the status of trusts for the segregated management of cash margin and other deposits prescribed in Article 143(1)(i) of the FIB Cabinet Office Ordinance.

(vii) Loss-Cut Transactions

In cases where the over-the-counter financial futures business operator conducts currency-related over-the-counter derivative transactions, whether it provides appropriate explanations regarding the fact that an agreement regarding loss-cut transactions (referring to the transactions prescribed in Article 123(1)(xxi-2) of the FIB Cabinet Office Ordinance; the same shall apply hereafter) is in place and the details therein. Also, whether it provides appropriate explanations regarding the risk of losses in cases where a loss-cut transaction cannot be conducted as intended.

(viii) Low-Spread Transactions

In cases where the currency-related over-the-counter derivatives business operator, who provides transactions with particularly low spreads or fees (hereinafter referred to as “low-spread transactions”), makes indications in advertisements and so forth which emphasize that its spreads or fees are low, whether any of the following risks, for instance, have arisen:

- A. The risk that customers could be led to erroneously believe that, even though fees, commissions, other rewards and expenses that they must also pay do exist, the rewards and expenses to be paid by the customer are substantially lower than the actual levels.
- B. The risk that a difference between the price indicated to the customer at order or designated by the customer at order and the actual contracted price (hereinafter, "slippage") could occur, resulting in a transaction being conducted at a spread higher than indicated in advertisements and so forth.

(5) Points of Attention Regarding the Accountability of Securities-Related Over-The-Counter Derivatives Business Operators

The provisions of (4) above shall be applied mutatis mutandis to points of attention regarding matters to be explained to customers by business operators engaged in securities-related over-the-counter derivatives intended for individuals.

(6) Points of Attention Regarding the Accountability of Over-The-Counter Derivatives Business Operators that Trade in Currency Options, Interest Rate Swaps, etc.

Even in cases where (4) and (5) above do not apply, whether the over-the-counter derivatives business operator pays attention to the following points when conducting over-the-counter derivative transactions of currency options or interest rate swaps, for example.

(Note) Even in cases where a Financial Instruments Business Operator sells complex structured bonds and investment trusts that are similar to over-the-counter derivative transactions, it should be kept in mind whether the business operator is treating them correspondingly.

(i) Whether the over-the-counter derivatives business operator provides full and appropriate explanations about the descriptions and risks of the said over-the-counter derivative transactions, including on the following

issues for example, using such methods as issuing a document which gives specific and easy-to-understand explanations.

- A. Whether the over-the-counter derivatives business operator provides explanations to customers, in a way that they can understand, about the maximum anticipated loss assuming the worst-case scenario (based on reasonable assumptions such as data from previous times of stress; the same shall apply hereinafter) regarding, inter alia, the levels of financial indices that cover the said over-the-counter derivative transactions (including, as necessary, levels of volatility; the same shall apply hereinafter), including the fact that circumstances different to those assumed may result in any loss becoming even greater.
  - B. Whether the over-the-counter derivatives business operator confirms the amount of losses that are acceptable to a customer as far as the said over-the-counter derivative transactions are concerned, and confirms that the said amount of loss would not have a material effect on the management and financial condition of the customer's business. Furthermore, in cases that do not amount to the abovementioned worst-case scenario, but where there is a possibility that the customer may suffer a loss greater than that acceptable, whether the over-the-counter derivatives business operator provides explanations to customers, in a way that they can understand, about how the financial indices or other circumstances would have to be for such a situation to occur.
  - C. In cases where the over-the-counter derivatives business operator uses illustrations and so forth which are unavoidably different to the actual over-the-counter derivative transactions for the sake of explanation, whether the business operator explains that the said illustrations and so forth are different to the actual transactions.
- (ii) Whether the over-the-counter derivatives business operator provides full and appropriate explanations about the premature cancellation of the said over-the-counter derivative transactions and the resultant settlement money, including on the following issues for example, using such methods as issuing a document which gives specific and easy-to-understand explanations.

(Note) In the case of the sale of structured bonds, for instance, the term "premature cancellation" shall be replaced with "premature sale," and the term "settlement money on cancellation" shall be replaced with "estimated amount of losses resulting from the premature sale." With regard to B. below, in cases where tentatively calculating the estimated amount of losses resulting from the premature sale is difficult, it is desirable that, wherever possible, explanations assuming the worst-case scenario be given.

- A. In cases where the said over-the-counter derivative transactions are, in principle, unable to be cancelled prematurely, whether the over-the-counter derivatives business operator explains this to customers, in a way that they can understand.
- B. In cases where settlement monies arise if the said over-the-counter derivative transactions are prematurely cancelled, whether the over-the-counter derivatives business operator provides explanations to customers, in a way that they can understand, about this fact and about the details of the settlement money on cancellation (including the tentatively calculated amount of the settlement money on cancellation assuming the worst-case scenario regarding the levels of financial indices and so forth, and if there is a possibility that the amount could be greater than the said tentatively calculated amount, an

explanation to this effect).

C. Whether the over-the-counter derivatives business operator confirms the amount of settlement money on cancellation that is acceptable to a customer as far as the said over-the-counter derivative transactions are concerned. Furthermore, in cases that do not amount to the abovementioned worst-case scenario, but where there is a possibility that the customer may suffer a loss greater than that acceptable, whether the over-the-counter derivatives business operator provides explanations to customers about this, in a way that they can understand.

(iii) In cases where over-the-counter derivative transactions are provided for the purpose of hedging, whether the over-the-counter derivatives business operator confirms that the customer understands that the following is necessary regarding the said transactions, and based on the results of this confirmation, whether the business operator provides full and appropriate explanations.

A. The over-the-counter derivative transactions shall function as a hedging instrument that is effective in conducting ongoing business operations even when taking into account the customer's business situation and its competitive relationship in the market (Note 1).

B. The situation described above of the over-the-counter derivative transactions functioning effectively as a hedging instrument is expected to continue until the end of the contract period (Note 2).

C. Forecasting future business management will not instead be made more difficult for the customer (Note 3).

(Note 1) It should be kept in mind that, for example, even if exchange rates or interest rates fluctuate, it should be comprehensively determined whether or not the customer has the price-bargaining power or price-setting power likely to reduce the effects of these fluctuations.

(Note 2) It should be kept in mind that, for example, even in cases where losses have not arisen due to the hedging instrument itself, due to changes in the customer's business situation, such as the assumed scale of operations contracting, the customer's hedging needs might be swayed or the effects of the hedge might stop functioning effectively for those needs before the end of the contract period.

(Note 3) It should be kept in mind that using hedges to fix a purchase price or the like could affect the customer's price competitiveness.

(iv) Whether measures have been taken in order to confirm from customers that they have received an explanation based on the matters listed in (i) through (iii) above, for example, receiving a written confirmation or the like from customers and keeping it.

(v) With regard to the solicitation of persons believed to be excluded from the ban on uninvited solicitation for over-the-counter derivative transactions, whether, based on the law (Note), the customer's hedging needs have been confirmed such as by using past customer transaction histories, and whether soliciting is for contracts that are within the scope of those needs.

(Note) It should be kept in mind that "corporations engaging in foreign trade and foreign currency transactions" (Article 116(1)(ii) of the FIB Cabinet Office Ordinance) that are excluded from the ban on uninvited solicitation includes cases where, for example, a domestic building contractor, who imports lumber from

overseas, in reality, imports and exports through a domestic trading firm rather than transacting directly with overseas exporters, but does not include cases where it simply purchases imported lumber from a domestic trader.

- (vi) Whether, if requested to do so by the customer, the over-the-counter derivatives business operator provides, in a timely and appropriate manner, information which is needed for the customer to settle its accounts or make decisions on canceling transactions, such as by providing customers with market price information on their position or notifying them of the amount of settlement money on cancellation at a particular time on a periodic or as-needed basis.
- (vii) With regard to confirming the customer's intention to enter into a contract for the said over-the-counter derivative transactions, whether the over-the-counter derivatives business operator has developed a control environment wherein it can confirm customers' intentions in a way which is mindful of the decision-making process that corresponds, inter alia, to the content and scale of the contract as well as to the nature of the customer's business operations and to their size and control environment for governance.

For example, in cases where the contemplated over-the-counter derivative transaction could have a significant impact on the customer's future business management, it should be kept in mind that it is important to confirm whether the contract would be entered into with the decision being made by the said customer's board of directors or other such body.

#### (7) Points of Attention Regarding the Accountability of Crypto-and Other Assets-Related Over-The-Counter Derivatives Business Operators

The provisions of III-2-14(3)(i) and IV-3-3-2(4) shall be applied mutatis mutandis to points of attention regarding matters to be explained to customers by crypto-and other assets-related over-the-counter derivatives business operators. In addition, supervisors shall pay attention to the following points:

- (i) As provided in Article 146-4(2)(i) of the FIB Cabinet Office Ordinance, when handling crypto-and other assets-related over-the-counter derivatives transactions, the Financial Instruments Business Operator, etc. is required to explain to customers that crypto-and other assets are not a legal currency. In particular, in the case where a crypto-and other assets-related over-the-counter derivatives business operator concurrently engages in currency-related over-the-counter derivative transactions, the business operator shall make deliberations on matters including the methods of transactions so that its crypto-and other assets-related over-the-counter derivatives transactions and currency-related over-the-counter derivatives transactions are recognized by customers as types of transactions that can be clearly distinguished from each other.
- (ii) The "act of making an indication concerning the matters set forth in Article 78(v) through (vii) or (xiii)(a) through (e) without showing reasonable grounds to support it" as prescribed in Article 117(1)(xli) of the FIB Cabinet Office Ordinance could include, for example, the following:
  - A. An act of predicting the price transition of the crypto-and other assets by using biased analysis results.
  - B. An act of indicating that the crypto-and other assets are safe and low-risk on the basis that they are subject to transactions by a Financial Instruments Business Operator.
  - C. An act of indicating that the Financial Instruments Business Operator's financial conditions, etc. are sound

on the basis that it has obtained registration for engaging in crypto-and other assets-related over-the-counter derivatives business.

(iii) With regard to "the outline and specific characteristics of the crypto-and other assets" prescribed in Article 146-4(2)(iv) of the FIB Cabinet Office Ordinance and "matters which should be noted by the customer in relation to the nature of crypto-and other assets" prescribed in item (v) of that paragraph, the Financial Instruments Business Operator, etc. shall explain matters including those prescribed in III-2-14(3)(i), while also making reference to information such as the contents of the document on the outline of crypto-and other assets published by a Financial Instruments Firms Association.

(8) Points of Attention Regarding Provision of Pre-Contract Documents

(i) The "reasons for the possibility of a loss exceeding the principal amount," as specified under Article 82(iv)(b) of the FIB Cabinet Office Ordinance shall include a rapid market movement that could cause a loss exceeding the principal amount despite the Loss-Cutting Rule.

(ii) The "reasons for the termination of the relevant financial instruments transaction contract," as specified under Article 82 (viii) of the FIB Cabinet Office Ordinance shall include items related to the Loss-Cutting Rule.

(iii) The "types and calculation methods of cash margin and other deposits to be made by customers with regard to the relevant derivatives transactions, etc.," as specified under Article 93(1)(iv) of the FIB Cabinet Office Ordinance shall include items related to the minimum margin deposits and additional margin deposits that must be made when the existing deposits have fallen short of the required level due to market movements, etc. (hereinafter referred to as "margin calls").

(iv) Regarding currency-related transactions, the "major terms and other basic items regarding derivatives trading," as specified under Article 93(1)(vii) of the FIB Cabinet Office Ordinance shall include items related to the method of determining prices of financial instruments, etc., and the Swap Point. In cases where the Swap Point may be either received or paid by customers and where a loss may arise, these possibilities shall be properly indicated.

(v) Regarding the "counterparty to a cover transaction," as specified under Article 94(1)(i) of the FIB Cabinet Office Ordinance, all such counterparties shall be indicated when two or more counterparties exist. However, in cases where a participant in the interbank foreign currency market engaging in a cover transaction finds it impossible to identify the counterparty thereto, it shall suffice that an indication to that effect be contained in the Explanation Document.

(vi) Regarding the "trustee," as specified under Article 94(1)(iv) of the FIB Cabinet Office Ordinance, the specific name of the trustee of a trust for the segregated management of cash margin and other deposits in the case of securities-related over-the-counter derivative transactions, and the specific name of the trustee of cash margin and other deposits, as specified under each item of Article 143(1)(i) or (ii)(a) to (d), in the case of over-the-counter derivative transactions other than securities-related over-the-counter derivative transactions, shall be indicated.



(9) Points of Attention Regarding Provision of Documents Related to Receipt of Cash Margin and Other Deposits

The “date of the receipt of deposits by the relevant Financial Instruments Business Operators, etc.,” as specified under Article 114(1)(iv) of the FIB Cabinet Office Ordinance may be either the date on which the deposit is made or a date after that date, depending on the agreement between the business operator and the customer.

(10) Points of Attention Regarding Ban on Uninvited Solicitation

Regarding customer solicitation for over-the-counter financial futures transactions, in the past, there were some cases in which solicitation by means of telephone calls and door-to-door visits led customers to engage in such transactions without sufficient understanding of the risks and schemes involved and caused disputes, a situation that eventually developed into a social issue. In light of this, a ban has been imposed, under Article 38(iv) of the FIEA, on over-the-counter derivatives business operators and their officers and employees visiting or placing phone calls to customers who have not requested solicitation in order to solicit them to sign contracts for over-the-counter derivative transactions (in the case of derivatives transactions other than for over-the-counter financial futures transactions and crypto-and other assets-related over-the-counter derivatives transactions, limited to over-the-counter derivatives transactions made with individual customers; hereinafter the same shall apply in (10)) (a practice known as “uninvited solicitation”).

Meanwhile, Article 116 of the FIB Cabinet Office Ordinance allows over-the-counter derivatives business operators to solicit the customers with whom they have on-going transactions to sign contracts for over-the-counter derivatives transactions, and to solicit corporations engaging in foreign trade and foreign currency transactions to sign such contracts, in order to offset the possibility of losses that may be incurred by the corporations as a result of exchange rate movements related to their assets and liabilities.

In order to ensure compliance with the above provisions, it is important for over-the-counter derivatives business operators to develop a control environment for customer management so as to precisely identify the status of customers’ solicitation requests. Therefore, supervisors shall conduct supervision by paying attention to the following points, for example:

(i) Eligibility for Uninvited Solicitation

- A. The “solicitation for signing contracts for financial futures transactions through visits or phone calls,” as specified under Article 38(iv) of the FIEA, shall include inquiring with customers as to whether they are willing to accept visits for solicitation.
- B. The “persons who have outstanding unsettled over-the-counter financial futures transactions in their accounts” as specified under Article 116(1)(i) of the FIB Cabinet Office Ordinance, the “persons who have outstanding unsettled crypto-and other assets-related over-the-counter derivatives transactions in their accounts” as specified under Article 116(1)(ii)-2 of the FIB Cabinet Office Ordinance, the “persons who have outstanding unsettled securities-related over-the-counter derivative transactions in their accounts” as specified under Article 116(1)(iv) of the FIB Cabinet Office Ordinance, and the “persons who have outstanding over-the-counter derivative transactions in their accounts,” as specified under Article 116(1)(v) of the FIB Cabinet Office Ordinance shall include persons who hold options contracts for which the exercise period has not expired.

C. An inquiry regarding general items submitted via the telephone or through other means to an over-the-counter derivatives business operators over-the-counter financial futures business operator from a customer who has seen an advertisement, or a request therefrom for documents regarding the outline of transactions shall not in itself be deemed to constitute a “request for the solicitation for signing contracts for financial futures transactions.”

(ii) Identification of Status of Customers’ Solicitation Requests

- A. Whether the over-the-counter financial futures business operator strives to identify the status of customers’ solicitation requests and past transactions in a timely manner, by developing a system of customer cards, for example, and whether it ensures that all officers and employees strive to solicit customers in an appropriate manner in light of the status of their solicitation requests and past transactions.
- B. Whether the over-the-counter financial futures business operator has prescribed specific procedures for the management of customer information, such as the status of their solicitation requests and past transactions, and ensures that all officers and employees are aware of and comply therewith. In particular, whether the business operator has prescribed the procedures for managing customer information based on sufficient deliberations made from the viewpoint of the confidentiality obligation.
- C. Whether the internal control division strives to grasp how the over-the-counter financial futures business operator identify the status of customers’ solicitation requests and past transactions and manage customer information. Furthermore, whether the said division examines, as necessary, if solicitation is conducted in an appropriate manner, and strives to develop a control environment that ensures the effectiveness of the procedures for managing customer information by reviewing and revising them, for example.

(11) Points of Attention Regarding the Solicitation of Complex Structured Bonds and Investment Trusts that are Similar to Over-The-Counter Derivative Transactions (Reasonable-Basis Suitability and Solicitation Commencement Standards)

Regarding the sale of complex structured bonds and investment trusts that are similar to over-the-counter derivative transactions, there has been an increase in problems, especially between Financial Instruments Business Operators and individual customers, due to such problems as the difficulty for customers to understand the risks. In view of these circumstances, from the perspective of improving investor protection, it is important for Financial Instruments Business Operators that solicit individual customers for these structured bonds and investment trusts to ensure appropriate solicitation based on the principle of suitability. As such, supervisors shall examine this by paying attention to the following points, for example:

- (i) Whether the Financial Instruments Business Operator verifies in advance the suitability of financial products to be sold to investors (reasonable-basis suitability), based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members.”
- (ii) Whether the Financial Instruments Business Operator appropriately formulates solicitation

commencement standards according to the risk profile of the financial products and the nature of the customers based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members,” and conducts proper solicitation in accordance with those standards.

#### (12) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding an over-the-counter derivatives business operator’s control environment for customer solicitation and explanations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the over-the-counter derivatives business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the over-the-counter derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the over-the-counter derivatives business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### IV-3-3-3 Discretionary Trading Contracts, etc.

##### (1) Points of Attention Regarding Discretionary Trading Contracts with Foreign Financial Futures Companies

When supervisors receive a notification from an over-the-counter derivatives business operator for the signing of a contract based on Article 16(1)(viii)(b) of the Cabinet Office Ordinance Regarding Definitions, they shall pay attention to the following points:

- (i) Whether the division that executes transactions regarding the said contract is clearly separated from the divisions that receive and execute orders for other brokerage transactions.
- (ii) Whether it is ensured that account books are compiled in ways to enable the identification of transactions related to the said contract.

##### (2) Scope of Specified Agreements by Over-the-Counter Derivatives Business Operators

Specified agreements under Article 123(1)(xiii)(b) and (c) of the FIB Cabinet Office Ordinance include the following agreements:

- (i) Agreements regarding rewards and contracted values higher or lower than the specified rewards and contracted values (including rewards and contracted values determined with a prescribed method)
- (ii) Agreements regarding an appropriate range determined with a specified reward or a contracted value as a base point.
- (iii) Agreements regarding the determination of rewards and contracted values at the discretion of over-the-counter derivatives business operators on condition that they follow the best execution practice in daily trading.

### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding an over-the-counter derivatives business operator's practices specified under Article 123(1)(xiii)(a) to (e) of the FIB Cabinet Office Ordinance through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the over-the-counter derivatives business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA, while paying consideration to the above viewpoints. When the over-the-counter derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the over-the-counter derivatives business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### IV-3-3-4 Control Environment for Business Execution

##### (1) Points of Attention Regarding Treatment of Slippage in Currency-Related Over-the-Counter Derivative Transactions, etc.

Slippages unavoidably occur due to such factors as the passage of time for communicating orders. In supervising the treatment of slippage, for the purpose of establishing a system in which currency-related over-the-counter derivatives business operators are encouraged to execute business operations honestly and fairly, the following points shall be noted.

- (i) Whether the over-the-counter derivatives business operator, as regards to slippages that arise in dealings with customers, are treating them asymmetrically in a way that work advantageously toward the customer, such as in the cases below.
  - A. The over-the-counter derivatives business operator executes a transaction at a price disadvantageous to the customer when there is a slippage disadvantageous to the customer (when the execution price is more disadvantageous to the customer than the price at order), while it also executes a transaction at a price disadvantageous to the customer even when there is a slippage advantageous to the customer (when the execution price is more advantageous to the customer than the price at order).
  - B. The over-the-counter derivatives business operator sets a wider slippage range in which it executes transactions at prices disadvantageous to the customer than the slippage range in which it executes transactions at prices advantageous to the customer (including cases in which the customer is allowed to designate the slippage and the operator makes an arrangement by means of which the slippage range in which transactions are executed at prices disadvantageous to the customer is set wider than that in which transactions are executed at prices advantageous to the customer).
  - C. The upper limit of the value of transactions executed when the slippage is disadvantageous to the customer is set higher than the upper limit of the value of transactions executed when the slippage is advantageous to the customer.

- (ii) Even when the over-the-counter derivatives business operator does not engage in asymmetric treatment disadvantageous to the customer, as provided in (i) above, but slippage does occur, whether the operator provides appropriate and sufficient explanation of the occurrence of slippages and their causes, the possibility that slippages can be either advantageous or disadvantageous toward the customer, its policy on the treatment of advantages and disadvantages due to slippage that have occurred, and so forth.

## (2) Points of Attention Regarding Specified Over-the-Counter Derivatives Transactions

Specified over-the-counter option transactions for individual customers such as so-called binary option transactions, etc. (meaning the specified over-the-counter option transactions provided in Article 123(vii) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter) include those of which profit/loss results become known in short time, leading to customers engaging in excessively speculative transactions, and those that are products based on complex theoretical principles but are likely to give the false impression that they are simple products, making it difficult for the customer to precisely judge their risks.

In consideration of the above, when an over-the-counter derivatives business operator handles specified over-the-counter option transactions for individuals, supervisors shall be mindful of the purpose of securing and establishing a system in which product design and business operations necessary and appropriate for protecting public interests and investors are executed, and conduct verification on whether such operators comply with the provisions in the self-regulatory rules established by self-regulatory organizations.

### (i) Points of Attention Regarding Product Characteristics

Whether an over-the-counter derivative business operator pays attention to the following points in order to secure, for the specified over-the-counter option transactions for individual customers it provides, appropriateness and soundness as financial instrument transactions.

#### A. Transaction Period and Transaction Maturity

- a. Whether transaction periods (i.e., the period between the time the transaction starts and the judgment time) are set so short that it may encourage excessively speculative transactions.
- b. Whether intervals between transaction maturities on the same issue are set so short that they may encourage excessively speculative transactions. In addition, regarding transaction maturities overlapping different issues (such as currency pairs), whether short time lags are set between them without reasonable grounds in ways in which they encourage excessively speculative transactions overlapping different issues, repeatedly and continuously.
- c. Whether the operator responds to customers' buy transaction orders or sell transaction orders (including fresh transaction orders) as far as possible until the transaction maturity during the transaction period.

#### B. Exercise Price

- a. Whether the exercise prices (or the calculating method if such prices are decided according to a certain method of calculation) are decided and indicated in ways in which customers can precisely grasp the risks associated with the transaction so that they can make appropriate investment decisions.
- b. Whether exercise prices are set at levels that significantly differ from the prices of underlying assets

at the beginning of the transaction, which may lead to excessively speculative transactions.

#### C. Fairness of Transactions

Regarding products that have the same underlying assets, transaction period and exercise price, whether transaction conditions advantageous to the over-the-counter derivatives business operator are eliminated by the adoption of measures such as simultaneously providing opportunities for fresh buy transactions and fresh sell transactions, or eliminating settings in which all customers can sustain loss on exercise prices.

#### D. Transaction Prices (Value)

Whether Transaction Prices (Value) are calculated by fair methods considering the exercise period, exercise price, prices of underlying assets and so forth.

#### (ii) Points of Attention Regarding Customer Management and Transaction Management

Whether the over-the-counter derivatives business operator is exercising appropriate handling of specified over-the-counter option transactions for individuals in accordance with the characteristics of the customer by giving consideration to the following points.

- A. Whether it has standards for initiating transactions in accordance with the customer's knowledge, experience and financial resources.
- B. Whether it has an upper limit on transaction values depending on characteristics of the customer, and conducts monitoring.

#### (iii) Points of Attention Regarding Provision of Information to Customers

Whether an over-the-counter derivatives business operator provides necessary and sufficient explanation and information on the risk, content of the product, past profit/loss performance, and so forth on specified over-the-counter option transactions for individuals so that customers can precisely grasp the risks associated with the transaction and make an appropriate investment judgment. In addition, whether the over-the-counter derivatives business operator adjusts its advertising and publicity and has an appropriate system to screen advertising so that its advertising may not lead investors to have excessively optimistic expectations or erroneous understanding.

#### (iv) Points of Attention Regarding Appropriate Transaction Conditions

##### A. Disclosure of Grounds for Calculation of Transaction Conditions

Whether sufficient explanations are provided to customers on the grounds for setting transaction prices, exercise prices and expiry prices so that they can make reasonable investment judgments.

##### B. Suspension of Transactions

In light of the fact that suspension of transactions stops services to customers and the provision of liquidity, whether the operator is mindful of its impact on customers and takes the following measures.

- a. Whether the operator explains to customers in advance its judgment criteria for deciding the suspension of transactions.
- b. Whether the operator publicizes, when a transaction suspension occurs, the fact of its occurrence and the reason on its website, etc., as well as storing such information in the form of documents.
- c. Whether the operator, when a transaction suspension occurs, has a third party, rather than its

responsible sections, investigate the causes of the occurrence and conduct monitoring to prevent recurrence.

#### C. Monitoring of Transaction Conditions

Whether the operator conducts verification of the appropriateness of transaction prices and expiry prices by having a third party, rather than its responsible internal sections, monitor them and verify their appropriateness.

### (3) Points of Attention Regarding Crypto-and Other Assets-Related Over-the-Counter Derivatives Transactions

The provisions of III-2-14(1) shall be applied mutatis mutandis to points of attention regarding crypto-and other assets-related over-the-counter derivatives transactions. In addition, supervisors shall also pay attention to the following points:

- (i) Whether, according to the patterns or contents of a customer's orders relating to crypto-and other assets-related over-the-counter derivatives transactions or the status of such transactions or any other circumstances, the crypto-and other assets-related over-the-counter derivatives business operator screens whether there is any violation of Article 185-22(1), Article 185-23(1), or Article 185-24(1) or (2) of the FIEA, and if it finds that there may be a violation, it takes measures such as suspending crypto-and other assets-related over-the-counter derivatives transactions with that customer and any other measures necessary for preventing unfair acts relating to crypto-and other assets-related over-the-counter derivatives transactions such as the following for example.

(Note) "Unfair acts relating to crypto-and other assets-related over-the-counter derivatives transactions " include an act of using crypto-and other assets handled or to be newly handled by the crypto-and other assets-related over-the-counter derivatives business operator or the information stated in (ii) below regarding the crypto-and other assets-related over-the-counter derivatives business operator to benefit itself or a third party.

#### A. Establishment of Arrangements and Procedures for Transaction Screening

Whether the crypto-assets-related over-the-counter derivatives business operator has developed necessary arrangements and procedures for preventing unfair acts by customers, such as specifying necessary procedures for transaction screening in internal rules, etc. and setting up a division in charge of transaction screening.

#### B. Precise Identification of Customers' Trading Patterns and Thorough Management

- a. Whether the over-the-counter derivatives business operator has established specific procedures for identifying customers' trading patterns as represented by features such as the types of crypto-and other assets, etc. subject to transactions and the method and characteristics of their trading, and precisely identifies their trading motives by monitoring its trading activity as necessary in accordance with the procedures.
- b. Whether the internal control division makes sure that all officers and employees are aware of and follow the above procedures, and ensures the effectiveness thereof by revising them as necessary, for example.
- c. In cases where the over-the-counter derivatives business operator has recognized the possibility of

customers using accounts opened under fictitious names, whether it investigates the true identity of the customers and monitors transactions involving the said accounts with special care.

C. Establishment of Transaction Screening Criteria and Efficient Utilization Thereof

- a. Whether the over-the-counter derivatives business operator has established the criteria for selecting the crypto-and other assets, etc. for screening, for each of their types, in light of factors such as the advancers-to-losers ratio and the status of transactions, in order to ensure the fairness of customers' transactions, and makes appropriate selection based on said criteria.
  - b. Whether the over-the-counter derivatives business operator conducts appropriate trading management regarding selected crypto-and other assets, etc. by, for example, establishing specific screening criteria and taking measures necessary (e.g., making inquiries with customers, issuing alerts and suspending trading) for preventing illegal trading practices, such as market manipulation.
  - c. Whether the internal control division has developed a control environment for examining the consistency of the selection and screening criteria and the implemented measures with the actual status in a timely manner, and is ensuring the effectiveness of the measures and criteria by making revisions as necessary, for example.
- (ii) Whether the following measures, for example, are taken with regard to important information on the crypto-and other assets, etc. subject to or to be newly made subject to crypto-and other assets-related over-the-counter derivatives transactions or on the crypto-and other assets-related over-the-counter derivatives business operator, which is deemed to affect customers' decisions on those transactions (Note).

(Note) The following information, for example, could fall under the category of such information. However, this excludes the case where the information is made readily accessible to all customers of the financial instruments business, etc. conducted by the crypto-and other assets-related over-the-counter derivatives business operator.

- Important changes to functions, effects, or plans of the crypto-and other assets, etc., such as changes in the forks of the blockchain used for the crypto-and other assets, etc. or other technical specifications used for the crypto-and other assets, etc.
- Material changes in the status of business operations or property of a person or body that is able to decide the specifications, etc. of the crypto-and other assets, such as commencement of bankruptcy proceedings, special liquidation proceedings, civil rehabilitation proceedings, or corporate rehabilitation proceedings, or other insolvency proceedings equivalent thereto of the issuer, etc. of the crypto-and other assets, etc.
- Decision or occurrence of matters that have a serious impact on the price or liquidity of the crypto-and other assets, etc., such as a decision that the handling of the crypto-and other assets, etc. will be commenced or discontinued, or occurrence of a fact of receiving a number of orders large enough to have a serious impact on the price of the crypto-and other assets.
- Decision or occurrence of matters that have a material impact on the status of business operations or property related to the crypto-and other assets-related over-the-counter derivatives business operator's financial instruments business, such as occurrence of a security incident that seriously



disturbs implementation of the financial instruments business or commencement of insolvency proceedings.

- A. Whether the crypto-assets-related over-the-counter derivatives business operator specifies the types or the scope of information that could fall under the category of such information in internal rules, etc.
- B. Whether the crypto-assets-related over-the-counter derivatives business operator has set up an independent division for managing such information and has established arrangements and procedures for appropriately managing such information.
- C. Whether the crypto-assets-related over-the-counter derivatives business operator has established arrangements and procedures for preventing an officer or employee that has acquired such information from communicating the information to a third party beyond the scope necessary for business.

#### (4) Points of Attention Regarding Services to Operate Electronic Transaction Platforms

In cases where Financial Instruments Business Operators provide services to operate platforms for electronic transactions prescribed in Article 1(4)(xvi) of the FIB Cabinet Office Ordinance, supervisors shall require them to thoroughly comply with laws, etc. as Type I Financial Instruments Business Operators and supervise such operations by paying attention to the following points in view of ensuring fairness and transparency in over-the-counter derivative transactions.

- (i) Whether the electronic transaction platform operator (referring to a Type I Financial Instruments Business Operator that provides the service of operating an electronic transaction platform; the same shall apply hereinafter) is equipped with a control environment/system to disclose quotations of sales and purchase transactions accurately on a page of its electronic transaction platform. Also, whether it is equipped with a control environment/system to accurately and swiftly communicate quotations of sales or purchase transactions offered by the relevant party to the other party when deciding a transaction price based on negotiations between customers.
- (ii) Whether the electronic transaction platform operator has a control environment/system to disclose general information about over-the-counter derivative transactions settled on its electronic transaction platform accurately and in a timely manner in accordance with laws, etc.

In particular, in cases in which the relevant disclosure service (service to disclose transactions that have been settled) is outsourced, whether the outsourced contractor makes it clear in disclosing such information that the information is disclosed for the electronic transaction platform operator (the consigner). Also, whether the electronic transaction platform operator (the consigner) is appropriately conducting selection, monitoring, etc. of outsourced contractors in accordance with internal rules so that disclosures are carried out accurately and in a timely manner in accordance with laws, etc.

- (iii) Whether the electronic transaction platform operator provides in a contract, etc. that the customer is to observe the rules established by the operator and submit information on transactions with the operator at the request of the operator.

#### (5) Points of Attention Regarding Storage and Reporting of Transaction Data in Specified Currency-Related Over-

#### the-Counter Derivatives Transactions

Whether a control environment has been established for the appropriate storing and reporting of information concerning specified currency-related over-the-counter derivatives transactions (meaning the specified currency-related over-the-counter derivatives transactions prescribed in Article 117(1)(xxviii)-2 of the FIB Cabinet Office Ordinance) pursuant to the provisions of Article 123(1)(xxi)-7 and (xxi)-8 of the FIB Cabinet Office Ordinance and the rules of the Financial Instruments Firms Association (the rules within the limits designated by the Commissioner of the Financial Services Agency; for currency-related over-the-counter derivatives business operators that are not affiliated with a Financial Instruments Firms Association that has determined Rules Set by Associations, etc., the Commissioner of the Financial Services Agency shall determine the rule).

#### (6) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the control environment for the execution of business operations of an over-the-counter derivatives business operator through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement in business operations made by the over-the-counter derivatives business operator through thorough interrogation or by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### IV-3-3-5 Control Environment for Managing Risk Related to Currency-Related Over-The-Counter Derivative Transactions

Regarding currency-related over-the-counter derivative transactions (meaning the currency-related over-the-counter derivative transactions prescribed in Article 123(4) of the FIB Cabinet Office Ordinance; the same shall apply hereafter), it is important for currency-related over-the-counter derivatives business operators to manage their own risks. Therefore, supervisors shall supervise currency-related over-the-counter derivatives business operators' control environments for risk management and their execution of business by paying attention to the following points.

#### (1) Points of Attention Regarding Transactions with Customers and Counterparties to Cover Transactions

- (i) In cases where there is the possibility of a timing gap arising between the execution of a transaction with a customer and the execution of a cover transaction, whether the currency-related over-the-counter derivatives business operator has developed a control environment for risk management that is well prepared for the risk of a rapid market movement occurring during the intervening period.
- (ii) In cases where a cover transaction is made at a specific interval of time or for a specific amount of transactions, or made at the discretion of dealers, rather than being made for each transaction with a customer, whether the currency-related over-the-counter derivatives business operator has developed a control

environment for risk management that is well prepared for the risk of a rapid market movement occurring between the execution of a transaction with a customer and the execution of a cover transaction, with due consideration of the timing gap.

- (iii) In cases where the currency-related over-the-counter derivatives business operator makes cover transactions after executing customers' limit orders or loss-cutting orders in light of quotations indicated by information vendors and other factors, whether the business operator has developed a control environment for risk management that is well prepared for the risk of a rapid market movement occurring during the intervening period.
- (iv) Basically, handling of information technology risk related to cover transactions made through a computer system shall be examined from the viewpoints regarding the development of the relevant control environment that are specified in III-2-8. However, with due consideration of the possibility of computer system troubles disrupting cover transactions, supervisors shall also examine whether the currency-related over-the-counter derivatives business operator has developed a control environment for risk management that is well prepared for the risk of a rapid market movement occurring during the intervening period.
- (v) Whether the currency-related over-the-counter derivatives business operator fully understands the contents of a contract with the counterparty to cover transactions and has developed a control environment that ensures quick and appropriate response in the event of a dispute.

## (2) Points of Attention Regarding Response to Rapid Market Movements

Whether the currency-related over-the-counter derivatives business operator has established a specific policy for risk management in preparation for a possible rapid market movement, such as refraining from taking orders from customers when it has suspended proprietary trading or when it is impossible to make transactions with the counterparty to cover transactions, and whether it has developed a control environment that ensures compliance with the policy.

## (3) Points of Attention Regarding Proprietary Trading

In cases where a currency-related over-the-counter derivatives business operator engages in proprietary trading in addition to cover transactions related to customers, supervisors shall pay attention to the following points:

- (i) Whether the currency-related over-the-counter derivatives business operator has established internal rules regarding position limits, stop-loss limits (on daily and monthly bases) and overnight position limits regarding employees engaging in proprietary trading.
- (ii) Whether the currency-related over-the-counter derivatives business operator has set both soft limits and hard limits regarding order placement by employees engaging in proprietary trading in order to prevent erroneous orders.
- (iii) Whether the currency-related over-the-counter derivatives business operator has developed a control environment that ensures that the compliance of transactions made by employees engaging in dealing with internal rules is constantly monitored by back-office staff.

#### (4) Points of Attention Regarding Loss-Cut Transactions Intended for Individuals

- (i) Whether the currency-related over-the-counter derivatives business operator has set a level for executing loss-cut transactions in light of price volatility risk, liquidity risk and other factors, in order to prevent a customer's loss from exceeding the margin they deposit.
- (ii) Whether the currency-related over-the-counter derivatives business operator has formulated internal rules and so forth in which agreements on loss-cut transactions are specified, and whether it reflects them in contracts with customers.
- (iii) Whether the currency-related over-the-counter derivatives business operator properly identifies the position of a customer at each point during the trade, and in cases where the position conflicts with the level mentioned in (i) above, whether it executes the loss-cut transaction without exception.
- (iv) Whether the currency-related over-the-counter derivatives business operator, periodically or as necessary, reports to the board of directors, etc. on the execution of loss-cut transactions.

#### (5) Points of Attention Regarding Low-Spread Transactions

Unless a currency-related over-the-counter derivatives business operator, who provides low-spread transactions, can secure and maintain a considerable trade volume, there is the risk that its financial situation will worsen. On the other hand, the business operator needs to develop a control environment wherein it can appropriately manage a trade volume of sufficient size to ensure management stability.

From this perspective, whether the currency-related over-the-counter derivatives business operator has developed an adequate control environment for risk management, including the following issues for example.

- (i) When developing a company-wide control environment for risk management (for example, formulation of a basic policy on risk management), whether the currency-related over-the-counter derivatives business operator fully recognizes the risks associated with low-spread transactions and has appropriately reflected them.
- (ii) When beginning to provide low-spread transactions, whether the currency-related over-the-counter derivatives business operator has decided on spreads and fees after considering whether it can secure adequate profitability in light of its earnings structure and trade volume. Also, whether the business operator periodically examines the said decision with due consideration of any changes in its earnings structure or trade volume, and whether it makes revisions as necessary. Whether the business operator has clarified such procedures in its internal rules and so forth.
- (iii) Whether the currency-related over-the-counter derivatives business operator, who provides low-spread transactions, has fully understood the trade volume and transaction details of the said transactions and the effects on the company's financial situation, and whether it has developed a control environment for reporting to the board of directors, etc. in an appropriate and timely manner.
- (iv) Whether the currency-related over-the-counter derivatives business operator, who provides low-spread transactions, has fully developed systems and other necessary control environments for realizing the assumed earnings structure. Also, whether the business operator examines its actual earnings situation as needed, and whether it makes appropriate revisions to the said control environment.

(6) Points of Attention Regarding the Assumed Ratio of Foreign Exchange Risk of Specific Currency-Related Over-The-Counter Derivative Transactions Intended for Corporations (meaning Specific Currency-Related Over-The-Counter Derivative Transactions Stipulated in Article 117(1)(xxxix) of the FIB Cabinet Office Ordinance)

- (i) In the case where the currency-related over-the-counter derivatives business operator calculates the assumed ratio of foreign exchange risk stipulated in Article 117(31) and (32) of the FIB Cabinet Office Ordinance
  - A. Whether the currency-related over-the-counter derivatives business operator has developed an accurate and reasonable model (meaning the quantitative calculation model stipulated in the “Notice of the Establishment of the Method of Calculating the Assumed Ratio of Foreign Exchange Risk Pertaining to Specific Currency-Related Over-The-Counter Derivative Transactions;” the same shall apply hereinafter in (6)), and whether it has established a control environment for calculating the assumed ratio of foreign exchange risk based on data continuously calculated using a reasonable method.
  - B. Whether the currency-related over-the-counter derivatives business operator verifies the assumed ratio of foreign exchange risk that was calculated using the model at every calculation and after calculation, and whether it has developed a control environment for reviewing the model as needed.
- (ii) In the case where the currency-related over-the-counter derivatives business operator outsources the calculation of the assumed ratio of foreign exchange risk stipulated in Article 117(31) and (32) of the FIB Cabinet Office Ordinance
  - A. Whether the currency-related over-the-counter derivatives business operator monitors whether the outsourcee has developed an accurate and reasonable model, and whether it has established a control environment for calculating the assumed ratio of foreign exchange risk based on data continuously calculated using a reasonable method.
  - B. Whether the currency-related over-the-counter derivatives business operator monitors whether the outsourcee verifies the assumed ratio of foreign exchange risk that was calculated using the model at every calculation and after calculation, and whether it has developed a control environment for reviewing the model as needed.
  - C. In the case where all or part of the operations of A and B above are outsourced more than once, whether the currency-related over-the-counter derivatives business operator checks if the outsourcee adequately monitors the subcontractor. Also, whether the currency-related over-the-counter derivatives business operator directly monitors the subcontractor as needed.
  - D. In the cases where a Financial Instruments Firms Association calculates and publishes the assumed ratio of foreign exchange risk (including cases where said Association outsources all or part of the calculation and publication of the ratio), whether the currency-related over-the-counter derivatives business operator has developed a control environment for using the ratio precisely and continuously, when it uses the ratio.

(Note) In the case of D above, the supervisory authorities shall examine whether said Association is properly operated.

#### (7) Points of Attention Regarding Stress Testing

Whether a control environment has been established for the appropriate stress testing as prescribed in Article 123 (1)(xxi-4) of the FIB Cabinet Office Ordinance and the rules of the Financial Instruments Firms Association (the rules within the limits designated by the Commissioner of the Financial Services Agency. for currency-related over-the-counter derivatives business operators that are not affiliated with a Financial Instruments Firms Association that has determined Rules Set by Associations, etc., the Commissioner of the Financial Services Agency shall determine the rule) in order to enhance settlement risk management.

#### (8) Supervisory Method and Actions

- (i) In order to check the appropriateness of the currency-related over-the-counter derivatives business operator's control environment for risk management, supervisors shall identify the details (spreads, fees and so forth) of the products and transactions provided by the currency-related over-the-counter derivatives business operator, through hearings and other means.
- (ii) When supervisors have, through daily supervisory administration or the reporting of problematic conduct, recognized an issue regarding a currency-related over-the-counter derivatives business operator's control environment for risk management, they shall identify and keep track of the status of voluntary improvement made by the currency-related over-the-counter derivatives business operator by holding in-depth hearings, and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the currency-related over-the-counter derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions such as issuing an order for business improvement based on Article 51 of the FIEA. When the business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA. When supervisors have recognized an issue of supervisory concern regarding a currency-related over-the-counter derivatives business operator's control environment for risk management, through daily supervisory administration, they shall identify and keep track of the risk management status by conducting in-depth hearings and, when necessary, requiring the submission of a report based on Article 56-2(1) of the FIEA. When the business operator's risk management status is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the business operator is deemed to have the risk of defaulting in light of its business condition or asset status, the FSA shall consider taking necessary actions, such as issuing an order for business suspension under Article 52(1) of the FIEA.

#### IV-3-3-6 Control Environment for Managing Risk Related to Securities-Related Over-The-Counter Derivative Transactions

The provisions of IV-3-3-5(1) to (5) and (8) shall be applied *mutatis mutandis* to the establishment of control environments for risk management and to the execution of business pertaining to securities-related over-the-counter derivative transactions intended for individuals.

#### IV-3-3-7 Control Environment for Managing Risk Related to Crypto-Assets, etc.-Related Over-the-Counter Derivatives Transactions

The provisions of IV-3-3-5(1) through (5) and (8) shall be applied mutatis mutandis to the development of a control environment for managing risk and implementation of business operations related to crypto-assets, etc.-related over-the-counter derivatives transactions. In addition, supervisors shall also pay attention to the following points:

##### (1) Points of Attention Regarding Transactions with Customers and Counterparties to Cover Transactions

- (i) When the crypto-and other assets-related over-the-counter derivatives business operator receives from a customer a deposit of substitute crypto-and other assets as the whole or part of a customer margin or any other security deposit, whether it requires the customer to deposit a volume of crypto-and other assets that sufficiently exceeds the required amount, taking into account the price fluctuation risk of the substitute crypto-and other assets.
- (ii) When the crypto-and other assets-related over-the-counter derivatives business operator deposits crypto-and other assets to the counterparty to cover transactions, whether it screens the counterparty to cover transactions based on the control environment developed under IV-3-6-4(3), and confirms that the counterparty to cover transactions appropriately manages the deposited crypto-and other assets to ensure that they are not leaked outside.

##### (2) Points of Attention Regarding the Assumed Risk Ratio of Crypto-Assets, etc. of Specific Crypto-Assets, etc.-Related Over-The-Counter Derivatives Transactions Intended for Corporations (meaning Specific Crypto-Assets, etc.-Related Over-The-Counter Derivatives Transactions stipulated in Article 117(1)(xlix) of the FIB Cabinet Office Ordinance)

- (i) In the case where the crypto-assets-, etc.-related over-the-counter derivatives business operator calculates the assumed risk ratio of crypto-assets, etc. stipulated in Article 117(51) and (52) of the FIB Cabinet Office Ordinance
  - A. Whether the crypto-assets-, etc.-related over-the-counter derivatives business operator has developed an accurate and reasonable model (meaning the quantitative calculation model stipulated in the “Notice of the Establishment of the Method of Calculating the Assumed Risk Ratio of Crypto-Assets, etc. Pertaining to Specific Crypto-Assets, etc.-Related Over-The-Counter Derivatives Transactions”; the same shall apply hereinafter in (2)), and whether it has established a control environment for calculating the assumed risk ratio of crypto-assets, etc. based on data continuously calculated using a reasonable method.
  - B. Whether the crypto-assets, etc.-related over-the-counter derivatives business operator verifies the assumed risk ratio of crypto-assets, etc. that was calculated using the model at every calculation and after calculation, and whether it has developed a control environment for reviewing the model as needed.
- (ii) In the case where the crypto-assets, etc.-related over-the-counter derivatives business operator outsources the calculation of the assumed risk ratio of crypto-assets, etc. stipulated in Article 117(51) and (52) of the

#### FIB Cabinet Office Ordinance

- A. Whether the crypto-assets, etc.-related over-the-counter derivatives business operator monitors whether the outsourcee has developed an accurate and reasonable model, and whether it has established a control environment for calculating the assumed risk ratio of crypto-assets, etc. based on data continuously calculated using a reasonable method.
- B. Whether the crypto-assets-related, etc. over-the-counter derivatives business operator monitors whether the outsourcee verifies the assumed risk ratio of crypto-assets, etc. that was calculated using the model at every calculation and after calculation, and whether it has developed a control environment for reviewing the model as needed.
- C. In the case where all or part of the operations of A and B above are outsourced more than once, whether the crypto-assets, etc.-related over-the-counter derivatives business operator checks if the outsourcee adequately monitors the subcontractor. Also, whether the crypto-assets, etc.-related over-the-counter derivatives business operator directly monitors the subcontractor as needed.
- D. In the cases where a Financial Instruments Firms Association calculates and publishes the assumed risk ratio of crypto-assets, etc. (including cases where said Association outsources all or part of the calculation and publication of the ratio), whether the crypto-assets, etc.-related over-the-counter derivatives business operator has developed a control environment for using the ratio precisely and continuously, when it uses the ratio.

(Note) In the case of D above, the supervisory authorities shall examine whether said Association is properly operated.

#### IV-3-4 Appropriateness of Business Operations Related to Commodity-Related Market Derivatives Business

##### IV-3-4-1 Control Environment for Legal Compliance

If commodity-related market derivatives business operators (meaning Type I Financial Instruments Business Operators which engage in the activities prescribed under Article 28(1)(i)-2 of the FIEA on a regular basis; the same shall apply hereinafter) are to gain the trust of investors, thereby building trust in the commodity-related market, it is important that they strive to manage their business operations in a sound and appropriate manner while strictly complying with laws, regulations and various business rules, and fully recognizing their roles as commodity-related derivatives market players.

Commodity-related market derivatives business operators' control environments for legal compliance shall basically be examined based on the supervisory viewpoints and method specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules established by self-regulatory organizations.

In cases where a commodity-related market derivatives business operator manages money or any other property deposited by customers for subject commodity derivatives transaction-related transactions (referring to the subject commodity derivatives transaction-related transactions specified in Article 43-2-2 of the FIEA; the same shall apply hereafter), it is basically required to conduct management under the provisions of Articles 142-3 through 142-5 of



the FIB Cabinet Office Ordinance. However, it should be kept in mind that, if the commodity-related market derivatives business operator is a specified member (meaning the “specified member” prescribed in Article 4(1) of the Supplementary Provisions of the Act Partially Amending the Financial Instruments and Exchange Act, etc. (Act No. 86 of 2012); the same shall apply hereinafter), it has the possibility of selecting a method to manage money or any other property deposited by customers for subject commodity derivatives transaction-related transactions by taking property management measures (meaning the “property management measures” prescribed in Article 2(1) of the Supplementary Provisions of the Act Partially Amending the Cabinet Office Ordinance on Financial Instruments Business, etc. (Cabinet Office Ordinance No. 11 of 2014)), notwithstanding these provisions.

#### IV-3-4-2 Control Environment for Customer Solicitation and Explanations

##### (1) Points of Attention Regarding Advertisements, etc.

- (i) In cases where losses exceeding the amount of cash margin and other deposits may arise due to rapid market movements despite the Loss-Cutting Rule, whether the commodity-related market derivatives business operator properly indicates this risk in the advertisement.
- (ii) Whether the commodity-related market derivatives business operator has forced customers to continue attending seminars and similar events despite their expression of unwillingness to do so (including cases where it has effectively forced them to do so). It should be kept in mind that this kind of practice shall be deemed to meet the provision of Article 38(vi) of the FIEA (known as “prohibition of re-solicitation”).

##### (2) Points of Attention Regarding Confirmation of Willingness to be Solicited

While the soliciting of a customer to conclude a contract on entrustment of commodity-related market derivatives transactions is prohibited without obtaining confirmation from the customer, prior to solicitation, regarding whether or not the customer is willing to be solicited, whether the commodity-related market derivatives business operator explains this restriction on solicitation to customers and appropriately confirms whether they are willing to be solicited.

In addition, in the case where customers are individuals, whether the commodity-related market derivatives business operator uses a method of making a visit or phone call or a method of assembling customers without clearly indicating to them that the purpose of such assembly is solicitation (the methods set forth in Article 117(1)(viii)-2, A. and B. of the FIB Cabinet Office Ordinance) as the method for confirmation. For example, when it intends to assemble customers to a seminar, etc. and confirm the customers’ willingness to be solicited, whether the commodity-related market derivatives business operator clearly indicates to them in advance by an advertisement or notice, etc. on the seminar, etc. that the purpose of the seminar, etc. is solicitation for conclusion of a contract on entrustment of commodity-related market derivatives transactions.

Meanwhile, there are differences in the regulation on solicitation between commodity-related market derivatives transactions and commodity derivatives transactions under the Commodity Derivatives Transaction Act (including transactions other than the commodity transaction contracts with prohibitions on uninvited solicitation prescribed in Article 30 of the Order for Enforcement of the Commodity Derivatives Act).

Therefore, attention should be paid to whether a business operator that handles both commodity-related market derivatives transactions and commodity derivatives transactions has established an effective control environment for managing sales staff, such as establishing internal procedures and rules based on such differences and making sure that all officers and employees are aware of them, and developing a control environment where the internal control division, etc. can conduct ex-post facto examination on the status of implementation.

### (3) Points of Attention Regarding Explanation Documents

“The Key Points of the Status of Internal Control” in the Explanation Documents as specified under Article 46-4 of the FIEA shall describe specific arrangements and procedures for handling complaints and inquiries from customers and for conducting internal audits.

### (4) Points of Attention Regarding the Distribution of Notices of Warning Concerning the Solicitation Methods, etc. for Commodity-Related Market Derivatives Transactions

When conducting commodity-related market derivatives transactions, whether, based on the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning Solicitation for Investments and Management of Customers, etc., by Association Members,” the commodity-related market derivatives business operator alerts customers appropriately by distributing clear and concise documents (Notice of Warning) which specify in large print and in an easily understandable manner: (i) an alert to the associated risks; and (ii) the contact details of the designated ADR body in the event of a problem arising, etc. and by giving explanations suited to the customer attributes. Whether there is a control environment in place in which the implementation status of this can be appropriately identified.

### (5) Points of Attention Regarding Commodity-Related Market Derivatives Business Operator’ Responsibility for Explanation

#### (i) Hedging

A. Whether the commodity-related market derivatives business operator recommends customers to match the volume and maturity in the transactions made by them with those in corresponding transactions (meaning transactions intended to offset possible losses involved in the transactions made by them (so-called hedging)) with regard to entrustment, etc. of commodity-related market derivatives transactions.

B. Cases where a commodity-related market derivatives business operator confirms the possibility of an individual customer making hedging transactions, when the customer has expressed willingness to make such transactions or when the customer inquired about the possibility of making such transactions shall not automatically be deemed to fit the provision of Article 117(1)(xxxv) of the FIB Cabinet Office Ordinance. However, whether the business operator confirms that the customer fully understands the transactions, by explaining that hedging may lack economic rationality in some cases, as the customer must pay double fees, the gains and losses will be fixed or limited, and negative spreads could occur.

C. In addition, even in cases where the volume and maturity in corresponding transactions do not match

those in the transactions made by the customer, whether the commodity-related market derivatives business operator accepts entrustment of the transactions after confirming that the customer fully understands the transactions, by providing the explanation referred to in B. above or by other means.

(ii) Obligation to Explain *Sagyoku-mukai*

When a commodity-related market derivatives business operator which conducts “transactions to intentionally match the customer's transactions with transactions of its own account” (hereinafter referred to as “specified transactions”) intends to accept entrustment of individual transactions from a customer, whether it sufficiently explains the matters set forth in Article 117(1)(xxxviii) of the FIB Cabinet Office Ordinance in a manner that the customer can understand. For example, whether it explains matters such as that, when transactions are settled while using specified transactions and if all customers’ total loss is higher than their total gain, it produces profit for the commodity-related market derivatives business operator, and could generate conflicts of interest between the commodity-related market derivatives business operator and customers.

In addition, even if a customer has entrusted transactions after receiving an explanation about specified transactions conducted by the commodity-related market derivatives business operator, whether the commodity-related market derivatives business operator, each time it places an order for its own transactions, notifies the customer that has placed an order for entrusted transactions corresponding to the business operator’s own transactions of the fact that the entrusted transactions became the corresponding transactions for the commodity-related market derivatives business operator’s own transactions, so as to enable the customer to confirm how often the customer’s entrusted transactions become the corresponding transactions for the commodity-related market derivatives business operator’s own transactions, in an effort to make the customer’s understanding based on the explanation above more sufficient.

(Note) “Transactions to intentionally match the customer's transactions with transactions of its own account”

means placing an order for own transactions in a manner that the total number of open sell positions and the total number of open buy positions become balanced between entrusted transactions (transactions conducted by a commodity-related market derivatives business operator based on entrustment by a customer) and own transactions (transactions conducted by a commodity-related market derivatives business operator on its own account), regardless of whether it is conducted manually or automatically. The balance in the total number of open positions is not limited to the matching number of sell and buy positions.

If measures to prevent leakage of trading information on entrusted transactions are precisely taken between the division that accepts entrustment of and executes entrusted transactions and the division that executes own transactions, even if the total number of open sell positions and the total number of open buy positions become balanced between entrusted transactions and own transactions, it is considered unintentional.

(iii) Response to Rapid Market Movements

Whether the commodity-related market derivatives business operator provides appropriate explanations regarding how it responds to rapid market movements, when requested to do so by customers.

(iv) Internal Control Environment for Proprietary Trading

Whether the commodity-related market derivatives business operator provides appropriate explanations regarding whether it engages in proprietary trading and, if it does so, regarding its control environment for risk management, when requested by customers to provide such explanations.

(v) Status of Segregated Management

Whether the commodity-related market derivatives business operator provides customers with appropriate explanations, when requested by them to do so, regarding the status of the commodity customer segregated fund trusts prescribed in Article 142-5 of the FIB Cabinet Office Ordinance.

(vi) Loss-Cut Transactions

In cases where the commodity-related market derivatives business operator has an agreement regarding loss-cut transactions in place, whether it provides appropriate explanations regarding the details therein. Also, whether it provides appropriate explanations regarding the risk of losses in cases where a loss-cut transaction cannot be conducted as intended.

(6) Points of Attention Regarding Provision of Pre-Contract Documents

(i) The “reasons for the possibility of a loss exceeding the principal amount,” as specified under Article 82(iv)(b) of the FIB Cabinet Office Ordinance shall include a rapid market movement that could cause a loss exceeding the principal amount despite the Loss-Cutting Rule.

(ii) The “reasons for the termination of the relevant financial instruments transaction contract,” as specified under Article 82 (viii) of the FIB Cabinet Office Ordinance shall include items related to the Loss-Cutting Rule.

(7) Points of Attention Regarding Provision of Documents Related to Receipt of Cash Margin and Other Deposits

The “date of the receipt of deposits by the relevant Financial Instruments Business Operators, etc.,” as specified under Article 114(1)(iv) of the FIB Cabinet Office Ordinance may be either the date on which the deposit is made or a date after that date, depending on the agreement between the business operator and the customer.

(8) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a commodity-related market derivatives business operator’s control environment for customer solicitation and explanations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the commodity-related market derivatives business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA.

When the commodity-related market derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the commodity-related market derivatives business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the

FIEA.

#### IV-3-5 Appropriateness of Business Operations Related to Financial Instruments Business Operators Who Provide Service of Handling Electronic Public Offerings

##### IV-3-5-1 Basic View on Financial Instruments Business Operators Who Provide Service of Handling Electronic Public Offerings

Financial instruments business operators who provide services of handling electronic public offerings (referring to the service of handling electronic public offerings prescribed in Article 29-2(1)(6) of the FIEA; the same shall apply hereinafter) are required to provide appropriate information through the Internet in order to protect investors, as information on the Internet is expected to influence the investment decisions of investors. Supervisors shall oversee such business operators by paying attention to the following points.

##### IV-3-5-2 Appropriateness of Service of Handling Electronic Public Offerings

When a Financial Instruments Business Operator handles public offering, secondary distribution or private placement, or solicits sales transactions for specified investors, involving securities that are prescribed in each item of Article 3 of the FIEA or those that are not listed on a financial instruments exchange (excluding those prescribed in Article 15-4-2 of the FIEA Enforcement Order; the same shall apply in IV-3-4 and V-2-4), by a method using an electronic data processing system or that using communications technology, such an act constitutes a service of handling electronic public offerings. Verification of the appropriateness of business operations by Financial Instruments Business Operators that provide services of handling electronic public offerings shall be conducted by paying attention to the following points.

##### IV-3-5-2-1 Control Environment for Legal Compliance

Control environments for legal compliance by Financial Instruments Business Operators that provide services of handling electronic public offerings shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules established by self-regulatory organizations.

##### IV-3-5-2-2 Provision of Information Intended to Protect Investors

In providing services of handling electronic public offerings, Financial Instruments Business Operators that provide such services are required to disclose information that may have a material impact on investors' investment decisions on their website, and ensure such information is accessible to investors during the period in which electronic public offerings are being made (including cases in which such operators outsource services; the same shall apply in IV-3-4 and V-2-4). As such, the following points shall be taken into consideration regarding the services of handling electronic public offerings.

(1) Posting of trade names, etc.

In providing services of handling electronic public offerings, whether items required to be included in a sign as specified in Article 36-2(1) of the FIEA are posted in a noticeable location on the website. In the case of a Type 1 Small-Amount Electronic Public Offering Services Operator (referring to the said operators as prescribed in Article 29-4-2(9) of the FIEA; the same shall apply hereinafter), whether such an operator posts items prescribed in Article 29-4-2(8) of the FIEA in a noticeable location on their website.

#### (2) Representation of Items That Can Have a Material Impact on Investors' Judgment

Providers of services handling electronic offerings are required to maintain information prescribed in Article 146-2(3) of the FIB Cabinet Office Ordinance in a state accessible to investors on their website. Posting of the relevant information shall be examined by paying attention to the following points.

- (i) Whether the relevant information is displayed clearly and accurately in a location that is easy to see on the website. Also, whether appropriate and easy-to-understand descriptions are made, from the viewpoint of protecting investors.
- (ii) Whether the operator is making efforts not to impair the ability of investors to understand by, for example, first displaying important information that has material impact on their judgment, in light of purposes of posting relevant information on the website as well as the aims of provisions regarding method of indicating relevant information
- (iii) Whether relevant information is displayed on the website in ways in which investors can access its location easily during the period in which the service of handling electronic public offerings is being provided

#### IV-3-5-3 Appropriateness of Electronic-Application-Style Services of Handling Electronic Public Offerings

Financial Instruments Business Operators providing services of handling electronic public offerings in the electronic-application style (as prescribed in Article 70-2(3) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter) are required to maintain a system to ensure appropriate screening of the issuer's business plan and appropriate provision of information, as well as to provide information regarding the Financial Instruments Business Operators themselves. The appropriateness of services handling electronic public offerings in electronic application style shall be checked by paying attention to IV-3-4-2 and the following points.

##### IV-3-5-3-1 System to Control Operations

###### (1) Appropriate Screening Regarding Business Plan, Etc., of Issuer

Whether appropriate rules are introduced regarding screening of items specified in Article 70-2(2)(iii) of the FIB Cabinet Office Ordinance, and meaningful screening is accurately conducted. Also, whether a system to accurately verify the results of such screening is in place. In addition, whether a system is in place to ensure appropriate screening can be conducted to ensure that the business plan is based on rational reasoning and that a reasonable target amount is set for the offering in view of the said business plan and the issuer's financial status.

## (2) Points of Attention Regarding Level of Offer Target and Handling of Subscribed Amount

- (i) Whether representations are made to avoid misunderstanding by investors on the "method to handle subscribed amount when the target of amount of offer is not reached or such a target is exceeded" prescribed in Article 70-2(2)(iv) of the FIB Cabinet Office Ordinance. Examination, for example, shall be conducted by paying attention to the following points.
  - A. When securities are issued even though the subscribed amount failed to reach the target, whether the reason that the issuance of the said securities is deemed rational in view of the issuer's business plan and the purpose of the funds being raised so as to prevent misunderstanding on the part of investors is clearly presented.
  - B. When the subscribed amount exceeds the target of offer and the securities are issued for the higher amount, whether the purpose of the funds being raised to the amount exceeding the amount of offering target and the possible impact the amount exceeding the amount of offering target may have on the details of the issuer's business plan are clearly explained in ways that prevents misunderstanding on the part of investors.
- (ii) In cases where the securities are issued only when subscription reaches the target subscription amount, whether "measures have been taken to ensure that the issuer will not receive the payment of subscription price (including an amount similar thereto; the same applies in item (vii) and Article 83(1)(vi)(d)) before the target subscription amount is achieved" as prescribed in Article 70-2(2)(v) of the FIB Cabinet Office Ordinance, for example, by ensuring that the account into which subscribed amounts are paid only after the total subscribed amount reaches the target subscription amount.

## (3) Points of Attention Regarding Cancellation of Application

Whether there are measures in place to ensure investors can retract their application or cancel the contract with the issuer regarding the said application (hereinafter referred to as "application cancellation, etc.") within eight days from the day the application was made to acquire the said securities (hereinafter referred to as "application cancellation period"), with regard to public offering or private placement of securities handled in services handling electronic public offerings in an electronic application style, etc.

When judging whether the above-mentioned measures are employed to a satisfactory degree, the following points, for example, shall be considered.

- (i) Whether applicants can retract their application unconditionally during the application cancellation period. For example, whether the Financial Instruments Business Operator providing a service of handling electronic public offerings in the electronic application style, in facing a retraction of application, may be able to claim payment of a penalty (regardless of what this is called, for example, damages, fees, etc.) for the said retraction
- (ii) Whether clear representation is made that investors can retract their application during a specified period as well as about necessary information for retracting an application (such as the method for retraction, procedure, contact information and how to get refunded on the payment of subscription amount that have already been paid, etc.)

#### (4) Ensuring Provision of Information About Status of Business Operation

Whether measures are taken to ensure that the issuer periodically provide the customer with information about the former's operational status (such a measure can be, for example, a scheme in which the Financial Instruments Business Operator providing a service of handling electronic public offerings in the electronic application style receives reports on the issuer's operational status, and disclose them to investors by posting them on the said Financial Instruments Business Operator's website or sending them by email.

#### IV-3-5-4 Appropriateness of Type 1 Small-Amount Electronic Public Offering Services

Part of the registration requirements for Type 1 Small-Amount Electronic Public Offering Services (prescribed under Article 29-4-2(10) of the FIEA) has been relaxed for Type I Financial Instruments Business for Financial Instruments Business Operators who handle Electronic Public Offering Services that meet certain requirements, such as those in which the amount of the securities(referring to stocks or stock acquisition right certificates (limited to those not listed on financial instruments exchanges and excluding securities specified under Article 15-4-2(4) and (5) of the FIEA Enforcement Order); the same shall apply in IV-3-4-4) issued is small. The appropriateness of Type 1 Small-Amount Electronic Public Offering Services shall be checked in accordance with IV-3-4-2 and IV-3-4-3, as well as by paying attention to the following points.

#### IV-3-5-4-1 Control Environment for Customer Solicitation and Explanations

##### (1) Supervisory viewpoints

As services by Type 1 Small-Amount Electronic Public Offering Services Operators for public offerings or private placement of securities are provided only through the method utilizing communications technology as specified in each item of Article 6-2 of FIB Cabinet Office Ordinance, such operators are banned from soliciting acquisition of securities using methods other than the specified one. (For example, they cannot use solicitation using phone calls or visits customers individually.) It should be noted, therefore, that Type 1 Small-Amount Electronic Public Offering Services Operators soliciting acquisition using methods other than the specified one do not qualify for the special clause of Article 29-4-2 of the FIEA, resulting in such operators operating Type I Financial Instruments Business without registration under the FIEA.

##### (2) Supervisory Method and Actions

If a Type 1 Small-Amount Electronic Public Offering Services Operator is found to be handling public offering or private placement of securities using methods other than that utilizing the communications technology specified in each item in Article 6-2 of the FIB Cabinet Office Ordinance, supervisors shall conduct in-depth hearing and, if necessary, instruct submission of a report in accordance with provisions of Article 56-2(1) of FIEA to look into status of spontaneous efforts to improve the situation at such operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions,



including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### IV-3-5-4-2 Points of Attention Regarding Total Issued Amount of Securities

##### (1) Basic Points to Consider

Whether a Type 1 Small-Amount Electronic Public Offering Services Operator has taken necessary and appropriate measures to prevent the total issued amount of securities (Type 1 Small-Amount Electronic Public Offering Services public offerings or private placement of securities the same(2)and(3)) of which it handles public offering or private placement from exceeding 100 million yen and individual investors acquiring relevant securities from paying in excess of 500,000 yen

When judging whether the above-mentioned measures are employed to a satisfactory degree, the following points, for example, shall be considered.

- (i) Whether the operator has checked to see if the issuer of securities for public offering or private placement, in relation to calculation method based on provisions of Article 16-3(1) of the FIB Cabinet Office Ordinance, issued the same type of securities through a different Financial Instruments Business Operator in the past one-year period before the day the said public offering or private placement is started or using a method specified in Article 2(8)(vii) of FIEA (along with the specific amount of issuance if the issuer is found to have done so) by means of an appropriate method before starting to solicit acquisition of the securities, such as by examining documents showing calculations and, if necessary, questioning the issuer.
- (ii) Whether the operator has checked to see if the investor in securities for public offering or private placement, in relation to calculation methods based on the provisions of Article 16-3(2) of the FIB Cabinet Office Ordinance, has acquired the same type of securities issued by the same issuer in the past one-year period before the day of the said public offering or private placement is started (and that the operator has confirmed the specific acquisition value of such securities if it is possible to obtain the figure), using an appropriate method

##### (2) Points of Attention When Service Becomes Disqualified for Type 1 Small-Amount Electronic Public Offering Services Operators

It should be noted that if the total amount of issued securities for public offering or private placement that are handled by a Type 1 Small-Amount Electronic Public Offering Services Operator exceeds 100 million yen or a person acquiring the said securities pays more than 500,000 yen, such a service becomes disqualified from the special clause of Article 29-4-2 of the FIEA, resulting in the said Type 1 Small-Amount Electronic Public Offering Services Operator providing services under the Type I Financial Instruments Business.

##### (3) Supervisory Method and Actions

If a Type 1 Small-Amount Electronic Public Offering Services Operator is found to be handling public offering or private placement of securities whose issuance totals 100 million yen or more or the amount paid by the person acquiring the said securities exceeds 500,000 yen, supervisors shall conduct in-depth hearing and, if necessary,

request submission of reports based on provisions of Article 56-2(1) of FIEA to look into status of spontaneous efforts to improve the situation at such an operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### IV-3-6 Appropriateness of Business Operations Related to Financial Instruments Business Operators That Handle Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

Financial instruments business operators that handle electronically recorded transferable rights that must be indicated on securities, etc. (meaning the electronically recorded transferable rights that must be indicated on securities, etc. prescribed in Article 1(4)(xvii) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter) are required to appropriately develop a control environment from the viewpoint of investor protection in light of the high degree of freedom in the design of electronically recorded transferable rights that must be indicated on securities, etc. and their transferability. Supervisors shall oversee such business operators by paying attention to the following points in addition to the points indicated in IV-3-1.

Meanwhile, electronically recorded transferable rights (meaning the electronically recorded transferable rights prescribed in Article 2(3) of the FIEA; the same shall apply hereinafter) do not fall under the category of crypto-assets, as prescribed in Article 2(14) of the Payment Services Act. However, in the case where electronically recorded transferable rights also have a function to be used to pay the price for purchase of goods or provision of services, for example, supervisors shall examine the state of development of the control environment for distribution and management, etc. of the electronically recorded transferable rights while referring to Guideline for Administrative Processes (Vol. 3: 16 Crypto-Asset Exchange Service Providers) as needed.

(Note) In the case where the Financial Instruments Business Operator provides electronic public offering services, supervisors shall also refer to IV-3-4.

##### IV-3-6-1 Control Environment for Legal Compliance

The control environment for legal compliance by Financial Instruments Business Operators that handle electronically recorded transferable rights shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules established by self-regulatory organizations.

##### IV-3-6-2 Control Environment for Customer Solicitation and Explanations

###### (1) Principle of Suitability

A characteristic of electronically recorded transferable rights that must be indicated on securities, etc. is that the rights are transferred and electronically recorded by using an electronic data processing system without involving the book-entry transfer institution specified by the Act on Book-Entry Transfer of Corporate Bonds and Shares. This scheme gives transferability to unlisted securities, but it could involve risks that differ from those for ordinary securities in respect to the holding, transfer, settlement, and so on of the rights, etc. Therefore, supervisors shall examine whether the Financial Instruments Business Operator handles electronically recorded transferable rights that must be indicated on securities, etc. in consideration of the following points from the viewpoint of suitability:

- (i) Whether the Financial Instruments Business Operator continuously conducts appropriate examination regarding the risks involved in the networks, such as the blockchain, used for the electronically recorded transferable rights that must be indicated on securities, etc. it handles by, for example, undergoing an examination by experts as necessary, in light of the importance of the risks.
- (ii) In conducting purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc. with customers, whether the Financial Instruments Business Operator has appropriately established standards for initiating transactions. In addition, whether the standards take into consideration not only customers' investment experience and status of property, but also the degree of understanding of the scheme of holding and transferring electronically recorded transferable rights that must be indicated on securities, etc. and the risks involved therein, and the experience in transactions of products using a similar scheme.

(2) Points of Attention Regarding Advertisements, etc.

In the case of making an advertisement, etc. with regard to an act that constitutes a financial instruments transaction with regard to electronically recorded transferable rights that must be indicated on securities, etc., the making of an inappropriate representation of the matters prescribed in Article 78(xii) of the FIB Cabinet Office Ordinance is prohibited. Examples of "a representation that substantially differs from the truth" or "a representation that substantially misleads others" could include the following:

- (i) A representation that could cause others to have a misconception regarding the fact that fluctuations in the transaction volume or price of the electronically recorded transferable rights that must be indicated on securities, etc. could generate a loss
- (ii) A representation that could cause others to have a misconception regarding the fact that transfer of the electronically recorded transferable rights that must be indicated on securities, etc. will be restricted for a specific period according to the scheme of the rights
- (iii) A representation that could cause investors to have a misconception regarding the financial conditions of the issuer of the electronically recorded transferable rights that must be indicated on securities, etc. or the status of progress of business conducted by the issuer

(3) Points of Attention Regarding Explanation of Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

In a pre-contract document for purchase and sale or other transactions of electronically recorded transferable

rights that must be indicated on securities, etc., the Financial Instruments Business Operator is required to state the outline of the electronically recorded transferable rights that must be indicated on securities, etc. and the matters which should be noted by the customer, based on Article 83(1)(vii) of the FIB Cabinet Office Ordinance.

For example, the explanation of the outline of the electronically recorded transferable rights that must be indicated on securities, etc. should be stated in a manner easy for investors to understand, by using figures or the like if it includes technical explanation. In addition, it should be kept in mind that, if the scheme of the electronically recorded transferable rights that must be indicated on securities, etc. involves risks, etc. that differ from those for ordinary securities in respect to the method of holding or transferring the rights or the like (this includes but is not limited to the reaching of an agreement, settlement, the method of satisfaction of the requirement for perfection, etc. relating to transfer of the rights), the Financial Instruments Business Operator is required to explain this appropriately.

#### IV-3-6-3 Points of Attention Regarding the System to Control Operations

In the case of handling electronically recorded transferable rights that must be indicated on securities, etc. in the course of electronic-based application type electronic public offering services, etc., the Financial Instruments Business Operator needs to develop the system to control operations prescribed in Article 70-2(2)(ii) through (vii) of the FIB Cabinet Office Ordinance as stated in IV-3-4-3-1 above. Of this system, regarding the examination on the handling of electronically recorded transferable rights that must be indicated on securities, etc. (item (iii) of that paragraph), supervisors shall examine whether the Financial Instruments Business Operator, etc. appropriately examines the points in IV-3-4-3-1(1) above as well as, for example, whether the scheme of the electronically recorded transferable rights that must be indicated on securities, etc. does not cause serious risks, etc. to investors in respect to the method of holding or transferring the rights or the like (this includes but is not limited to the reaching of an agreement, settlement, the method of satisfaction of the requirement for perfection, etc. relating to transfer of the rights), as "matters to facilitate the decision of whether it is appropriate to handle the securities as part of electronic-based application type electronic public offering services, etc." In addition, supervisors will pay attention to whether the Financial Instruments Business Operator continuously conducts appropriate examination regarding the risks involved in the networks, such as the blockchain, used for the electronically recorded transferable rights that must be indicated on securities, etc. by, for example, undergoing an examination by experts as necessary, in light of the importance of the risks.

#### IV-3-6-4 Measures such as Verification at the Time of Transaction

The characteristics of the purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc. are that the transactions are generally conducted without any face-to-face contact and that the rights can be electronically transferred without involving a book-entry transfer institution. Given such characteristics, etc. of the transactions, special attention should be paid from the viewpoint of preventing terrorism financing and money laundering. Therefore, supervisors shall examine the following points, for example, in addition to the points stated in III-2-6 above and the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism.

(1) Identification, Assessment, and Reduction of Risks Based on the Specific Characteristics, etc. of Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

Whether the Financial Instruments Business Operator identifies and assesses the risks involved in the electronically recorded transferable rights that must be indicated on securities, etc. in light of the scheme of the electronically recorded transferable rights that must be indicated on securities, etc. (including the issuer, manager, and other persons concerned, and details of the invested business and underlying assets pertaining to the electronically recorded transferable rights that must be indicated on securities, etc.), the status of distribution, technology used in the electronically recorded transferable rights that must be indicated on securities, etc., and other characteristics of the rights, and develops an internal control environment for appropriately reducing those risks, including the implementation of the measures referred to in (2) below. In addition, whether these are periodically examined and reviewed.

(2) Measures against Cases of Money Laundering and Terrorism Financing

Whether the Financial Instruments Business Operator, etc. carefully determines the scope of electronically recorded transferable rights that must be indicated on securities, etc. to be handled in light of the risk that the electronically recorded transferable rights that must be indicated on securities, etc. would be exploited in cases of money laundering and terrorism financing, and other factors. For example, it should be kept in mind that electronically recorded transferable rights that must be indicated on securities, etc. of which transfer records are extremely difficult to trace should not be made subject to purchase and sale or other transactions, as the risk of such electronically recorded transferable rights that must be indicated on securities, etc. becoming exploited in cases of money laundering and terrorism financing is particularly high.

In addition, in the case of conducting purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc., whether the Financial Instruments Business Operator, etc. has developed a control environment for effectively reducing the risk of money laundering and terrorism financing associated with the handling of electronically recorded transferable rights that must be indicated on securities, etc. based on III-2-6 and the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism, and whether it appropriately confirms that the transactions are unlikely to fall under the category of suspicious transactions. In particular, whether it has determined the need for the suspicious transaction reporting by appropriately considering whether there are any suspicious aspects about the counterparty to the transaction being the true holder of the electronically recorded transferable rights that must be indicated on securities, etc. in respect to attributes of the counterparty to the transaction and the management method of the electronically recorded transferable rights that must be indicated on securities, etc.

(3) Points of Attention Regarding Transactions Between Financial Instruments Business Operators

In the case where the Financial Instruments Business Operator conducts purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc. with another Financial Instruments Business Operator or a foreign financial instruments business operator, or grants a license to use a

system it has developed to another Financial Instruments Business Operator or a foreign financial instruments business operator, whether it has developed the following control environment based on the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism:

- (i) The Financial Instruments Business Operator gathers information on the customer base and the nature of business operations of the counterparty to the transactions, the status of development by the counterparty of arrangements and procedures for preventing terrorism financing and money laundering, and if the counterparty is a foreign business operator, the local supervisory authorities' arrangements and procedures for supervising the business operator, and properly assesses the risk of the transaction being exploited in cases of terrorism financing and money laundering. In addition, it periodically reviews this, and as necessary, reviews the risk assessment when a new event that could have a serious impact on measures against terrorism financing and money laundering occurs.
- (ii) The Financial Instruments Business Operator takes appropriate risk reduction measures, such as appropriately examining and determining the conclusion or continuation of a contract for transactions with the counterparty to the transactions, including requiring approval by the manager.
- (iii) The Financial Instruments Business Operator clarifies, by way of documentation or the like, the sharing of responsibility and roles between the Financial Instruments Business Operator and the counterparty to the transactions with regard to prevention of terrorism financing and money laundering.

#### (4) Points of Attention Regarding Business Partners, etc.

In the case where the Financial Instruments Business Operator forms a partnership with or outsources part of operations to another company with regard to the purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc., whether it has developed the following control environment based on the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism. If the partner or outsourced contractor (hereinafter referred to as the "partner, etc.") is the specified business operator provided for in Article 2(2) of the Anti-Criminal Proceeds Act, supervisors shall refer to the matters set forth in (3) above.

- (i) The Financial Instruments Business Operator gathers information on the customer base and the nature of business operations of the partner, etc. and the status of development by the partner, etc. of arrangements and procedures for preventing terrorism financing and money laundering, and properly assesses the risk of the partner, etc. of being exploited in cases of terrorism financing and money laundering. In addition, it periodically reviews this, and as necessary, reviews the risk assessment when a new event that could have a serious impact on measures against terrorism financing and money laundering occurs.
- (ii) The Financial Instruments Business Operator takes appropriate risk reduction measures, such as appropriately examining and determining the conclusion or continuation of the contract with the partner, etc.
- (iii) The Financial Instruments Business Operator clarifies, by way of documentation or the like, the sharing of responsibility between the Financial Instruments Business Operator and the partner, etc. with regard to the prevention of terrorism financing and money laundering.

#### IV-3-6-5 Control Environment for Managing Information Technology Risk

In conducting purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc., the Financial Instruments Business Operator often has an advanced and complicated information system that assumes the use of the internet, due to the nature of the operations, and electronically recorded transferable rights that must be indicated on securities, etc. are indicated on property value that can be electronically recorded on a blockchain, etc. and transferred via a network. Therefore, there are growing risks of unauthorized computer access or leakage of important information due to cyberattacks that are becoming more cunning day by day. Also, there can be cases where the Financial Instruments Business Operator outsources these operations to a third party, or cases where multiple Financial Instruments Business Operators use a common network which they jointly designed and developed. In such case, supervisors shall examine the following points, for example, in addition to the points stated in III-2-8(1) above.

##### (1) Control Environment for Managing Information Technology Risk, Assessment of Information Technology Risk

- (i) Whether the Financial Instruments Business Operator has constantly reviewed the control environment for managing information technology risk according to identification and analysis of system trouble, etc., risk management implementation results, and technological progress, etc.

(Note) It is desirable to have the control environment for managing information technology risk periodically assessed by a third party (external organization).

- (ii) Whether the computer system division assesses the residual risk that remains after taking measures against the identified risks, and reports it to the board of audit.

Whether risks such as the following are included in the information technology risk:

- Risk caused by using external services
- Risk caused by API disclosure, provision, connection, etc.

##### (2) Management of Cybersecurity

- (i) Whether the Financial Instruments Business Operator has developed procedures in preparation for ex-post facto investigation (forensic investigation), such as keeping logs and acquiring image copies for checking the scope affected and investigating the cause in case of receiving a cyberattack.
- (ii) Whether the Financial Instruments Business Operator has clearly specified the procedures for periodic information gathering and analysis of and response to information on vulnerabilities and threats and implements these in an organizational manner. In addition, whether it properly conducts risk assessment in the case where a cybersecurity incident occurs inside or outside Japan.

##### (3) System Planning/Development/Management

- (i) Whether the Financial Instruments Business Operator has formulated rules concerning the preparation of documents and programs concerning design/development according to the system development process. In the system design/development phase, security-related matters, such as the following, should be included in the rules:

- To clarify the specific security requirements.
  - To take measures for preventing generation of vulnerable points, such as implementation of secure coding.
- (ii) Whether the Financial Instruments Business Operator has formulated rules and procedure manuals concerning quality management, including the following contents:
- To conduct reviews and keep records.
  - To formulate completion standards for each process and conduct assessment.
  - To ensure sufficient performance design and manage the upper limits of the system capacity and performance.
  - To identify the limit values at the time of system development.
- (iii) Whether the Financial Instruments Business Operator has established rules on system changes. In addition, whether it prepares documents and requires the manager's approval for system changes.
- (iv) Whether the Financial Instruments Business Operator has formulated system operation and management rules and procedure manuals in consideration of points including the following:
- A scheme to efficiently isolate a problem at the time of detection in the monitoring settings.
  - Unification of escalation rules concerning monitoring.
  - Incorporation of recording, approval, and inspection in the work process.
  - Recording and keeping the status of implementation of operations concerning the system operation management.
- (v) Whether the Financial Instruments Business Operator has specified the purpose and policy of management of system configurations and the scope of application.
- In addition, whether it identifies the configurations and checks the effectiveness of management regarding points including the following:
- Physical resources (hardware, networks, servers, PCs, etc.)
  - Logical resources (licenses, software, connection configuration, etc.)
  - Cloud services, operations outsourced to a third party, etc.
- (vi) Whether the Financial Instruments Business Operator has secured human resources that are well versed in the mechanism of the current system and have expertise in system planning, development, and operation management.

#### (4) Management of Outsourcing of Business Operations

- (i) When using an external service, such as a cloud service, whether the Financial Instruments Business Operator considers the risks involved in the service to be used, and take measures against them,
- For example, whether it implements measures such as the following:
- Identification of the base where important data are processed and stored.
  - Reflecting of the auditing authority, monitoring authority, etc. in the written contract.
  - Acquisition and evaluation of the assurance report.
- (ii) Whether the Financial Instruments Business Operator takes necessary measures in outsourced system-related work (including work further subcontracted) in order to prevent the work from being completely left



to outsourced contractors, such as allocating its personnel to the outsourced contractors as the outsourcer.

- (iii) Whether the Financial Instruments Business Operator has its internal control division or system auditor, etc. conduct audit of important outsourced contractors and acquires and evaluates reports on internal controls of the outsourced contractors.

"Reports on internal controls of the outsourced contractors" could include, for example, reports prepared according to IT Committee Practical Guideline No. 7 "Assurance Reports on Internal Control Concerning Security, Availability, Processing Integrity, Confidentiality, and Privacy of Entrusted Business" and Auditing and Assurance Practice Committee Practical Guideline No. 86 "Assurance Reports on Controls at a Service Organization" published by the Japanese Institute of Certified Public Accountants (JICPA).

#### (5) Contingency Plan

- (i) With regard to a contingency plan, whether the Financial Instruments Business Operator has developed a procedure manual based on the plan. In addition, whether it has established arrangements and procedures for dealing with emergencies, including those for important outsourced contractors.
- (ii) In formulating a contingency plan, whether the Financial Instruments Business Operator adopts a sufficient risk scenario that assumes risks including the following:
- Cyberattacks
  - Disasters and pandemics
  - System troubles
  - Information leakage
- (iii) Whether the Financial Instruments Business Operator takes measures against a case where data become damaged, such as periodically making backups of data.

#### IV-3-6-6 Points of Attention Regarding Segregated Management

When a Financial Instruments Business Operator receives deposits of electronically recorded transferable rights that must be indicated on securities, etc. from customers, appropriate handling of segregated management of those rights needs to be ensured based on the provisions of Article 43-2 of the FIEA and Article 136(1)(v) or (vi) of the FIB Cabinet Office Ordinance.

In particular, given that measures are required to be taken against risk of leakage with regard to the scheme of holding and transferring electronically recorded transferable rights that must be indicated on securities, etc. as indicated in IV-3-5-7 below, supervisors need to pay attention to the following points:

- (1) Case where the Financial Instruments Business Operator manages the electronically recorded transferable rights that must be indicated on securities, etc. itself
- (i) Electronic equipment, etc. that has been connected to the internet even once does not fall under the category of "electronic equipment, etc. that is never connected to the internet" (Article 136(1)(v)(b) of the FIB Cabinet Office Ordinance).
- (ii) Whether or not certain measures can be regarded as "equivalent technical security control measures"

(Article 136(1)(v)(b) of the FIB Cabinet Office Ordinance) needs to be substantially determined according to the actual state in individual cases. However, a possible case could be, for example, where the private key or any other information (hereinafter referred to as the "private key, etc.") required for transferring the property value on which electronically recorded transferable rights that must be indicated on securities, etc. are indicated is recorded and managed in electronic equipment, etc. that only connects to the internet when affixing a signature, while the technical specifications make it possible to affix a signature within the electronic equipment, etc., without having the private key, etc. recorded in the electronic equipment, etc. to be transferred from the electronic equipment, etc. to outside, and the authenticity of the contents of transactions is confirmed each time by manually affixing a signature with the private key, etc.

(iii) Whether or not electronically recorded transferable rights that must be indicated on securities, etc. can be regarded as "the minimum required for ... in order to secure customer convenience and smoothly implement financial instruments business" (Article 136(1)(v) and (vi) of the FIB Cabinet Office Ordinance) needs to be considered individually based on their contents and transferability. However, in the following cases, for example, it is not permissible to record and manage a private key, etc. in electronic equipment, etc. connected to the internet:

A. A case where the electronically recorded transferable rights that must be indicated on securities, etc. include common benefit rights, such as a corporation's voting rights, and in the event of leakage, it is difficult to recover the damage caused to investors by monetary compensation alone.

B. A case where the instantaneousness of transfer is not sought, such as where the settlement is not executed simultaneously with the agreement on transfer of the right, etc., and there is little need to record and manage the private key, etc. in an electronic equipment, etc. connected to the internet.

(2) Case where a Financial Instruments Business Operator outsources the management of electronically recorded transferable rights that must be indicated on securities, etc. to a third party

Whether or not a method can be regarded as a "method that is reasonably found to secure equivalent customer protection as the case of conducting management itself" needs to be substantially determined according to the actual state in individual cases. However, a possible case could be, for example, where all of the following points are satisfied:

(i) In light of the points prescribed in (1) above, the third party appropriately takes the measures referred to in Article 136(1)(v)(b) of the FIB Cabinet Office Ordinance and appropriately takes necessary actions against the risk of leakage based on IV-3-5-7.

(ii) The Financial Instruments Business Operator, which is the outsourcer, appropriately manages the outsourced contractors as stated in III-2-8(1)(viii) and IV-3-5-5(2) above.

IV-3-6-7 Points of Attention Regarding Actions against Risk of Leakage of Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

When a Financial Instruments Business Operator received deposits of electronically recorded transferable rights that must be indicated on securities, etc. from customers, there is a risk that investor protection would not be

ensured due to leakage of the private key, etc. for the entrusted electronically recorded transferable rights that must be indicated on securities, etc. as a result of unauthorized computer access, etc., such as where it becomes unable to return the electronically recorded transferable rights that must be indicated on securities, etc. to customers. Therefore, it is required to take appropriate actions against such risk of leakage through establishment of an internal control environment (including a control environment for internal audits according to the nature of the business), such as segregated management and information technology risk management, etc., in normal times.

While recording and transfer, etc. of electronically recorded transferable rights that must be indicated on securities, etc. are to be conducted via a network, such as a blockchain, there have been several cases where large amounts of entrusted crypto-and other assets, which use a similar scheme, were leaked as a result of unauthorized computer access, etc. Therefore, taking actions against the abovementioned risk of leakage is one of the top-priority issues also in receiving entrustment of electronically recorded transferable rights that must be indicated on securities, etc.

In confirming whether a Financial Instruments Business Operator receiving deposits of electronically recorded transferable rights that must be indicated on securities, etc. is taking appropriate actions against the abovementioned risk of leakage, supervisors shall pay attention to the following points, for example:

(1) Identification and Assessment of the Risk of Leakage

- (i) Whether the Financial Instruments Business Operator appropriately identifies and assesses the risk of leakage of the electronically recorded transferable rights that must be indicated on securities, etc. it handles, for each type of those rights.
- (ii) In identifying the risk of leakage, whether the Financial Instruments Business Operator determines assumable situations of leakage (including but not limited to leakage, theft, unauthorized use, or loss of a private key, etc.) and specifically identifies the risks that cause the leakage (including but not limited to cyberattacks as well as clerical error, internal fraud, and system failure) by taking into consideration circumstances including the scheme of holding and transferring electronically recorded transferable rights that must be indicated on securities, etc., the technology used for the electronically recorded transferable rights that must be indicated on securities, etc., the internal system and network environment, and operations for using (signing with) the private key, etc. for the entrusted electronically recorded transferable rights that must be indicated on securities, etc. (affixing electronic signatures).
- (iii) In assessing the identified risk of leakage, whether the Financial Instruments Business Operator specifically analyzes and assesses the impact that the materialization of the risk could have on the entrusted electronically recorded transferable rights that must be indicated on securities, etc. and on customers and business management. In addition, whether the Financial Instruments Business Operator periodically reviews the risk assessment, and as necessary, reviews the risk assessment when a new event that could have a serious impact on the management of electronically recorded transferable rights that must be indicated on securities, etc. occurs.
- (iv) When newly commencing the handling of electronically recorded transferable rights that must be indicated on securities, etc., whether the Financial Instruments Business Operator analyzes the electronically recorded

transferable rights that must be indicated on securities, etc. and examines them from the viewpoint of the risk of leakage in advance.

## (2) Reduction of the Risk of Leakage

In reducing the risk of leakage, whether the Financial Instruments Business Operator takes effective measures to reduce the risk of leakage identified and assessed in (1) above, while taking into account the changes in the modes of leakage and technological progress, and for example incorporating the following points:

- (i) Whether the Financial Instruments Business Operator has arrangements and procedures where multiple persons in charge become involved in transfer of entrusted electronically recorded transferable rights that must be indicated on securities, etc., according to the procedure specified in internal rules, etc. in advance.
- (ii) Whether the Financial Instruments Business Operator manages the private key, etc. in a manner ensuring that no person other than authorized persons can use (sign with) it. In particular, when managing the private key, etc. in a physical medium, such as hardware or paper, whether the Financial Instruments Business Operator stores it in an environment that no person other than authorized persons can access, such as a locked security room or a safe.
- (iii) Whether the Financial Instruments Business Operator takes appropriate measures, such as requiring an electronic signature that requires multiple private keys, etc., for transfer of entrusted electronically recorded transferable rights that must be indicated on securities, etc. When using multiple private keys, etc., whether it manages the private keys, etc. by storing each of them in different places.
- (iv) In transfer of entrusted electronically recorded transferable rights that must be indicated on securities, etc., whether the Financial Instruments Business Operator confirms the authenticity of the contents of transactions pertaining to transfer of the electronically recorded transferable rights that must be indicated on securities, etc.
- (v) Whether the Financial Instruments Business Operator creates a backup of a private key, etc. in case of losing it. Whether it also manages the backup of the key safely based on (ii) above.
- (vi) Whether the Financial Instruments Business Operator makes the procedure of transfer of entrusted electronically recorded transferable rights that must be indicated on securities, etc. subject to internal audit.

## (3) Response at the Time of Leakage

- (i) Whether the Financial Instruments Business Operator has developed a system monitoring arrangements and procedures that can immediately detect leakage of entrusted electronically recorded transferable rights that must be indicated on securities, etc. or other internal control arrangements and procedures necessary for immediately detecting leakage.
- (ii) Whether the Financial Instruments Business Operator has developed internal communication arrangements and procedures for securely and promptly conveying the detected contents when leakage of entrusted electronically recorded transferable rights that must be indicated on securities, etc. has been detected.
- (iii) With regard to response in the case of detecting leakage of entrusted electronically recorded transferable rights that must be indicated on securities, etc., whether the Financial Instruments Business Operator has

formulated a contingency plan assuming a time of leakage, and has established emergency arrangements and procedures including the following measures, for example:

A. Measures necessary for preventing secondary damage

(Note) It is necessary to consider the response according to the state of leakage and the specific characteristics of the electronically recorded transferable rights that must be indicated on securities, etc. that are stored. For example, in the case where a private key, etc. is stored in an environment connected to the internet, the private key, etc. should immediately be isolated from the internet, the electronically recorded transferable rights that must be indicated on securities, etc. which are managed using that private key, etc. should immediately be transferred to an environment that is not connected to the internet, and the Financial Instruments Business Operator should check whether the leakage affects other electronically recorded transferable rights that must be indicated on securities, etc.

B. Response to users that incurred damage (including opening a consultation service, etc.)

(Note) It should be kept in mind that, in recovering the damage incurred by users, the Financial Instruments Business Operator is required to make response in accordance with the policy on performance of the obligations prescribed in Article 70-2(5) of the FIB Cabinet Office Ordinance.

C. Reporting to and cooperation with persons concerned, including the authorities and outsourced contractors, etc.

D. Consideration and implementation of prompt causal analysis and new risk reduction measures

(Note) It should be kept in mind that, in order to conduct causal analysis promptly, it is necessary to appropriately preserve evidence on the related server, etc. and to have recorded access logs or the like that include sufficient information for tracking the event.

#### IV-3-6-8 Development of an Environment for Screening the Issuer of Electronically Recorded Transferable Rights

##### (1) Points of Attention Regarding Screening of Underwriting, etc.

Electronically recorded transferable rights are able to represent various rights, and they may have high transferability due to their scheme. On the other hand, however, when the transferability increases, asymmetry of information is inclined to occur between the issuer and investors, so the issuer needs to appropriately perform its obligations under disclosure regulations. In addition, in order to ensure the accuracy of the disclosed contents and to prevent fraudulent cases, it is necessary to appropriately develop a scheme for third-party screening of the issuer's business and financial conditions, etc.

Therefore, supervisors shall examine, for example, the following points to check whether the Financial Instruments Business Operator has appropriately developed a control environment for screening the issuer in underwriting electronically recorded transferable rights, etc., based on laws and regulations and voluntary regulatory rules established by self-regulatory organizations:

- (i) Whether the Financial Instruments Business Operator has developed appropriate rules for screening the issuer's business and financial conditions, the networks, such as the blockchain, used for purchase and sale

or other transactions of electronically recorded transferable rights, and other matters to facilitate the decision of whether the underwriting, etc. is appropriate, and precisely conducts substantive screening. In addition, whether it has developed arrangements and procedures for securely examining the results of the screening.

- (ii) Whether the Financial Instruments Business Operator depends solely on screening by other Financial Instruments Business Operators, without conducting screening itself, even in the case where multiple Financial Instruments Business Operators jointly conduct underwriting, etc.
- (iii) Whether the Financial Instruments Business Operator has developed arrangements and procedures for appropriately conducting screening, such as properly securing the independence of the division conducting the screening from the sales division in terms of functions and effects.
- (iv) Whether the Financial Instruments Business Operator has a function to examine and assess conflicts of interest with other divisions in the company. In addition, whether it has developed a control environment for appropriately preventing a state of conflicts of interest, based on such function.
- (v) Whether the Financial Instruments Business Operator has developed appropriate rules concerning the price calculation method, etc. in order to prevent the conducting of underwriting, etc. for a volume, price, or other conditions that are found to be extremely inappropriate, and whether it has developed a control environment for appropriately deciding the conditions for underwriting, etc.

## (2) Points of Attention Regarding Issuers Affiliated with Anti-Social Forces

From the viewpoint of preventing distribution of electronically recorded transferable rights by antisocial forces or by entities closely affiliated therewith, it is desirable that Financial Instruments Business Operators handling electronically recorded transferable rights, make sure to properly identify such attempts, through cooperation with relevant authorities, self-regulatory organizations, and other organizations, and that they refuse to underwrite such rights in some cases.

## IV-3-6-9 Segregated Management of Investments Through Crypto-and Other Assets

When a Financial Instruments Business Operator conducts purchase and sale, etc. of rights pertaining to equity in a collective investment scheme (fund) that falls under the category of electronically recorded transferable rights, the invested or contributed money needs to be managed separately from own property of the person conducting business by using the invested or contributed money, based on Article 40-3 of the FIEA and Article 125 of the FIB Cabinet Office Ordinance.

In addition, when crypto-and other assets are invested or contributed, the Financial Instruments Business Operator needs to appropriately manage the crypto-assets by entrusting the management to a crypto-and other asset exchange service provider or a trust company, etc. Therefore, supervisors shall oversee whether the Financial Instruments Business Operator appropriately confirms the control environment, etc. for reducing the risk of leakage developed by the outsourced crypto-asset exchange service providers or trust company, etc.

## IV-3-7 Points of Attention Regarding Supervision of Non-Affiliated Business Operators

(1) Major Supervisory Viewpoints

- (i) In the case of a Financial Instruments Business Operator who does not have membership in any Financial Instruments Firms' Association (referred to as "Non-Affiliated Business Operators" in IV-3-7), whether it has developed internal rules with due consideration of rules such as articles of incorporation set by Financial Instruments Firms' Associations (hereinafter referred to as the "Rules Set by Associations, etc.?).
- (ii) Whether the Non-Affiliated Business Operatorshave developed a control environment that ensures appropriate compliance with internal rules (e.g., information sharing among officers, information sessions for employees and examination of status of compliance).
- (iii) When Rules Set by Associations, etc. have been revised, whether the Non-Affiliated Business Operators make sure to quickly review and revise internal rules accordingly.

(2) Supervisory Method and Actions

If a problem is found regarding the creation and revision of internal rules at a Non-Affiliated Business Operator and status of compliance, supervisors shall conduct in-depth inquiry and, if necessary, have the operator submit a report based on the provisions of Article 56-2(1) of the FIEA to look into the status of spontaneous efforts to improve the situation at the said Financial Instruments Business Operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. Further, if, after requesting for a report, an operator is not confirmed to have introduced internal rules that are in line with Rules Set by Associations, etc., or that it has failed to introduce a system to ensure compliance with the relevant internal rules, supervisors shall consider necessary responses, including issuance of a Business Improvement Order based on the provisions of Article 52(1) of the FIEA.

## IV-4 Various Administrative Procedures (Type I Financial Instruments Business Operator)

### IV-4-1 Registration

#### (1) Trade Names

A Local Finance Bureau that has received an application from a business operator shall inquire with the FSA and other Local Finance Bureaus, when necessary, to check whether the trade name of the applicant does not violate Article 29-4(1)(vi)(b) of the FIEA.

#### (2) Items Regarding Examination of System's Appropriateness

When examining whether or not a Financial Instruments Business Operator is sufficiently staffed to properly conduct the financial instruments business as specified under Article 29-4(1)(i)(e) of the FIEA, supervisors shall check the following points based on its application and attachments thereto as well as hearings. Note that the examination as to whether the operator has the structure/system necessary to operate financial instruments business appropriately, thereby falling under Article 29-4(1)(i)(f) of the FIEA, shall also be based on the following points.

- (i) Whether it can be deemed that officers and employees with sufficient knowledge and experience have been secured and a sufficient organization has been established to conduct the relevant financial instruments business in light of the following requirements.
  - A. Top managers must be sufficiently qualified to conduct financial instruments business in a fair and appropriate manner, in terms of their backgrounds and capabilities.
  - B. Managing directors must understand the viewpoints regarding governance indicated in the FIEA and various other laws and regulations, and have sufficient knowledge and experience to conduct governance, in addition to sufficient knowledge and experience regarding compliance and risk management to conduct financial instruments business in a fair and appropriate manner.
  - C. The staff must include two or more permanent officers or employees with more than three years of experience regarding the relevant Type I Financial Instruments Business.
  - D. The Financial Instruments Business Operator must be staffed and organized so that managers in charge of internal control are appropriately allocated, and personnel necessary for conducting business in an appropriate manner are allocated to individual divisions. (Regarding the conduct of underwriting business in particular, it is necessary to ensure a sufficient control environment and secure staff to conduct the business in a fair and appropriate manner.)
  - E. The compliance division (staff in charge of compliance) should be independent from the sales division and staffed with personnel who have necessary knowledge and experience.
  - F. Staff capable of conducting the following processes should be secured, with regard to the relevant business.
    - a. Compilation and management of account books, reports and other documents.
    - b. Disclosure
    - c. Segregated management of customer assets



- d. Risk Management
  - e. Computer system management
  - f. Trading management, customer management
  - g. Advertisement screening
  - h. Customer information management
  - i. Processing of complaints and disputes
  - j. Internal audits
- (ii) When the qualifications of employees and officers are examined in a comprehensive manner in relation to the following criteria regarding organized crime groups, their members and financial crimes, whether there is the risk that public confidence in the Financial Instruments Business Operator could be damaged because of the inclusion among its staff of officers and employees with inappropriate qualifications.
- A. Officers and employees should not be current or former members of organized crime groups.
  - B. Officers and employees should not have close relationships with organized crime groups.
  - C. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - D. Officers and employees should not have the experience of being sentenced to a fine (including similar punishments imposed under foreign laws and regulations equivalent thereto) for violation of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions of Article 32-2(7) of the same act) or other foreign laws and regulations equivalent thereto, or for committing a crime prescribed under the Penal Code or under the Act on Punishment of Physical Violence and Others.
  - E. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion as well as attempts at these crimes).)
- (Note) It should be kept in mind that in cases where it is deemed, as a result of comprehensive examination based on the criteria described in (ii) A to E, that a major shareholder in the Financial Instruments Business Operator could exercise undue influence on it, thereby damaging public confidence in it, the business operator may be deemed to be “not adequately staffed to properly conduct financial instruments business.”

### (3) Documents Specifying Contents and Methods of Business Operations

- (i) In cases where the business operator handles currency-related over-the-counter derivative transactions and securities-related over-the-counter derivative transactions that are intended for individuals, supervisors shall check whether a clear statement to this effect has been included in the section on the types of derivative transactions the business operator conducts, in the documents specifying the contents and methods of the business operator’s business operations.
- (ii) In cases where an electronic transaction platform operator outsources disclosure of information in accordance

with Article 40-7(2) of the FIEA, supervisors shall check to see if this is mentioned along with the name of the outsourced contractor in “method of disclosure in accordance with Article 40-7(2) of the FIEA” in Article 8(vi)e(8) of the FIB Cabinet Office Ordinance.

(iii) In cases where the business operator handles commodity-related market derivatives transactions, supervisors shall confirm that internal procedures and rules on confirmation of the willingness to be solicited have been established and a control environment for conducting ex-post facto examination on the status of implementation has been developed, in the documents specifying the contents and methods of the business operator’s business operations.

(iv) A business operator that intends to handle crypto-and other assets related over-the-counter derivatives transactions needs to attach a document explaining the outline of the crypto-and other assets or financial indicators (referred to as an "outline document" in (iii)) to the application for registration based on Article 9(x) of the FIB Cabinet Office Ordinance. The contents of the outline document to be attached are to conform to the format, etc. separately published by Financial Instruments Firms Associations.

(Note) It should be kept in mind that an outline document is also required in the case of making advance notification of crypto-and other assets, etc. to be newly made subject to crypto-and other assets-related over-the-counter derivatives transactions.

#### (4) Authorization Column of Registry Book of Financial Instruments Business Operators

When authorization has been granted to a financial instruments business, the fact of authorization shall be recorded in the authorization column of the book of registry of the Financial Instruments Business Operator, based on Article 30(1) of the FIEA. Authorization granted by the FSA to Financial Instruments Business Operators under its jurisdiction each month shall be collectively notified by the 15th day of the following month to individual Local Finance Bureaus at which the business operators have been registered.

#### (5) Points of Attention Regarding Business Operators That Do Not Have Plans to Join Any Financial Instruments Firms’ Association

Supervisors shall notify the following points and request appropriate responses to business operators who do not have plan to join any Financial Instruments Firms' Association at the time of submission of a registration request.

- (i) That supervisory responses in accordance with IV-3-7 shall be taken if the operator fails to introduce internal rules that are in line with Rules Set by Associations, etc. or a system to ensure compliance with such rules after registration
- (ii) That failure to revise internal rules in accordance with revisions in Rule Set by Associations, etc., may constitute a situation that corresponds to (i).

#### (6) Points of Attention Regarding Applications for New Registrations

Supervisors shall confirm with a business operator who applies for a new registration whether there are grounds for rejecting the application, in principle, by requiring the submission of the following documents.

Of the prima facie evidence, certificates of savings and other deposit balances issued by financial institutions

shall be originals.

- (i) Prima facie evidence of documents which show the calculation of net assets (referring to net assets prescribed in Article 29-4(1)(v)(b) of the FIEA)
- (ii) Prima facie evidence of documents which show the calculation of the ratio prescribed in Article 29-4(1)(vi)(a) of the FIEA
- (iii) Prima facie evidence of documents which show the calculation of net assets and the capital-to-risk ratio for the most recent month
- (iv) For a business operator who intends to conduct currency-related derivatives transactions, etc. (referring to the currency-related derivatives transactions, etc. prescribed in Article 143(3) of the FIB Cabinet Office Ordinance), copies of the trust agreements relating to those trust accounts that have been opened at either trust companies or financial institutions conducting trust business for the purpose of conducting the segregated management of money.

#### IV-4-2 Approval and Notification

##### IV-4-2-1 Authorization

The Proprietary Trading System (PTS) has functions similar to exchanges, and thus the FIEA stipulates that an authorization system shall be maintained for the operations of the PTS, as under the former Securities and Exchange Act. Based on this, business authorization prescribed in Article 2(8)(x) of the FIEA needs to be examined with due consideration to the following points:

- (i) The following points shall be considered when deciding whether the relevant operation falls under the PTS category:
    - A. A system acting as an agent for transactions involving securities in the financial instruments exchange markets or the over-the-counter (OTC) securities markets, or acting as an agent for transactions involving securities for another Financial Instruments Business Operator shall not fall under the category of the PTS or financial instruments exchange market, etc.
- (Note) For example, if the brokerage service is one prescribed in Article 70-2(7) of the FIB Cabinet Office Ordinance that is provided by using a system that conducts determination of a price or any other transaction conditions or an act similar thereto prescribed in the same paragraph, the system shall, basically, not fall under the category of the PTS or financial instruments exchange markets, etc. On the other hand, even in the case of such brokerage service, if orders are integrated, offset or otherwise combined within the system, the system may fall under the category of the PTS or financial instruments exchange markets, etc.
- B. Some cross trading systems, in which securities are traded with clients, may fall under the category of the PTS or financial instruments exchange market, etc., if the trade is conducted based on bid and offer price indications, bringing together supply and demand for securities on a number of orders.
  - C. Financial instruments business operators and information vendors, which provide information on stock prices and financial information, may fall under the category of Financial Instruments Business

Operators (intermediary) and are required to obtain approval for the PTS operations in the cases where indicative prices presented by several Financial Instruments Business Operators are shown in the list (price competition) and order-matching methods concerning business conditions are provided, including distribution of exclusive terminals and setting up of links, etc., for order placement and negotiation.

(ii) The following points shall be considered when authorizing the operations:

A. Internal control

Whether the following items have been developed regarding the state of internal control of operations:

- a. Personnel in charge of management of operations have, in principle, at least five years of experience in securities-related operations, and a division in charge of operations has an organization and staff necessary for the implementation of the operations
- b. A system to implement verification at the time of transaction based on the Anti-Criminal Proceed Act has been established in operations
- c. Methods and measures have been developed in the operations to exclude transactions that undermine the fairness of trade, such as insider trading, market manipulation, intentional market making, and short selling and other acts which would infringe on restrictions on short-selling. Furthermore, the said methods and measures are listed in the content and methods of operations concerning authorization as the “important matters related to the securing of fair trade,” prescribed in Article 17(13) of the FIB Cabinet Office Ordinance
- d. In the case of handling securities for specified investors in the operations, methods and measures have been developed to prohibit the transactions that are restricted under Article 40-4 of the FIEA; in such case, said items are listed in the content and methods of operations concerning authorization as the “criteria for the commencement of transactions with customers and the customer management methods,” prescribed in Article 17(v) of the FIB Cabinet Office Ordinance
- e. In-house regulations for operations have been developed in compliance with laws and regulations, such as the FIEA, etc.
- f. If, as part of the said business, a financial instruments business operator is to handle margin transactions, the following measures shall be taken:
  - i) Appropriate measures to prevent conflicts of interest, such as ensuring that the financial instruments business operator or its group companies etc. is not the effective provider of the funds or shares
  - ii) Based on the self-regulatory rules of the Japan Securities Dealers Association, rules shall be established relating to the handling of margin transactions as part of the said business, and by, for example, requiring compliance with said rules by participants in margin transactions as part of said business, equivalency with financial instruments exchange self-regulatory functions pertaining to margin transactions shall be achieved with respect to the handling of margin transactions as part of the said business.

B. Accountability to Clients

Whether a system allowing for sufficient explanations concerning the following has been developed, when providing clients with explanations:

- a. The method to determine trading prices.
  - b. Trading rules covering from order placement to confirmation and settlement.
  - c. The handling of settlement failure.
  - d. The possibility of a contract at the offered price.
- C. Ensuring of Safety and Certainty of System Capacity, etc.

Whether the following items have been developed regarding safety/certainty of system capacity for operations:

- a. To rationally estimate the number of orders and contracts, and to ensure system capacity sufficient for the estimation.
  - b. To perform sufficient tests based on the estimation mentioned above.
  - c. To prevent the occurrence of excess system capacity and system failure, and to establish a monitoring method and a system for early detection.
  - d. To have developed a method to handle system failures (including providing explanations to, making contact with clients) and to have developed such a system.
  - e. To have a dual system (back-up system).
  - f. To receive third-party evaluation (from an external organization) on the above items and to confirm the safety and certainty of system capacity, etc.
- D. Measures for Confidentiality of Trade Information

Whether sufficient measures are taken, including the following items, with respect to confidentiality of clients' trade information:

- a. To clearly separate the operators engaged in the operations of the relevant business division from those engaged in other divisions.
  - b. To prohibit persons engaged in the relevant operations from conducting the operations using information related to other operations, and to prohibit persons engaged in other operations from conducting their operations using information pertaining to the relevant operations.
  - c. To have accurately taken measures for the prevention of leakage of client information.
  - d. To have developed in-house regulations in respect to the above measures.
- (iii) The following conditions shall be attached to the authorization of the relevant operations:

- A. Disclosure of Price Information, etc. (limited to the cases of securities traded in the relevant business (securities specified in the items of Article 14 of the Cabinet Office Ordinance Concerning Financial Instruments Firms' Associations, etc.)).

“To disclose the best quotations/trading prices, etc., of the PTS in such a form which allows comparison with other PTSs and in such a form which allows free access from the outside in real time.

However, information shall be disclosed in such a way which allows free access from the outside until a disclosure format which allows comparison with other PTSs is established.”

- B. Quantity Standards for Trade Volume

The figures of trade volume of the PTS shall be used for the quantity standards. However, it is necessary to make sure that the figures obtained using the trade volume of a PTS system network to which the said PTS belongs (referring to a network comprising PTSs in the relevant area in the cases where orders of the said PTS are matched with orders of another PTS by using an electronic information processing organization) would not conflict with the quantity standards.

a. In the case of a PTS that handles share certificates and bonds with share options and determines prices by a method other than auctions (limited to those listed in financial instruments exchanges or those registered pursuant to Article 67-11(1) of the FIEA):

1. In the cases where the ratio of average payments of daily transactions of share certificates or bonds with share options traded on financial instruments exchanges or OTC markets (limited to those listed in financial instruments exchanges and those registered pursuant to Article 67-11 (1) of the FIEA) exceeds 10% of the sum of transaction payments of any security and exceeds 5% of the entire share certificates and bonds with share options of the previous six months, the following measures shall be taken:

- A. To expand and develop a system (organization/personnel) for administering trade and inspection in order to ensure trade fairness.
- B. To establish a system equivalent to the accumulated reserve for breach of contract losses in the financial instruments exchanges in order to ensure settlement.
- C. To establish a periodic monitoring system to ensure the safety and certainty of system capacity, etc.

2. If the said ratio exceeds 20% of any security and 10% of the total share certificates and bonds with share options of the previous six months, a license to establish a financial instruments exchange market shall be obtained.

3. In addition to the above, new criteria shall be introduced within the boundaries of PTSs that trade other debit securities, if, with the expansion in trading volume, etc., the need arises from the viewpoint of public welfare or investor protection.”

b. Other cases

“New criteria shall be introduced within the boundaries of PTSs that trade other debit securities, if, with the expansion in trading volume, etc., the need arises from the viewpoint of public welfare or investor protection.”

C. Report on the Trade Volume

a. In the case of a PTS that determines prices by the auction method:

“With regard to the ratio, etc., prescribed in Article 1-10(i) and (ii) of the FIEA Enforcement Order, a Financial Instruments Business Operator shall submit a report about end-of-month figures to the Commissioner of the Financial Services Agency or the Director General of the Local Finance Bureau that supervises the said Financial Instruments Business Operator, by the 20th of the following month.”

(Note) With regard to the “gross trading volume” concerning the PTS prescribed in Article 1-10(i) and

- (ii) of the FIEA Enforcement Order, the figures obtained pursuant to the proviso of “B. Quantity standards concerning trade volume” shall also be reported.
- b. In the case of a PTS in which prices are determined by a method other than the auction method:
  - “Regarding the ratio prescribed in a-1 and a-2 of B above, etc., a Financial Instruments Business Operator shall submit a report about the end-of-month figures to the Commissioner of the Financial Services Agency or the Director-General of the Finance Bureau that supervises the said Financial Instruments Business Operator, by the 20th of the following month.”
  - D. “New criteria shall be introduced, within its boundaries, if the need arises from the viewpoint of public welfare or investor protection.”
- (iv) The following points shall be considered as a supervisory response after authorization is given for the relevant operations:
  - A. To verify the trading volume, etc., using the reports, etc., in order to judge whether authorization requirements are being met.
  - B. To verify the progress of implementation of various measures that have been examined at the time of authorization by requesting reports, on an as needed basis.
  - C. When changes are made to the method used to determine trade prices and the operation methods, including delivery and other settlement methods, after the approval, early submission of an application for change shall be requested.

#### IV-4-2-2 Approval

- (1) When approving other businesses, based on Article 35(4) of the FIEA, supervisors shall pay attention to the following points:
  - (i) Whether the business violates applicable laws and regulations.
  - (ii) Whether the calculation of the value of the loss risk equivalent related to the relevant business is appropriate, and whether it is ensured that the calculated value is properly reflected in the applicant Financial Instruments Business Operator’s capital adequacy ratio.
  - (iii) Whether the division in charge of calculating and managing the value of the loss risk equivalent related to the relevant business is independent from the sales division.
  - (iv) In cases where the relevant business involves the signing of contracts, whether the Financial Instruments Business Operator has prescribed the specific procedures necessary for investor protection regarding the signing of contracts with customers.
  - (v) Whether the Financial Instruments Business Operator has established internal rules regarding the relevant business.
  - (vi) Whether the applicant Financial Instruments Business Operator’s capital adequacy ratio is more than 140%.

#### (2) Points of Attention Regarding Deposits, etc. of Crypto-and Other Assets

While crypto-and other assets are deemed to be money pertaining to purchase and sale of securities based on Article 2-2 of the FIEA, it should be kept in mind that, even when a Financial Instruments Business Operator

receives deposits, etc. of crypto-and other assets from customers in relation to purchase and sale of securities, it needs to obtain the approval for other services under Article 35(4) of the FIEA, if the receipt of deposits, etc. cannot be considered to be services incidental to financial instruments business.

#### IV-4-2-3 Notification

Supervisors shall receive and process notifications specified under the FIEA with due consideration of the following points. When they have received notifications regarding the businesses specified under Article 35(2) of the FIEA in particular, supervisors shall pay attention to whether the procedures legally necessary for regulating the businesses have been implemented. In addition, regarding the businesses listed below, they shall check whether their contents and methods meet the following criteria. In this case, the provision of relevant written documents and the implementation of paper-based procedures may be substituted by electronic means using computer systems and other information technologies, subject to customers' consent. Regarding businesses that do not meet the following criteria, the applicant business operators shall be required to file an application based on Article 35(4) of the FIEA.

(1) Businesses Related to Signing of Association Contracts as Specified under Article 667 of the Civil Code and Intermediary, Brokerage and Agency Businesses Therefor and Businesses Related to Signing of Anonymous Association Contracts as Specified under Article 535 of the Commercial Code and Intermediary, Brokerage and Agency Services Therefor (excluding the businesses specified under Article 2(8)(ix) of the FIEA)

When soliciting customers to sign association contracts, whether the Financial Instruments Business Operator and its officers and employees provide sufficient explanations regarding the contents of the contracts and make solicitation in an appropriate manner suited to the customers' intentions, knowledge and experiences regarding the relevant associations, as well as their financial capacity and the nature of their investment funds. At the time of the signing of the contracts, whether they provide the customers with written explanations regarding the contents of the contracts.

(2) Business Related to Signing of Loan Participation Contracts and Intermediary, Brokerage and Agency Services Therefor.

(i) Description of Business

The loan participation contract is a contract envisaged by "Accounting Treatment and Representation of Loan Participation," a report issued on June 1, 1995 by the Japanese Institute of Certified Public Accountants.

(ii) Conduct of Business.

Supervisors shall examine whether the Financial Instruments Business Operator meets the following requirements regarding the conduct of business:

- A. To take due care to protect the original debtors and the transferees in executing business.
- B. To provide the transferees with sufficient explanations regarding the nature and contents of the relevant debts.
- C. To establish adequate arrangements and procedures for evaluating the relevant debts and ensure appropriate price formation



- D. To provide appropriate solicitation in light of the transferees' intentions and experiences as well as their financial capacity.
- E. At the time of the signing of the contract, to provide the transferee with written explanations regarding the contents of the contract.

#### IV-4-2-4 Points to Consider Concerning Cumulative Investment Business

The following points shall be considered concerning the conclusion of a contract for cumulative investment prescribed in Article 35(1) (vii) of the FIEA:

##### (1) Type of Securities Traded in Cumulative Investment

- (i) Government bond certificates
- (ii) Local government bond certificates
- (iii) Bank debentures and other claims issued by juridical persons pursuant to special laws
- (iv) Corporate bond certificates that are deemed to be issued periodically, in substantial amounts, such as corporate bond certificates issued by electricity business operators, etc.
- (v) Investment trust beneficiary certificates (excluding listed investment trust beneficiary certificates; hereinafter the same shall apply in IV-4-2-4)
  - A. Unit type investment trusts
  - B. Open investment trusts (excluding bond investment trusts; hereinafter the same shall apply in IV-4-2-4)
  - C. Bond investment trusts
- (vi) Foreign ETFs
- (vii) Investment certificates of investment juridical persons (excluding listed investment certificates; hereinafter the same shall apply in IV-4-2-4)
- (viii) Foreign investment certificates
- (ix) Certificates of shares (limited to the certificates of shares listed in financial instruments exchanges or those registered in the registry of OTC traded securities held at the Japan Security Dealers Association, and those listed in (10); hereinafter the same shall apply in IV-4-2-4)
- (x) Listed investment trust beneficiary certificates (limited to those listed in (11); hereinafter the same shall apply in IV-4-2-4)
- (xi) Listed investment certificates (limited to those listed in (12); hereinafter the same shall apply in IV-4-2-4)

##### (2) Method of Purchase of Negotiable Securities in Cumulative Investment

- (i) Negotiable securities to be purchased shall be limited to those newly issued (provided, however, that this shall not apply to certificates of shares, listed investment trust beneficiary certificates and listed investment certificates), and the type and the method of appropriation for purchase shall be specified in advance in the contract. However, in the cases where there is no new issuance at the time specified in the contract or where new issuance is not adequately funded, the same type of negotiable securities that have already been issued

may be purchased, pursuant to the provisions of the prescribed contract.

(ii) When payment from a client, or securities deposited by a Financial Instruments Business Operator (hereinafter referred to as “paid-up money”) accrued from the acceptance of fruits or redemption of investment in negotiable securities deposited by a client (hereinafter referred to as “deposited negotiable securities”) has reached the purchase price of negotiable securities to be purchased by the client, the Financial Instruments Business Operator shall purchase the said negotiable securities, without delay. However, the client may instruct the Financial Instruments Business Operator to cancel the purchase of negotiable securities at any time.

(iii) The purchase price of negotiable securities shall be set as follows:

- A. The secondary offering price for the government bonds, local government bonds, financial bonds and other bonds and corporate bonds issued by juridical persons pursuant to special laws, however, in the case applicable to the proviso of (i) above, the market value of the financial instruments exchange prescribed in the contract or any other appropriate value;
- B. The following prices shall be applied to the following investment trust beneficiary certificates:
  - a. Unit type investment trust: Public offer price
  - b. Open investment trust: Net asset value on the purchase date or one day prior to the purchase date (in the case of an open investment trust in which the value of assets retained in the trust is collected at the time of purchase, the amount obtained by adding the said value of assets retained in the trust to the net asset value)
  - c. Open bond investment trust: net asset value on the purchase date or one day prior to the purchase date
- C. Net asset value on one day prior to the purchase date for foreign investment fund beneficiary certificates
- D. Value as specified in the bylaws or the equivalent document for investment certificates or foreign investment certificates
- E. Market value at the financial instruments exchange prescribed in the contract for certificates of shares (when there are several contract prices at the exchanges of the said stock, their weighted average price)
- F. Market value of the financial instruments exchange prescribed in the contract for listed investment trust beneficiary certificates (when there are several contract prices at the exchanges of the said stock, their weighted average price)
- G. Market value of the financial instruments exchange prescribed in the contract for listed investment beneficiary certificates (when there are several contract prices at the exchanges of the said stock, their weighted average price)

### (3) Payment of Money and Management Method for Deposits in Cumulative Investment

- (i) A client may pay, in part or in full, the buying price of negotiable securities as needed, however, this is done in a different way in the cases listed below from (8) to (12)
- (ii) Payments received from a client, etc., shall be listed as cumulative deposit, and the maturity of the said deposit, such as interest, shall not be paid to the client.

#### (4) Timing of Transfer and Delivery of Ownership Right of Securities in Cumulative Investment

In the case of joint purchase, joint possession shall be completed when the trade session and the number of securities purchased by the relevant clients are finalized and the ownership rights of the said securities shall be transferred to the said clients. Fruits of investment in the said securities and the right to the principal of the clients shall come into effect on the said purchase date.

#### (5) Method of Custody of Securities in Cumulative Investment

- (i) Securities purchased in cumulative investment activities shall be in custody in the following manner:
  - A. Deposit balance in securities based on cumulative investment, new deposit balance and amount of redemption shall be managed separately from other securities

In this case, securities jointly owned by a Financial Instruments Business Operator and its client(s) shall be further separated.
  - B. The Financial Instruments Business Operator may re-deposit the said securities in its own name in securities finance companies, banks or trust companies, instead of managing the said securities itself.

Here, in the cases where the rights and interests of the clients are deemed to be undamaged, a global certificate may be used for custody or re-deposit, upon obtaining consent from the client.
  - C. When returning deposited securities in response to the request made by a client, a clause may be included in the contract to the effect that return of securities may be replaced by the return of money obtained by selling the said securities at the market price (including necessary fees).
- (ii) Securities purchased not under the cumulative investment contract may be stored as securities based on the cumulative investment contract, when the client requests. However, the said securities shall be limited to the same type of securities as those purchased under the said cumulative investment contract.

#### (6) Cancellation of a Contract for Cumulative Investment

- (i) A contract shall be cancelled when a client requests. A client may request the cancellation at any time.
- (ii) When a client has not paid, in part nor in full, the buying price of securities for a consecutive period of one year or more, cancellation shall be effective; provided, however, that this shall not apply to contracts prescribed in the provisions of (7) below which allows purchase of negotiable certificates within one year of the date of previous purchase, solely as the consideration of the fruits of investment in securities or deposit in redemption, when the client has deposited securities to a Financial Instruments Business Operator based on a cumulative investment contract.
- (iii) Cancellation shall be effective when a Financial Instruments Business Operator can no longer conduct cumulative investment activities.
- (iv) In addition to the above, when a client has not paid, in part nor in full, the buying price of securities for a consecutive period of three months or more, a Financial Instruments Business Operator may cancel the contract; provided, however, that this shall not apply to the contract prescribed in the proviso of (ii) above (excluding the cases where all of the following conditions from A through D are met).
  - A. Reports, etc., to a client have been returned due to the forwarding address being unknown, etc.

- B. The address of the said client is unknown despite efforts being made to find it
- C. No payment of the buying price or sales have been made for one year or more after the return of a report, etc., mentioned in A. above.
- D. The balance is small (less than ¥10,000).

(7) A Financial Instruments Business Operator may conclude a contract to the effect that the Financial Instruments Business Operator shall periodically return part or all of the securities deposited or part or all of the fruits/redemption of investment in the said securities to a client when requested.

(8) The following can be done for joint purchase of government bonds in cumulative investment:

- (i) A contract shall be concluded with a client who applies to purchase government bonds jointly with other clients to the effect that a Financial Instruments Business Operator shall buy the said government bonds in the form of cumulative investment. In this case, regardless of (3)-(i) above, an amount less than the minimum amount of payment may be accepted from the second payment and onwards, and when the sum of payments of the client and other clients reaches the purchase value (or an amount equal to the integral multiple of that amount), the Financial Instruments Business Operator shall buy the said government bonds, without delay
- (ii) In the case of (i) above, when the total amount of payments from the clients is less than the purchase value of the government bonds, the Financial Instruments Business Operator shall jointly buy the bonds by paying the difference between the purchase value of the minimum unit and the said amount.
- (iii) Clients who made a joint purchase (including the Financial Instruments Business Operator in the case of (ii) above) shall acquire ownership rights (co- ownership) in accordance with their respective shares
- (iv) A Financial Instruments Business Operator shall set up an account for each client, in order to manage the clients' shares and the receipt of payments on fruits/redemption of the share of the government bonds co-owned by the clients, etc.

(9) The following shall be done for cumulative investment activity (hereinafter referred to as “property accumulation savings”) based on the Act on the Promotion of Workers’ Property Accumulation (hereinafter referred to as the “Property Accumulation Act”):

- (i) With respect to the purchase value of securities as listed in (1)(v)(B) above among the methods for buying securities, the following shall be used regardless of (2)(iii)(B)(b) above.
  - A. With respect to purchase under the workers’ property accumulation savings contract, prescribed in Article 6(1) of the Property Accumulation Act, net asset value on the date of purchase (in the case of an open investment trust in which the value of assets retained in the trust is collected at the time of purchase, the amount obtained by adding the said value of assets retained in the trust to the net asset value).
  - B. Net asset value on the date of purchase for a purchase under the workers’ property accumulation pension savings contract, prescribed in Article 6, paragraph 2 of the Property Accumulation Act, and under the contract on workers’ property accumulation savings for house construction prescribed in paragraph 4 of the said article.

- (ii) The following shall be used with respect to payment and management of deposits, regardless of (3)(i) and (ii) above.
  - A. The amount to be paid for the purchase of securities by clients shall be at least ¥1,000 (however, one yen in the cases listed below from B-b through e)
  - B. Payment shall be made in the following manner in line with the contract concluded between a business entity and a Financial Instruments Business Operator:
    - a. Payment by deduction from the said client's salaries
    - b. Payment by a business operator to the account of the said client for the purpose of encouraging property accumulation savings
    - c. Payment made from the said client's workers' property accumulation benefit or workers' property accumulation fund
    - d. In the cases where a client has changed employment, payment from the property accumulation handling organization of the former workplace
    - e. Payment of savings to be returned to the account of the said client by a business operator prescribed in Article 6(1) of the Property Accumulation Act.
  - C. Payments, etc., from a client shall be separately accounted as "asset-building savings."
  - D. Payments from a client shall be used for the purchase of negotiable certificates of the said client by adding the equivalent amount of interest to ordinary deposits. However, fruits of deposited securities, such as interest, shall not be paid to the client with respect to deposits generated from the receipt of fruits/redemption of investment in deposited securities.
- (iii) A clause may be included to the effect that when the government bonds are bought jointly between a client and another client with respect to property accumulation, and when the total amount of purchase balance and payment of the said government bonds of one client has reached an integral multiple of ¥10,000, the said government bonds may be sold to buy corporate bonds jointly with other clients at integral multiples of ¥10,000 as a unit/client. In this case, the provisions listed in (8)(ii) through (iv) above shall be applied to the purchase of corporate bonds.
- (iv) Deposit balance and the redemption amount of securities based on property accumulation activity shall be managed separately from other securities based on cumulative investment. In this case, the Financial Instruments Business Operator may re-deposit the said securities in its own name in securities finance companies, banks or trust companies instead of storing them themselves.
- (v) Cancellation shall be effectuated by the following methods, regardless of (6) above.
  - A. Contracts concerning property accumulation savings shall be cancelled in the following cases:
    - a. When a client makes a request. A client may request cancellation at any time
    - b. When a client no longer meets the requirements of property accumulation savings prescribed in the Property Accumulation Act
    - c. When a Financial Instruments Business Operator can no longer conduct "property accumulation savings" business.
  - B. In addition to the above, based on the said contract, the said contract may be cancelled when a client has

re-deposited securities in a Financial Instruments Business Operator, etc., and when the client has not paid, in part nor in full, the payment for the purchase of securities for a consecutive period of one year or more following the first payment, after three years have passed under the workers' property accumulation savings contract, or after five years have passed under the workers' property accumulation pension savings contract or the contract on workers' property accumulation savings for house construction.

However, this shall not apply to the cases where a client can purchase securities solely for the consideration of the deposited money from fruits or redemption of investment in the said securities when the client has deposited the securities to a Financial Instruments Business Operator, etc., pursuant to the said contract.

(vi) Report on balance, etc., may be submitted to a client via the employer of the said client.

(10) The following shall be done for joint purchase cumulative investment of stock certificates:

(i) A clause shall be included in a contract to the effect that stock certificates can be jointly purchased with other clients applying for joint purchase in the form of cumulative investment.

In this case, a Financial Instruments Business Operator shall conclude a contract with a client in advance, specifying the name of the purchasing certificates, the amount of payment of the client per payment, and the date of execution of purchase, etc., and shall perform purchase operations in line with the said contract.

(ii) When the sum of payment, etc., of one client and other clients (or its integral multiple) reaches the purchase value of the stock certificates, a Financial Instruments Business Operator shall buy the said stock certificates without delay.

(iii) In the case of (ii) above, when the sum of payments from one client and other clients is not sufficient enough for the purchase value of the stock certificates, a Financial Instruments Business Operator shall keep the said fractional part until the next purchase or shall buy the stock certificates by paying the difference between the purchase value of the minimum unit and the said amount.

(iv) Clients (including a Financial Instruments Business Operator in the case of (iii) above where the Financial Instruments Business Operator has bought stock certificates jointly with a client) shall acquire the ownership (co-ownership) of the purchased stock certificates and hold co-ownership rights in accordance with the proportion of the paid amount (excluding the case in (iii) above where a Financial Instruments Business Operator keeps the fractional part). The name of the stock certificates purchased jointly among the said clients shall be the name of the Financial Instruments Business Operator. However, when a co-owner's share has reached a number of unit shares, the stock certificates shall be divided into share units by the record date prescribed in Article 124(1) of the Companies Act, such as the first end of period of the issuing company of the said stock certificates, and the said units shall be excluded from the application of the cumulative investment contract.

(v) Dividends on the stock certificates co-owned by clients will be distributed according to their respective shares and shall then be re-invested.

(vi) Stock certificates co-owned by clients shall be managed separately from the other shares and the

ownership share of the clients and the dividends on their respective shares shall be managed by setting up an account for individual clients.

(11) The following shall be done for joint purchase cumulative investment of listed investment trust beneficiary certificates:

(i) A clause shall be included in a contract to the effect that listed investment trust beneficiary certificates can be jointly purchased with other clients applying for joint purchase in the form of cumulative investment.

In this case, a Financial Instruments Business Operator shall conclude a contract with a client in advance, specifying the name of the purchasing certificates, the amount of payment of the client per payment and date of execution of purchase, etc., and shall perform purchase operations in line with the said contract.

(ii) When the sum of payments, etc., of one client and others (or its integral multiple) reaches the purchase value of the listed investment trust beneficiary certificates, a Financial Instruments Business Operator shall buy the said certificates without delay.

(iii) In the case of (iii) above, when the sum of payments from one client and other clients is not sufficient enough for the purchase value of the listed investment trust beneficiary certificates, a Financial Instruments Business Operator shall keep the said fractional part until the next purchase, or shall buy the stock certificates by paying the difference between the purchase value of the minimum unit and the said amount.

(iv) Clients (including a Financial Instruments Business Operator in the case of (iv) above where the Financial Instruments Business Operator has bought listed investment trust beneficiary certificates jointly with a client) shall acquire the ownership (co-ownership) of the purchased listed investment trust beneficiary certificates and hold ownership rights in accordance with the proportion of the paid amount (excluding the case above (iv) where a Financial Instruments Business Operator keeps the fractional part). The name of the listed investment trust beneficiary certificates purchased jointly among the said clients shall be the name of the Financial Instruments Business Operator. However, when a co-owner's share has reached a number of unit shares, the shares shall be divided into share units and the said units shall be excluded from the application of the cumulative investment contract.

(v) Dividends on the listed investment trust beneficiary certificates co-owned by clients will be distributed according to their respective shares and shall then be re-invested.

(vi) Listed investment trust beneficiary certificates co-owned by clients shall be managed separately from the other shares, and the ownership share of the clients and the dividends on their respective shares shall be managed by setting up an account for individual clients.

(12) The following shall be done for joint purchase cumulative investment of listed investment certificates:

(i) A clause shall be included in a contract to the effect that listed investment certificates can be jointly purchased with other clients applying for joint purchase in the form of cumulative investment.

In this case, a Financial Instruments Business Operator shall conclude a contract with a client in advance, specifying the name of the purchasing certificates, the amount of payment of the client per payment and date of execution of purchase, etc., and shall perform purchase operations in line with the said contract.

- (ii) When the sum of payments, etc, of one client and other clients (or its integral multiple) reaches the purchase value of the listed investment certificates, a Financial Instruments Business Operator shall buy the said certificates without delay.
- (iii) In the case of (ii) above, when the sum of payments from one client and other clients is not sufficient enough for the purchase value of the listed investment certificates, a Financial Instruments Business Operator shall keep the said fractional part until the next purchase, or shall buy the stock certificates by paying the difference between the purchase value of the minimum unit and the said amount.
- (iv) Clients (including a Financial Instruments Business Operator in the case of (iii) above where the Financial Instruments Business Operator has bought listed investment certificates jointly with a client) shall acquire the ownership (co-ownership) of the purchased listed investment trust beneficiary certificates and hold ownership rights in accordance with the proportion of the paid amount (excluding the case of (iii) above where a Financial Instruments Business Operator keeps the fractional part). The name of the listed investment certificates purchased jointly among the said clients shall be the name of the Financial Instruments Business Operator. However, when a co-owner's share has reached a number of unit shares, the listed investment certificates shall be divided into share units by the record date as provided for in Article 77-3(2) of the Investment Trust Act, such as the first end of period of the issuing investment corporation of the said listed investment certificates, and the said units shall be excluded from the application of the cumulative investment contract.
- (v) Dividends on the listed investment certificates co-owned by clients will be distributed according to their respective shares and shall then be re-invested.
- (vi) Listed investment certificates co-owned by clients shall be managed separately from the other shares, and the ownership share of the clients and the dividends on their respective shares shall be managed by setting up an account for individual clients.

#### IV-4-3 Registration of Sales Representatives

##### (1) Scope of Registered Sales Representatives

Of Financial Instruments Business Operators' officers and employees engaging in in-branch business operations (including over-the-counter services), those who are in charge of any of the following operations need to be registered in the Registry of Sales Representatives specified under Article 64(1) of the FIEA.

- (i) Explanations of the contents of financial instruments transactions for solicitation purposes
- (ii) Solicitation for financial instruments transactions
- (iii) Order-taking
- (iv) Provision of information for solicitation purposes (excluding the provision of information regarding back-office operations and objective information requested by customers)
- (v) Activities specified under Article 64(1)(i) and (ii) of the FIEA

##### (2) Items to be Notified

It should be kept in mind that the case of a sales representative who has ceased to engage in the specified sales



representative operations temporarily, due to an intra-company personnel transfer shall not be deemed to fall under the provision of Article 64-4(iii) of the FIEA.

#### IV-4-4 Financial Instruments Transaction Liability Reserves

It should be kept in mind that a Financial Instruments Business Operator may withdraw funds from the financial instruments transaction liability reserves specified under Article 46-5 of the FIEA, only in cases where the following requirements are met:

- (i) An illegal or inappropriate act by an officer or employee of the business operator has been recognized.
- (ii) The amount of the withdrawn funds is appropriate and commensurate with the amount necessary to compensate the losses caused by the illegal or inappropriate act.

#### IV-4-5 Books and Documents Related to Service of Handling Electronic Public Offerings

The "records of information displayed on computer screens as specified in Article 146-2(1)" prescribed in Article 157(1)(xviii)(b) shall include printouts of web pages showing relevant information, and, when such documents are being created using electromagnetic records, electromagnetic records of the relevant web pages.

#### IV-5 Treatment of Designated Parent Company Groups

Financial instruments business groups conduct large, complex business operations, and as a result of the concentration of risk, their potential risk to the financial system is increasing. On the other hand, as organizations—especially groups with international operations—grow to immense size and as they become compartmentalized, the governance of entire groups is becoming difficult, and the location of groups’ overall risks are becoming less clear. Therefore, in cases where a Financial Instruments Business Operator engages in large and complex businesses as a group, there is a risk of financial or business-related problems, etc. brought about by the parent company, subsidiaries or fellow subsidiaries within the group leading to the sudden collapse of that Financial Instruments Business Operator, and, as a result, the market intermediary function of Financial Instruments Business Operators ceasing to function properly, a wide range of investors being adversely affected, and by extension, causing concern for the financial system.

In view of these circumstances, from the perspective of making Financial Instruments Business Operators, which are engaged in large and complex businesses as a group, subject to regulation and supervision on a consolidated basis, it has been stipulated that those large Financial Instruments Business Operators, which are deemed to be conducting financial services as a group, shall be subject to the consolidated regulation and supervision of the entire group, including the parent company (“upstream consolidation”).

With regard to designated parent company groups that are subject to this upstream consolidation, it is important to thoroughly ensure robust and comprehensive group-wide risk management under appropriate governance. Supervisors shall therefore conduct supervision with due consideration of the following points.

A “designated parent company group” refers to a group comprised of a designated parent company and its subsidiary corporations, etc.

##### IV-5-1 Governance

The following points, in addition to III-1, shall also be taken into consideration with regard to the governance of designated parent company groups:

- (i) Whether the directors of the designated parent company have the knowledge and experience to conduct governance of the group companies, including overseas offices, in an appropriate, fair and efficient manner, and whether they have sufficient social credibility.
- (ii) Whether the designated parent company has clearly specified a management policy and plans based on the overall vision that the group is striving for, and whether it has communicated these across the entire group, including at overseas offices. Also, whether the Business Management Company periodically reviews the progress status of the plans, including at overseas offices, and where necessary, whether it revises the plans, including the significance of their establishment and their positioning within the group.
- (iii) Whether the designated parent company fully understands the increased organizational complexity associated with forming a designated parent company group, as well as the subsequent increased difficulty of governance, and whether it has developed an appropriate control environment for governance. In particular, in terms of preparedness for ensuring the appropriate operation of its overseas offices, whether the designated parent company has achieved an appropriate combination of direct management and the necessary

authorization of management teams at its overseas offices, and whether it has clarified the division of responsibility.

- (iv) Whether the designated parent company has, while taking into consideration the nature of business operations and risk profiles of its overseas offices, developed a control environment wherein the internal audit divisions of the entire group or of the overseas offices can conduct internal audits appropriately. Also, whether it has implemented appropriate measures in light of the results of internal audits and so forth.
- (v) Whether the designated parent company has, in light of the positioning of overseas offices and their business strategy and business plan, developed a sufficient internal control environment at overseas offices taking into account their actual nature of business operations and risk profiles.
- (vi) Whether the designated parent company, having identified the operational and financial condition of the entire group, including overseas offices, and having fully understood the profile of risks faced by each base, has properly identified the status of risks and taken necessary actions.

#### IV-5-1-1 In the Case of a Designated Parent Company that is a Company with Auditors

##### (1) Representative Director

- (i) Whether the representative director counts legal compliance among the most important management issues, and is leading efforts to establish a control environment for legal compliance.
- (ii) Whether the representative director fully recognizes that disregard of the risk management division may have a serious impact on corporate earnings and attaches importance to said division.
- (iii) Whether the representative director establishes an internal control environment to disclose financial information and other corporate information in an appropriate and timely manner.
- (iv) Whether the representative director, based on the recognition of the importance of internal audits, sets appropriate objectives for internal audits and establishes arrangements for enabling the internal audit section to fully perform its functions (including securing the independence of the internal audit section), and periodically checks the effectiveness of the functions. With regard to the control environment for internal audit, whether the representative director actively makes efforts to establish an effective environment in view of issues pointed out in auditor's audits and inspections by inspection departments.

Whether the representative director immediately implements appropriate measures based on the results of internal audits.

- (v) Whether the representative director, based on an adequate recognition of the importance and usefulness of auditor's audits, recognizes that it is important to establish an environment that ensures the effectiveness thereof.

In particular, whether the representative director understands the developments that address changes in the environment surrounding auditor's audits, for example the Auditor's Auditing Standards (Japan Audit & Supervisory Board Members Association), and guarantees smooth auditing activities of auditors.

- (vi) Whether the representative director fully understands that banning any relationship with anti-social forces and firmly excluding such forces are vital for maintaining public confidence in the designated parent company

group and securing the appropriateness and soundness of its business. In addition, based on this understanding, whether the representative director has made clear, both throughout the company and to the outside, a basic policy decided by the board of directors with due consideration of the “Government Guideline.”

(2) Directors and Board of Directors

- (i) Whether directors check and prevent autocratic management by the representative director and other officers who are responsible for business execution, and are actively involved in the board of directors' decision-making and checking process concerning business execution.
- (ii) In the case where an outside director is elected, whether the outside director recognizes his/her significance from the perspective of ensuring objectivity of decision-making concerning management, and is actively involved in the board of directors. In addition, when deciding proposals regarding the election of outside directors, whether the designated parent company group examines the personal, capital, business and other relationships with the designated parent company group, in view of the roles expected of outside directors, and carefully examines their independence and eligibility.

Furthermore, whether the designated parent company group establishes some kind of framework so as to enable outside directors to make appropriate judgments at the board of directors' meetings, such as continuous provision of information.

- (iii) Whether the board of directors implements measures to ensure its appropriateness and fairness upon, for example, making important management decisions concerning legal compliance and risk control by making use of the advice of experts from outside the company or voluntary committees that consist of experts from outside the company, as necessary.
- (iv) Whether the board of directors has specified a management policy based on the overall vision of the desirable status of the designated parent company group. Whether it has established management plans in line with the management policy and communicated the plans throughout the company. Whether it regularly reviews and revises the progress status thereof.
- (v) Whether the directors and board of directors are sincerely leading efforts in legal compliance, and appropriately perform their functions so as to establish a company-wide internal control environment.
- (vi) Whether the board of directors fully recognizes that disregarding the risk management division may have a serious impact on corporate earnings, and attaches importance to said division. In particular, whether the director in charge has in-depth knowledge and understanding of the methods of measuring, monitoring and managing risks, in addition to an understanding of where risks reside and what kind of risks they are.
- (vii) Whether the board of directors has established a policy for managing risks based on strategic objectives and communicated the policy throughout the company. Whether the risk management policy is reviewed and revised on a periodic or as-needed basis. In addition, whether the board of directors makes use of risk-related information in the execution of business and the development of risk management systems by, for example, making necessary decisions based on risk-related information reported periodically.
- (viii) Whether the board of directors has fostered a culture within the company that emphasizes and clearly indicates to employees of all ranks the importance of governance, as well as reviews and establishes appropriate

and effective governance.

(ix) Whether the board of directors has set appropriate objectives for internal audits and established arrangements for enabling the internal audit section to fully perform its functions based on the recognition of the importance of internal audits (including securing the independence of the internal audit section), and periodically checks the effectiveness thereof. With regard to the control environment for internal audits, whether the board of directors is actively making efforts to establish an effective environment in view of issues that were pointed out in auditor's audits and inspections by inspection departments.

In addition, whether the board of directors approves basic matters concerning internal audit plans, including audit policy and priority items, in light of the risk management status, etc., of divisions subject to audits, and implements appropriate measures based on the results of internal audits.

(x) Whether directors, based on an adequate recognition of the importance and usefulness of auditor's audits, recognize that it is important to establish an environment that ensures the effectiveness thereof. When deciding proposals regarding the election of auditors, whether the directors carefully examine their independence and eligibility. In particular, whether directors recognize that the election of outside auditors is compulsory from the perspective of further improving the neutrality and independence of the audit system, and establish some kind of framework so as to enable outside auditors to make appropriate judgments, such as continuous provision of information.

(xi) Whether directors understand that establishing internal control environments such as for legal compliance, risk management, and financial reporting (the so-called internal control system) constitutes the duty of due care and duty of loyalty of directors, and endeavor to appropriately fulfill their obligations.

(xii) Whether the board of directors has decided a basic policy based on the Government Guideline, established a framework for implementing it and clearly positioned the prevention of damage that could be inflicted by anti-social forces in the internal control system as a matter of legal compliance and risk management by, for example, periodically examining the effectiveness thereof.

(xiii) In the decision process, etc. of proposals regarding the election of directors engaging in the ordinary business of a designated parent company, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Conduct Governance in an Appropriate, Fair and Efficient Manner

Whether the directors of the designated parent company understand the particulars of the viewpoints regarding governance indicated in the FIEA and other relevant regulations, as well as supervisory guidelines, and have the knowledge and experience necessary for exercising such viewpoints, sufficient knowledge and experience regarding compliance and risk management to conduct the operations of the designated parent company group in a sound and appropriate manner, and knowledge and experience to conduct other financial instruments businesses.

B. Sufficient Social Credibility

a. Whether the directors have been involved with anti-social forces.

b. Whether the directors are currently or were formerly members of organized crime groups, or have close relationships therewith.

- c. Whether the directors have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the directors have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the directors belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the directors were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).
- f. Whether the directors have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the directors have been the cause of the bankruptcy, etc., of a financial institution as an officer.

### (3) Auditors and Board of Auditors

- (i) Whether the independence of the board of auditors is ensured in accordance with the purpose of the board of auditors system.
- (ii) Whether auditors and the board of auditors properly exercise the broad authority granted thereto, as well as appropriately conducting audits of business operations in addition to audits of accounting affairs and taking necessary measures in a timely manner, based on the recognition that their basic responsibilities are to ensure the sound and sustainable growth of the designated parent company group by auditing the execution of duties of directors as an independent organization.
- (iii) Whether auditors and the board of auditors secure a system that assists the execution of duties of auditors and make effective use thereof in order to improve the effectiveness of audits and execute auditing duties in a smooth manner.
- (iv) Whether individual auditors recognize the importance of their own independence and actively take the initiative to conduct audits. Whether outside auditors, in particular, are aware that their election is required from the perspective of further improving the neutrality and independence of the audit system, and conduct audits under the recognition that they are especially expected to objectively express their audit opinions. In addition, whether full-time auditors monitor and examine on a daily basis the internal control environment for governance and administration thereof, such as by actively striving to establish an audit environment and gather information, based on the nature of a full-time employee.
- (v) With regard to proposals regarding the election of auditors that the directors submit to the general meeting of shareholders, whether the board of auditors carefully examines their independence and eligibility upon deliberation of consent.

In particular, whether the board of auditors examines the personal, capital, business and other relationships with the designated parent company group, with regard to outside auditors.

- (vi) Whether the auditors of a designated parent company understand that, since they bear the responsibility to audit business operations, they have the responsibility to audit whether or not directors establish an internal control environment (so-called internal control system) and that this constitutes auditors' duty of due care, and endeavor to properly fulfill the duty.
- (vii) In the decision process, etc. of proposals regarding the election of auditors of a designated parent company, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Audit the Execution of Duties of Directors of a Designated Parent Company in an Appropriate, Fair and Efficient Manner

Whether the auditors of the designated parent company have sufficient knowledge and experience to actively conduct audits based on their own independence and responsibility, as well as knowledge and experience to ensure sound and proper operation of business of the designated parent company group by auditing the execution of duties of directors from an independent position.

B. Sufficient Social Credibility

- a. Whether the auditors have been involved with anti-social forces.
- b. Whether the auditors are members of organized crime groups, or have close relationships therewith.
- c. Whether the auditors have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the auditors have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the auditors belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the auditors were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).
- f. Whether the auditors have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the auditors have been the cause of the bankruptcy, etc., of a financial institution as an officer. (Reference) Auditor's Auditing Standards (Japan Audit & Supervisory Board Members Association)

(4) Internal Audit Section

- (i) Whether the internal audit section has been established as an independent organization so as to fully check

the actions of divisions subject to audit, while being equipped with the environment and ability to gather important information concerning the state of business of divisions subject to audit, as well as a system to enable effective internal audits that appropriately respond to the state of business and environment surrounding the designated parent company group.

- (ii) Whether the internal audit section formulates efficient and effective internal audit plans in consideration of frequency and depth in accordance with the type and degree of risks and based on its understanding of the status of risk management, etc. by divisions subject to audit, reviews the plans appropriately according to the situation, and implements efficient and effective internal audits based on the internal audit plan.
- (iii) Whether the internal audit section reports important issues pointed out in internal audits without any delay to the representative director and board of directors. Whether the internal audit section accurately grasps the improvement status of the issues pointed out.

#### (5) Use of External Audits

- (i) Whether the designated parent company sufficiently recognizes that effective external audits are essential to ensuring sound and proper operation of the business of the designated parent company group and effectively uses them.
- (ii) Whether the designated parent company periodically examines if external audits are effectively conducted, and takes appropriate measures regarding the results of external audits.
- (iii) Whether the continuous audit years, etc. of the certified public accountant involved are treated appropriately.

#### (6) Coordination of Audit Functions

Whether the coordination between external audit functions and the internal audit section or auditors and board of auditors is functioning effectively.

### IV-5-1-2 In the Case of a Designated Parent Company that is a Company with a Nominating Committee, etc.

#### (1) Directors and Board of Directors

- (i) Whether the board of directors clarifies the authority to decide the execution of duties, such as the basic management policy, duties of executive officers, and matters concerning command and order relationships and other relationships between executive officers.

Whether the board of directors has established a system to ensure that the execution of duties by executive officers complies with laws and regulations, as well as a system necessary to ensure the appropriateness of operations, and periodically examines the effectiveness thereof. In addition, with regard to the control environment for internal audit, whether the board of directors actively makes efforts in establishing an effective environment in view of issues pointed out in inspections by the audit committee or inspection departments.

- (ii) Whether the board of directors actively makes efforts to develop a system necessary to execute the duties of the audit committee (audit assistant system, information reporting & control system, internal control system).



- (iii) Whether the board of directors has fostered a culture within the company that emphasizes and clearly indicates to employees of all ranks the importance of governance, as well as reviews and establishes appropriate and effective governance.
- (iv) Whether the board of directors makes use of committees and appropriately exercises its supervisory authority over business execution in coordination with the committees.
- (v) Whether the board of directors has established an internal control environment to disclose financial information and other corporate information in an appropriate and timely manner.
- (vi) Whether the directors are actively involved in the board of directors' decisions on business execution and the checking process concerning business execution, by directors and executive officers. Whether directors understand that establishing internal control environments such as for legal compliance, risk management, and financial reporting (the so-called internal control system) constitutes the duty of due care and duty of loyalty of directors, and endeavor to appropriately fulfill their obligations.
- (vii) Whether the board of directors has decided a basic policy based on the Government Guideline, established a framework for implementing it and clearly positioned the prevention of damage that could be inflicted by anti-social forces in the internal control system as a matter of legal compliance and risk management by, for example, periodically examining the effectiveness thereof.
- (viii) In the decision process, etc. of proposals regarding the election of directors engaging in the ordinary business of a designated parent company, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Conduct Governance in an Appropriate, Fair and Efficient Manner

Whether the directors of the designated parent company have sufficient knowledge and experience to actively decide, at the board of directors' meetings, matters concerning basic management policies and internal control systems as well as business execution, and to check the execution of duties of directors and executive officers, as well as the knowledge and experience to ensure sound and proper operation of the business of the designated parent company group by conducting the governance indicated in the FIEA and other relevant regulations as well as supervisory guidelines.

B. Sufficient Social Credibility

- a. Whether the directors have been involved with anti-social forces.
- b. Whether the directors are members of organized crime groups, or have close relationships therewith.
- c. Whether the directors have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the directors have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the directors belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities,

and whether the directors were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).

f. Whether the directors have received an order of dismissal from officer, etc. from financial supervisory authorities.

g. Whether the directors have been the cause of the bankruptcy, etc., of a financial institution as an officer.

(2) Audit Committee, etc.

(i) Whether the independence of each committee is ensured in accordance with the purpose of the system of the committees.

(ii) Whether the audit committee properly exercises the broad authority granted thereto, as well as appropriately conducting audits of business operations in addition to audits of accounting affairs and taking necessary measures in a timely manner.

(iii) Whether the audit committee makes effective use of employees who should assist the duties of the audit committee, the internal audit section, accounting auditor, etc. in order to conduct audits of the compliance and adequacy of the execution of duties by the directors and executive officers.

In view of the institutional basis of the audit committee that consists mainly of outside directors, which is to conduct so-called organizational audits through the internal control system, whether a system is in place for the internal audit section, in particular, to support the audit committee, in comparison to auditors of a company with auditors who are able to conduct so-called physical audits.

(iv) In the decision process, etc. of proposals regarding the election of audit committee members, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Audit the Execution of Duties of Executive Officers and Directors of a Designated Parent Company in an Appropriate, Fair and Efficient Manner

Whether the auditor committee members of the designated parent company have sufficient knowledge and experience to monitor and examine the status of the establishment and administration of the internal control system, as well as actively fulfilling their role in the deliberations of the board of directors concerning the establishment and administration of the internal control system, and the knowledge and experience to ensure sound and proper operation of business of the designated parent company group by auditing the duties of executive officers and directors from an independent position.

B. Sufficient Social Credibility

a. Whether the auditors have been involved with anti-social forces.

b. Whether the auditors are members of organized crime groups, or have close relationships therewith.

c. Whether the auditors have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.

- d. Whether the auditors have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the auditors belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the auditors were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).
- f. Whether the auditors have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the auditors have been the cause of the bankruptcy, etc., of a financial institution as an officer.

(Reference) Auditor's Auditing Standards (Japan Audit & Supervisory Board Members Association)

### (3) Executive Officers (Including Representative Executive Officers)

- (i) Whether executive officers make decisions on business execution in accordance with the basic management policy decided by the board of directors, based on sufficient acknowledgement of the authorities and responsibilities delegated by resolution of the board of directors.
- (ii) Whether executive officers have established management plans in line with the basic management policy and communicated the plans throughout the company. Whether they regularly review and revise the progress status thereof.
- (iii) Whether executive officers are sincerely leading efforts in legal compliance, and appropriately perform their function to establish and execute a company-wide internal control environment.
- (iv) Whether executive officers fully recognize that disregarding the risk management division may have a serious impact on corporate earnings, and attach importance to said division. In particular, whether the executive officer in charge has in-depth knowledge and understanding concerning the methods of measuring, monitoring and managing risks, in addition to an understanding of where risks reside and what kind of risks they are.
- (v) Whether executive officers have set up a policy for managing risks based on the basic management policy and communicated the policy throughout the company. Whether the risk management policy is reviewed and revised on a periodic or as-needed basis. In addition, whether the board of directors makes use of risk-related information in the execution of business and the development of risk management systems by, for example, making necessary decisions based on risk-related information reported periodically.
- (vi) Whether executive officers have taken measures to enable internal audit functions to fully perform based on the recognition of the importance of internal audits, and implements appropriate measures based on the results of internal audits.
- (vii) Whether executive officers fully understand that banning any relationship with anti-social forces and firmly excluding such forces are vital for maintaining public confidence in the designated parent company

group and securing the appropriateness and soundness of its business. In addition, based on this understanding, whether the executive officers have made clear, both throughout the company and to the outside, a basic policy decided by the board of directors with due consideration of the Government Guideline.

(viii) In the election process of executive officers, etc., whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Conduct Governance in an Appropriate, Fair and Efficient Manner

Whether the executive officers understand the particulars of the viewpoints regarding governance indicated in the FIEA and other relevant regulations, as well as supervisory guidelines, and have the knowledge and experience necessary for exercising such viewpoints, sufficient knowledge and experience regarding compliance and risk management to conduct the operations of the designated parent company group in a sound and appropriate manner, and knowledge and experience to conduct other financial instruments businesses.

B. Sufficient Social Credibility

- a. Whether the executive officers have been involved with anti-social forces.
- b. Whether the executive officers are members of organized crime groups, or have close relationships therewith.
- c. Whether the executive officers have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the executive officers have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the executive officers belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the executive officers were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).
- f. Whether the executive officers have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the executive officers have been the cause of the bankruptcy, etc., of a financial institution as an officer.

(4) Internal Audit Section

(i) Whether the internal audit section has been established as an independent organization so as to fully check the actions of divisions subject to audit, while being equipped with the environment and ability to gather

important information concerning the state of business of divisions subject to audit, as well as a system to enable effective internal audits that appropriately respond to the state of business and environment surrounding the designated parent company group.

- (ii) Whether the internal audit section formulates efficient and effective internal audit plans in consideration of frequency and depth in accordance with the type and degree of risks and based on its understanding of the status of risk management, etc. by divisions subject to audit, reviews the plans appropriately according to the situation, and implements efficient and effective internal audits based on the internal audit plan.
- (iii) Whether the internal audit section reports important issues pointed out in internal audits without any delay to the representative director and audit committee. Whether the internal audit section accurately grasps the improvement status of the issues pointed out.

#### (5) Use of External Audits

- (i) Whether the designated parent company sufficiently recognizes that effective external audits are essential to ensuring sound and proper operation of the business of the designated parent company group and effectively uses them.
- (ii) Whether the designated parent company periodically examines if external audits are effectively conducted, and takes appropriate measures regarding the results of external audits.
- (iii) Whether the continuous audit years, etc. of the certified public accountant involved are treated appropriately.

#### (6) Coordination of Audit Functions

Whether the coordination between external audit functions and the internal audit section or auditors and board of auditors is functioning effectively.

### IV-5-1-3 In the Case of a Designated Parent Company that is a Company with Audit and Supervisory Committees

#### (1) Representative Director

- (i) Whether the representative director counts legal compliance among the most important management issues, and is leading efforts to establish a control environment for legal compliance.
- (ii) Whether the representative director fully recognizes that disregard of the risk management division may have a serious impact on corporate earnings and attaches importance to said division.
- (iii) Whether the representative director establishes an internal control environment to disclose financial information and other corporate information in an appropriate and timely manner.
- (iv) Whether the representative director, based on the recognition of the importance of internal audits, sets appropriate objectives for internal audits and establishes arrangements for enabling the internal audit section to fully perform its functions (including securing the independence of the internal audit section), and periodically checks the effectiveness of the functions. With regard to the control environment for internal audit, whether the representative director actively makes efforts to establish an effective environment in view of issues pointed

out in audits by the audit and supervisory committee and inspections by inspection departments.

Whether the representative director implements appropriate measures based on the results of internal audits immediately.

- (v) Whether the representative director, based on an adequate recognition of the importance and usefulness of audits by the audit and supervisory committee, recognizes that it is important to establish an environment that ensures the effectiveness thereof.
- (vi) Whether the representative director fully understands that banning any relationship with anti-social forces and firmly excluding such forces are vital for maintaining public confidence in the designated parent company group and securing the appropriateness and soundness of its business. In addition, based on this understanding, whether the representative director has made clear, both throughout the company and to the outside, a basic policy decided by the board of directors with due consideration of the Government Guideline.

## (2) Directors and Board of Directors

- (i) Whether directors check and prevent autocratic management by the representative director and other officers who are responsible for business execution, and are actively involved in the board of directors' decision-making and checking process concerning business execution.
- (ii) Whether outside directors recognize their significance from the perspective of ensuring objectivity of decision-making concerning management, and are actively involved in the board of directors. In addition, when deciding proposals regarding the election of outside directors, whether the designated parent company group examines the personal, capital, business and other relationships with the designated parent company group, in view of the roles expected of outside directors, and carefully examines their independence and eligibility.

Furthermore, whether the designated parent company group establishes some kind of framework so as to enable outside directors to make appropriate judgments at the board of directors' meetings, such as continuous provision of information.

- (iii) Whether the board of directors implements measures to ensure appropriateness and fairness upon, for example, making important management decisions concerning legal compliance and risk control by making use of the advice of experts outside the company or voluntary committees that consist of experts outside the company, as necessary.
- (iv) Whether the board of directors has specified a management policy based on the overall vision of the desirable status of the designated parent company group. Whether it has established management plans in line with the management policy and communicated the plans throughout the company. Whether it regularly reviews and revises the progress status thereof.
- (v) Whether the directors and board of directors are sincerely leading efforts in legal compliance, and appropriately perform their functions so as to establish a company-wide internal control environment.
- (vi) Whether the board of directors fully recognizes that disregarding the risk management division may have a serious impact on corporate earnings, and attaches importance to said division. In particular, whether the director in charge has in-depth knowledge and understanding concerning the methods of measuring, monitoring and managing risks, in addition to an understanding of where risks reside and what kind of risks they are.

- (vii) Whether the board of directors has established a policy for managing risks based on strategic objectives and communicated the policy throughout the company. Whether the risk management policy is reviewed and revised on a periodic or as-needed basis. In addition, whether the board of directors makes use of risk-related information in the execution of business and the development of risk management systems by, for example, making necessary decisions based on risk-related information reported periodically.
- (viii) Whether the board of directors has fostered a culture within the company that emphasizes and clearly indicates to employees of all ranks the importance of governance, as well as reviews and establishes appropriate and effective governance.
- (ix) Whether the board of directors has set appropriate objectives for internal audits and established arrangements for enabling the internal audit section to fully perform its functions based on the recognition of the importance of internal audits (including securing the independence of the internal audit section), and periodically checks the effectiveness thereof. With regard to the control environment for internal audits, whether the board of directors is actively making efforts to establish an effective environment in view of issues that were pointed out in audits by the audit and supervisory committee and inspections by inspection departments.

In addition, whether the board of directors approves basic matters concerning internal audit plans, including audit policy and priority items, in light of the risk management status, etc., of divisions subject to audits, and implements appropriate measures based on the results of internal audits.

- (x) Whether directors, based on adequate recognition of the importance and usefulness of audits by the audit and supervisory committee, recognize that it is important to establish an environment that ensures the effectiveness thereof. When deciding proposals regarding the election of directors who are members of the audit and supervisory committee, whether the directors carefully examine their independence and eligibility. In particular, whether directors recognize that the election of outside directors who are members of the audit and supervisory committee is compulsory from the perspective of further improving the neutrality and independence of the audit system, and establishes some kind of framework so as to enable outside directors who are members of the audit and supervisory committee to make appropriate judgments, such as continuous provision of information.
- (xi) Whether directors understand that establishing internal control environments such as for legal compliance, risk management, and financial reporting (the so-called internal control system) constitutes the duty of due care and duty of loyalty of directors, and endeavor to appropriately fulfill their obligations.
- (xii) Whether the board of directors has decided a basic policy based on the Government Guideline, established a framework for implementing it and clearly positioned the prevention of damage that could be inflicted by anti-social forces in the internal control system as a matter of legal compliance and risk management by, for example, periodically examining the effectiveness thereof.
- (xiii) In the decision process, etc. of proposals regarding the election of directors engaging in the ordinary business of a designated parent company, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Conduct Governance in an Appropriate, Fair and Efficient Manner

Whether the directors of the designated parent company understand the particulars of the viewpoints regarding governance indicated in the FIEA and other relevant regulations, as well as supervisory guidelines, and have the knowledge and experience necessary for exercising such viewpoints, sufficient knowledge and experience regarding compliance and risk management to conduct the operations of the designated parent company group in a sound and appropriate manner, and knowledge and experience to conduct other financial instruments businesses.

#### B. Sufficient Social Credibility

- a. Whether the directors have been involved with anti-social forces.
- b. Whether the directors are members of organized crime groups, or have close relationships therewith.
- c. Whether the directors have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the directors have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the directors belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the directors were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain consequences).
- f. Whether the directors have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the directors have the experience of being the cause of the bankruptcy, etc., of a financial institution as an officer.

#### (3) Audit and Supervisory Committee

- (i) Whether the independence of the audit and supervisory committee is ensured in accordance with the purpose of its system.
- (ii) Whether the audit and supervisory committee properly exercises the broad authority granted thereto, as well as appropriately conducting audits of business operations in addition to audits of accounting affairs and taking necessary measures in a timely manner.
- (iii) Whether the audit and supervisory committee makes effective use of employees who should assist the duties of the audit and supervisory committee, the internal audit section, accounting auditor, etc. in order to conduct audits of the compliance and adequacy of the execution of duties by the directors.

In view of the institutional basis of the audit and supervisory committee that consists mainly of outside directors, which is to conduct so-called organizational audits through the internal control system, whether a



system is in place for the internal audit section, in particular, to support the audit and supervisory committee, in comparison to auditors of a company with auditors who are able to conduct so-called physical audits.

- (iv) With regard to proposals regarding the election of directors who are members of the audit and supervisory committee that the directors submit to the general meeting of shareholders, whether the audit and supervisory committee carefully examines their independence and eligibility upon deliberation of consent.

In particular, whether the audit and supervisory committee examines the personal, capital, business and other relationships with the designated parent company group, with regard to outside auditors who are members of the audit and supervisory committee.

- (v) In the decision process, etc. of proposals regarding the election of directors who are members of the audit and supervisory committee of a Designated Parent Company, whether elements such as the following are appropriately taken into consideration concerning their eligibility:

A. Knowledge and Experience to Audit the Execution of Duties of Executive Officers and Directors of a Designated Parent Company in an Appropriate, Fair and Efficient Manner

Whether the members of the audit and supervisory committee have sufficient knowledge and experience to monitor and examine the status of the establishment and administration of the internal control system, as well as actively fulfilling their role in the deliberations of the board of directors concerning the establishment and administration of the internal control system, and the knowledge and experience to ensure sound and proper operation of business of the designated parent company group by auditing the duties of directors from an independent position.

B. Sufficient Social Credibility

- a. Whether the members of the audit and supervisory committee have been involved with anti-social forces.
- b. Whether the members of the audit and supervisory committee are members of organized crime groups, or have close relationships therewith.
- c. Whether the members of the audit and supervisory committee have been imposed a fine (including similar punishments imposed under foreign laws and regulations thereto) for violation of the FIEA and other finance-related laws and regulations of Japan or other foreign laws and regulations equivalent thereto, or for committing a crime under the Penal Code or under the Act on Punishment of Physical Violence and Others.
- d. Whether the members of the audit and supervisory committee have been sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto).
- e. Whether the corporation to which the members of the audit and supervisory committee belonged or currently belong has received administrative disposition concerning legal compliance in the past such as a business improvement order, business suspension order, or rescission of license, registration or permit from financial supervisory authorities, and whether the members of the audit and supervisory committee were responsible for the cause of said disposition as the party to the act or from a position of giving directions and orders to the party concerned by intention or gross negligence (especially considerable inattention despite being in a situation where it was possible to be aware of and avoid certain

consequences).

- f. Whether the members of the audit and supervisory committee have received an order of dismissal from the position of officer, etc. from financial supervisory authorities.
- g. Whether the members of the audit and supervisory committee have been the cause of the bankruptcy, etc., of a financial institution as an officer.

(Reference) Auditor's Auditing Standards (Japan Audit & Supervisory Board Members Association)

#### (4) Internal Audit Section

- (i) Whether the internal audit section has been established as an independent organization so as to fully check the actions of divisions subject to audit, while being equipped with the environment and ability to gather important information concerning the state of business of divisions subject to audit, as well as a system to enable effective internal audits that appropriately respond to the state of business and environment surrounding the designated parent company group.
- (ii) Whether the internal audit section formulates efficient and effective internal audit plans in consideration of frequency and depth in accordance with the type and degree of risks and based on its understanding of the status of risk management, etc. by divisions subject to audit, reviews the plans appropriately according to the situation, and implements efficient and effective internal audits based on the internal audit plan.
- (iii) Whether the internal audit section reports important issues pointed out in internal audits without any delay to the representative director and the audit and supervisory committee. Whether the internal audit section accurately grasps the improvement status of the issues pointed out.

#### (5) Use of External Audits

- (i) Whether the designated parent company sufficiently recognizes that effective external audits are essential to ensuring sound and proper operation of the business of the designated parent company group and effectively uses them.
- (ii) Whether the designated parent company periodically examines if external audits are effectively functioning, and takes appropriate measures regarding the results of external audits.
- (iii) Whether the continuous audit years, etc. of the certified public accountant involved are treated appropriately.

#### (6) Coordination of Audit Functions

Whether the coordination between external audit functions and the internal audit section or the audit and supervisory committee is functioning effectively.

(Reference) The following may be used as reference regarding the viewpoints in supervising the control environment of governance:

- (i) "Framework for Internal Control Systems in Banking Organisations" The Basel Committee on Banking Supervision (September 1998)

- (ii) “Enhancing Corporate Governance for Banking Organisations” The Basel Committee on Banking Supervision (February 2006)
- (iii) “Guideline for How Companies Prevent Damage from Anti-Social Forces” (agreed upon at a meeting on June 19, 2007 of cabinet ministers responsible for anti-crime measures)
- (iv) “Principles for Enhancing Corporate Governance” The Basel Committee on Banking Supervision (October 2010)
- (v) “Corporate Governance Principles for Banks” The Basel Committee on Banking Supervision (July 2015)

(Note) Hereinafter in the Guidelines, descriptions presume cases of designated parent companies that are companies with auditors, in principle; however, in the case of designated parent companies that are companies with nominating committees, etc., or companies with an audit and supervisory committee, examinations shall be made by reading the Guidelines in accordance with the actual situation as needed, based on the purpose of the Guidelines.

#### IV-5-2 Appropriateness of Business Operations

The following points shall also be taken into consideration with regard to the appropriateness of business operations of designated parent company groups:

- (i) Whether the designated parent company has, in order to ensure thorough group-wide compliance with the relevant laws, regulations and rules of each country, established an appropriate control environment for legal compliance in accordance with the size of its overseas offices and the characteristics of its business operations, for example, by ensuring necessary staffing (such as the allocation of officers and employees who are adept in the relevant laws, regulations and rules of the local area) and developing rules and regulations. Whether the designated parent company continuously examines whether adequate control environments are being secured at overseas offices and other places.
- (ii) Whether the designated parent company continuously checks how adept officers and employees at overseas offices and other places are in the relevant laws, regulations and rules of the local area, and whether it examines if control environments have been secured for education and training to be appropriately conducted as necessary.
- (iii) From the viewpoint of preventing violations of the law and inappropriate business operations, whether there is a control environment in place in which the division of roles between the designated parent company and the overseas offices and other places is clarified, and in which the functions of checking and supervising the sales division, etc. can be properly exercised.
- (iv) Whether the designated parent company has developed a control environment wherein, in cases where a problem at an overseas base has been identified, information is promptly shared between the designated parent company and the overseas base and necessary actions are taken swiftly, and reports are made immediately to the Japanese and other relevant supervisory authorities.

#### IV-5-3 Adequacy of Equity Capital

The following points shall also be taken into consideration with regard to the capital adequacy of designated parent company groups:

(Note) In cases where a group does not fall under the category of a designated parent company group, but is required, by the supervisory authorities of the countries where it has business operations, to be monitored in Japan for its financial soundness as a group (on a consolidated basis), if the Financial Instruments Business Operators within the group have obtained approval for the use of an internal control model-based approach pursuant to the provisions of Article 10 of the Capital Adequacy Notice, the value of the market risk equivalent as part of the group's requisite equity capital may be calculated using the same approach.

##### IV-5-3-1 Appropriateness and Sufficiency of the Equity Capital of Final Designated Parent Companies

In order to secure the confidence of the markets, etc., it is extremely important that final designated parent companies work to improve their capital adequacy and retain a sufficient financial basis that is suited to the risks. To this end, a final designated parent company needs to have a process for evaluating its overall capital adequacy in the context of its risk profile, and it needs to implement appropriate measures for maintaining a sufficient level of equity capital.

###### IV-5-3-1-1 Directors and Board of Directors

(1) Whether the directors understand the nature and level of the risks taken by the final designated parent company as well as the relationship between risk and the appropriate level of equity capital.

(2) Whether the directors and the board of directors understand that, in order to achieve their strategic objectives, a capital plan, which is consistent with this, is an essential component, and whether they have formulated an appropriate capital plan according to the strategic objectives.

(3) In formulating management plans, whether the board of directors has analyzed the amount of equity capital needed now and in the future in relation to the strategic objectives, and whether it has given an outline in the management plans of the advisable level of equity capital in view of the strategic objectives as well as the amount of capital needed to be financed and the appropriate method for financing.

(4) Whether the directors have been sufficiently involved in adopting a process for evaluating the overall capital adequacy in the context of the risk profile and in implementing appropriate measures for maintaining a sufficient level of equity capital in terms of both quality and quantity.

(5) In the case of a final designated parent company which computes the consolidated capital adequacy ratio pursuant to Article 2 of the "the Notice of the Establishment of Standards for Determining Whether the Adequacy of Equity Capital of a Final Designated Parent Company and its Subsidiary Corporations, etc., is Appropriate

Compared to the Assets Held by the Final Designated Parent Company and its Subsidiary Corporations, etc.” (hereinafter the “Capital Adequacy Notice on Final Designated Parent Company”), whether the directors and the board of directors, when preparing the capital plan, fully take into consideration of such capital buffer which is required to be gradually reserved in and after 2016 in accordance with “Basel III: A global regulatory framework for more resilient banks and banking systems” (the Basel Committee on Banking Supervision, December 2010; hereinafter Basel III) and “Global systematically important banks: Assessment methodology and the additional loss absorbency requirement” (the Basel Committee on Banking Supervision, July 2011) (the agreements at the Basel Committee on Banking Supervision, including the foregoing documents, are hereinafter referred to as the “Basel Capital Accord”).

#### IV-5-3-1-2 Evaluating Capital Adequacy

(1) Whether the control environment for the final designated parent company to evaluate its overall capital adequacy in the context of its risk profile is appropriate and includes the following:

- (i) A policy and procedures for accurately recognizing, evaluating/measuring and reporting all risks
- (ii) A process to evaluate capital adequacy in comparison to the risks recognized and evaluated/measured in (i) above
- (iii) A process for setting equity capital targets in comparison to risk, taking strategic objectives and management plans into account
- (iv) An internal control process that includes an examination by the internal audit section for ensuring that the overall risk management processes of the final designated parent company are appropriate.

(2) The final designated parent company which computes the consolidated capital adequacy ratio pursuant to Article 2 of the Capital Adequacy Notice on Final Designated Parent Company is required to have the capital (Common Equity Tier 1, Tier 1 Capital, and Total regulatory capital) in excess of the level required in the Capital Adequacy Notice on Final Designated Parent Company in consideration of the purpose of the Basel Capital Accord. Whether the final designated parent company analyzes, not only the quantity of equity capital, but also the quality of equity capital which includes at least the following points, when evaluating capital adequacy:

- (i) Whether Common Equity Tier 1 mainly consists of shareholders’ equity in the form of common stock and whether capital in the form of common stock, capital surplus and retained earnings account for the main part of Common Equity Tier 1. Whether there is a risk that the ratio of Common Equity Tier 1 greatly fluctuates for the reason that Common Equity Tier 1 is excessively dependent on accumulated other comprehensive income, including valuation difference on available-for-sale securities.
- (ii) Whether common stock, Additional Tier 1 capital instruments and Tier 2 capital instruments satisfy all the requirements specified in the Capital Adequacy Notice on Final Designated Parent Company and fully conform to the purpose of the Basel Capital Accord.
- (iii) Whether common stock consists of voting stock of a single type. If stock of a type for which matters for which voting rights can be exercised at general shareholders meetings are limited is issued as common stock

under the Capital Adequacy Notice on Final Designated Parent Company, whether such stock has the same conditions as those for voting common stock, except for matters relating to voting rights, and whether such stock satisfies all requirements of the Capital Adequacy Notice on Final Designated Parent Company.

- (iv) Whether a final designated parent company has provided direct or indirect financing necessary for acquiring instruments to holders of capital-raising instruments, and whether subsidiaries, etc., or affiliates, etc., of the final designated parent company has acquired such instruments.
- (v) In the case that capital-raising instruments are paid for in property other than cash, whether the value of properties contributed in kind is properly computed and such payment has been approved by the supervisory authorities.

### (3) Deferred Tax Assets

With respect to matters relevant to the quality of equity capital, given that the large amount of deferred tax assets and the large ratio of deferred tax assets to equity capital is a potential problem from the perspective of the soundness of the final designated parent company, the following points shall also be taken into consideration:

- (i) Given the vulnerabilities of deferred tax assets, such as the fact that their qualification as assets relies on future taxable income, whether they have been recorded appropriately in light of the purpose of accounting standards, etc. on tax effect accounting.
- (ii) With regard to the basis for including deferred tax assets and the procedures for calculating them, in order to increase the reliability of the amount recorded for deferred tax assets, in addition to disclosing the matters listed in A to F below when announcing summaries of accounts (including interim results) and at other appropriate times, whether the final designated parent company provides easy-to-understand explanations suited to the calculation procedures and based on the disclosed figures.
  - A. The basis for including deferred tax assets (in cases where past business results and other circumstances are used as the main criteria, the illustrative classifications set forth in the Personal Information Protection Guidelines (Note) (including the nonrecurring, special factors in the case of the proviso of (iv)) and the estimation period for future taxable income (X years).
  - B. Taxable income for the past five years (actual figures for each fiscal year before using losses carried forward).
  - C. Estimated figure for the adjusted net business profit on which the estimation was made (total value for X years).
  - D. Estimated figure for the net income before tax on which the estimation was made (total value for X years).
  - E. Estimated figure for the taxable income before adjustments (total value for X years).
  - F. Common items to be disclosed regarding the main causes of the deferred tax assets and liabilities.
    - a. Deferred tax assets: including allowance for doubtful accounts, taxable depreciation of securities, valuation profit or loss on other securities, reserve for retirement allowances, and losses carried forward.
    - b. Deferred tax liabilities: including gains on the contribution of securities to retirement benefit trusts, valuation profit or loss on other securities, and unrealized gains on lease transactions.

(Note) “Audit Treatment of Judgments with Regard to Recoverability of Deferred Tax Assets” (November 9, 1999, Japanese Institute of Certified Public Accountants)

(4) The final designated parent company which computes the consolidated capital adequacy ratio pursuant to Article 2 of the Capital Adequacy Notice on Final Designated Parent Company is required to hold additional capital (Common Equity Tier 1 Capital related to capital conservation buffer and countercyclical buffer) in excess of the level required in the Capital Adequacy Notice on Final Designated Parent Company in consideration of the purpose of the Basel Capital Accord. Furthermore, the final designated parent company that was designated based on the provisions of Article 2-2(5)(i) of the Capital Adequacy Notice on Final Designated Parent Company (hereinafter referred to as “G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company”) or the final designated parent company that was designated based on the provisions of Article 2-2(5)(ii) of the Capital Adequacy Notice on Final Designated Parent Company (hereinafter referred to as “D-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company”) are required to hold additional capital (Common Equity Tier 1 Capital) in excess of the level required in the Capital Adequacy Notice on Final Designated Parent Company as a G-SIB buffer or D-SIB buffer respectively.

A capital conservation buffer is a capital buffer that can be used to absorb losses during periods of financial and economic stress.

A countercyclical buffer is a buffer against losses that may arise from future business fluctuations, in cases where credit has grown excessively in financial markets. It is computed by summing up the figures that were obtained according to the country or region by multiplying the ratio stipulated by the financial authorities of each country or region by the percentage that was obtained by dividing the amount of credit risk assets related to the country or region in question by the total amount of credit risk assets in possession. A ratio specified by the FSA Commissioner under Article 2-2(4)(i) of the Capital Adequacy Notice on Final Designated Parent Company (hereinafter referred to as the “Countercyclical Buffer Ratio”) shall be determined, in consideration of appropriate benchmark statistics acknowledged by the FSA (e.g. total credit to GDP ratio and Diffusion Index (DI) of financial institutions' lending attitudes) and in light of discussions with the Bank of Japan in a comprehensive manner. If the level of the Countercyclical Buffer Ratio is raised, such revised ratio shall be implemented within one year from the date of announcement. If the level of the ratio is reduced, the revised ratio shall be implemented on the date of the announcement.

The G-SIB buffer and D-SIB buffer are meant for G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company and D-SIBs designated by Capital Adequacy Notice on Final Designated Parent Company, respectively, to enhance capital for absorbing losses with the aim of reducing the possibility of bankruptcy in view of the systemic importance of the final designated parent company, etc. in question. The buffer level for each bank is specified in the Capital Adequacy Notice on Final Designated Parent Company in consideration of their systemic importance.

The evaluation of systemic importance pertaining to the selection of global systemically important banks (G-SIBs) is conducted by the Financial Stability Board, targeting internationally active banks for which, an amount of Attached List of Formats II, p. 32, item number 3 from among the quantitative disclosure items stipulated in Article

3 (5) of the “Regulatory Notice of the Establishment of Matters to be Included in a Document Stating the Capital Adequacy by a Final Designated Parent Company in Cases Specified by the FSA Commissioner” (hereinafter referred to as the “Notice of Disclosure”) (the total exposure as defined for use in the Basel III leverage ratio) translated to euros at the exchange rate as of the end of the fiscal year that ended most recently exceeds 200 billion euros. G-SIBs are deemed based on the following five criteria: (1) “scale;” (2) “interconnectivity;” (3) “substitutability/financial infrastructure;” (4) “complexity;” and (5) “global activities,” and designated in the Capital Adequacy Notice on Final Designated Parent Company in view thereof.

The evaluation of systemic importance pertaining to the selection of domestic systemically important banks (D-SIBs) is conducted by the authorities of each country. Upon evaluation of systemic importance in Japan, domestic banks, etc. with 15 trillion yen or more in total assets on a consolidated basis are subject. The score of each bank, etc. is computed using 13 indicators in four categories which are: (1) “scale;” (2) “interconnectivity;” (3) “substitutability/financial infrastructure;” and (4) “complexity.” Then of those included in such banks, etc. that are international active bank (including final designated parent companies) that were evaluated as systemically important by comprehensive judgment that takes into consideration the above scores as well as the characteristics of each bank such as their importance in specific markets are deemed as D-SIBs. Of the D-SIBs, final designated parent companies are designated in the Capital Adequacy Notice on Final Designated Parent Company.

The 13 indicators in the four categories and the weight of each indicator upon computation of the score are as below.

Category	Evaluation indicator	Weight
Scale	Total exposure as defined for use in the Basel III leverage ratio <sup>(*)</sup>	25%
Interconnectivity	Total amount of the following intra-financial system assets <sup>(*)</sup> <ul style="list-style-type: none"> <li>• The amount of deposits and loans to financial institutions (including the amount of commitment not yet withdrawn)</li> <li>• The amount of securities issued by financial institutions, etc. (collateralized bonds, senior unsecured bonds, subordinated bonds, short-term bonds, negotiable deposits and stocks) held</li> <li>• The amount of current exposure of repo-type transactions with financial institutions, etc. (must be able to consider the effect of legally valid bilateral netting contracts, limited to those that are no less than zero.)</li> <li>• The estimated fair value amount and the amount of add-ons calculated using the current exposure method of derivative transactions and transactions with long settlement periods with financial institutions, etc. that are conducted through other than financial markets, etc. (must be able to consider the effect of legally valid bilateral netting contracts, limited to those that are no less than zero.)</li> </ul>	5%
	Total amount of the following intra-financial system liabilities <sup>(*)</sup> <ul style="list-style-type: none"> <li>• The amount of deposits and borrowings from financial institutions, etc.</li> </ul>	5%



	(including the amount of commitment not yet withdrawn) <ul style="list-style-type: none"> <li>• The amount of current exposure of repo-type transactions with financial institutions, etc. (must be able to consider the effect of legally valid bilateral netting contracts, limited to those that are no more than zero.)</li> <li>• The estimated fair value amount and the amount of add-ons calculated using the current exposure method of derivative transactions and transactions with long settlement periods with financial institutions, etc. that are conducted through other than financial markets, etc. (must be able to consider the effect of legally valid bilateral netting contracts, limited to those that are no more than zero.)</li> </ul>	
	Outstanding securities issued (collateralized bonds, senior unsecured bonds, subordinated bonds, short-term bonds, negotiable deposits and stocks)(*)	5%
	The amount of stocks of available-for-sale securities with market value	5%
	Of general deposits, etc., the amount of the portion that exceeds 10 million yen, when the balance exceeds 10 million yen	5%
Substitutability/ financial infrastructure	The annual sum of settlements via the Bank of Japan Financial Network System, the Japanese Banks' Payment Clearing System and other similar settlement systems during the fiscal year that ended most recently (limited to settlements in Japanese yen)	8.33%
	The balance of trust assets and similar assets (limited to those entrusted by domestic residents)	8.33%
	The annual sum of underwriting pertaining to bonds and stocks during the fiscal year that ended most recently (limited to underwritings in the domestic bond market and stock market)	4.165%
	Total amount of trading volume	4.165%
Complexity	The balance of the amount of notional principal pertaining to derivative transactions and transactions with long settlement periods with financial institutions, etc. that are conducted through other than financial markets, etc.(*)	8.33%
	Outstanding cross-jurisdictional claims	8.33%
	Outstanding cross-jurisdictional liabilities	8.33%

(\*) Including the amount of exposure of insurance subsidiaries

(5) An Ultimate designated parent company is required to have Tier 1 Capital in excess of the level required in the Standards to Determine Soundness Concerning Leverage Stipulated in Complimentary Indices to the Standards to Determine Whether the Adequacy of Equity Capital of a Ultimate Designated Parent Company and its Subsidiary

Corporations, etc., are Appropriate Compared to the Assets of the Ultimate Designated Parent Company and its Subsidiary Corporations, etc. (hereinafter referred to as the “Consolidated Leverage Ratio Notice”) with regard to the consolidated leverage ratio (meaning the consolidated leverage ratio specified in Article 2 of the Consolidated Leverage Ratio Notice), which is a complimentary index to the standards to determine whether the adequacy of equity capital is appropriate and which is a simple and non-risk based index for restraining an excessive build-up of leverage.

Pursuant to the proviso to Article 2 of the Consolidated Leverage Ratio Notice, in order to achieve harmonization with the monetary policy implemented by the Bank of Japan under an exceptional macroeconomic environment where the Bank of Japan implements a monetary policy that causes substantial changes in the amount of money deposited with the Bank of Japan by financial institutions, the minimum required ratio is to be revised, while excluding the amount deposited with the Bank of Japan from the total exposure amount, which is the denominator of the consolidated leverage ratio, and the ratio is to be separately designated by the FSA Commissioner. The revised minimum required ratio is to be further revised as needed in light of the macroeconomic environment, etc.

#### IV-5-3-1-3 Confirming the Eligibility of Capital-Raising Instruments as Equity Capital for Consolidated Capital Adequacy Ratio

In relation to the evaluation of capital adequacy, with regard to final designated parent companies that calculate their consolidated capital adequacy ratio based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, in such cases as where there has been notification of an issuance, etc. pertaining to a capital-raising instrument, such as preferred equity investment certificates, subordinated loans and subordinated bonds issued by a special purpose company overseas, confirmation shall be made as to whether these are eligible as equity capital under the regulations on consolidated capital adequacy ratios, giving due consideration to the purposes of the Capital Adequacy Notice on Final Designated Parent Company and the Basel Capital Accord and the “Instruments Eligible for Inclusion in Tier 1 Capital” (Basel Committee on Banking Supervision, 1998). For details of the supervisory viewpoints, reference shall be made, as necessary, to III-2-1-1-3 of the Comprehensive Guidelines for Supervision of Major Banks, etc.

Furthermore, with regard to confirming the eligibility of subordinated loans and subordinated bonds of final designated parent companies that calculate their consolidated capital adequacy ratio based on Article 4 of the Capital Adequacy Notice on Final Designated Parent Company, reference shall be made, as necessary, to IV-2-1(1) of this Guideline.

#### IV-5-3-2 Accuracy of Consolidated Capital Adequacy Ratio of Final Designated Parent Companies

Supervisors shall check the calculation of risk assets for the consolidated capital adequacy ratio with due consideration of the following points.

##### IV-5-3-2-1 Judgment of Eligibility for Intentional Holdings and Checks concerning the Use of the Proportionate Consolidation Method

(1) In view of the point raised in the Basel Capital Accord, namely, that the financing of capital within a financial system (so-called double gearing) “makes the banking system more vulnerable to the rapid transmission of problems from one institution to another,” in Japan, the Capital Adequacy Notice on Final Designated Parent Company prescribes cases where a financial institution intentionally holds the shares or other capital instruments of other financial institutions, etc. for the purpose of improving the equity capital of the other financial institutions, etc. (hereinafter referred to as “intentional holdings”) as cases where they must be deducted as an “adjustment” from the equity capital of a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company.

For details of the supervisory viewpoints regarding judgment of these “intentional holdings,” reference shall be made, as necessary, to III-2-1-2-2 (excluding (2-2)) of the Comprehensive Guidelines for Supervision of Major Banks, etc.

(2) In cases where there has been notification regarding the use of the proportionate consolidation method for affiliated companies engaged in financial services when calculating the consolidated capital adequacy ratio, reference shall be made, as necessary, to III-2-1-2-2(4) of the Comprehensive Guidelines for Supervision of Major Banks, etc.

#### IV-5-3-2-2 Method of Calculating Risk Assets

(1) In cases where assets have been securitized, even if such securitization constitutes a transfer in legal terms, whether the risk has been completely transferred to the transferee or otherwise effectively transferred.

(2) The reduction effect on risk assets shall, in principle, be recognized for an assignment of claims with rights of repurchase; provided, however, that in cases where assignments of claims with rights of repurchase have been made across different accounting periods, the reduction effect on risk assets shall not be recognized for those where a contract is entered which provides an incentive to effect the redemption by exercising the said right within one year following the relevant accounting period.

Notwithstanding the above, in cases where an assignment of claims with rights of repurchase has been made with the intention of temporarily raising the consolidated capital adequacy ratio, the reduction effect on risk assets shall not be recognized.

(3) In cases where claims with bank guarantees, etc. are held into the following accounting period or at the end of the accounting period, the reduction effect on risk assets will, in principle, only be recognized where the remaining period of the relevant claim and the period of the guarantee, etc. are equal; provided, however, that even if the remaining period of the guarantee, etc. is less than the remaining period of the claim, in cases where there are justifiable reasons for the guarantee, etc. and there is an ongoing expectation for a reduction in credit risk (Note), the reduction effect on risk assets shall be recognized.

Notwithstanding the above, in cases where a contract of guarantee, etc. has been made with the intention of

temporarily raising the consolidated capital adequacy ratio, the reduction effect on risk assets shall not be recognized.

(Note) For the time being, this shall apply to cases where the remaining period of the guarantee, etc. is one year or longer (provided, however, that even if the remaining period of the guarantee, etc. is one year or longer, if a contract is entered which effectively provides an incentive to cancel the contract of guarantee, etc. within one year, the reduction effect on risk assets shall not be recognized).

(4) Of the positions subject to calculation of foreign exchange risk when calculating the market risk equivalent of a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company, for the time being, any positions pertaining to long-term contributions, etc. denominated in foreign currencies that are indicated at acquisition value in the financial statements shall be permitted to be excluded from foreign exchange risk.

(5) Regarding capital treatment of securitisations of nonperforming loans, whether any act falling under regulatory arbitrage is being conducted.

In particular, even in cases satisfying all of the requirements set forth in Article 245-4(2) of the Capital Adequacy Notice on Final Designated Parent Company, if the purpose is to reduce risk assets in relation to loans other than nonperforming loans, the risk weight specified in the same paragraph may not be applied.

#### IV-5-3-2-3 Internal Control, etc. for Assets and Transactions Related to Trading Operations

In the case of a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company, transactions subject to market risk regulations are primarily comprised of assets and liabilities relating to trading operations prescribed in Article 11 of the Capital Adequacy Notice on Final Designated Parent Company. In addition to clarifying the transactions subject to market risk regulations and eliminating any inappropriate transactions (Note), subject transactions need to be properly managed by the final designated parent company. Based on this perspective, supervisors shall check the following points.

(1) Whether the transactions subject to market risk regulations and the methods for managing them have been clearly documented (including the method for properly valuing the transactions according to their specific characteristics, based on the expected holding period and the probability that the holding period will exceed that expected).

(2) Whether periodic internal audits (internal audits and accounting audits on the appropriateness of the valuation method and the operation thereof) are used to confirm that the transactions are properly managed according to the said documents.

(Note) The Application of Basel II to Trading Activities and the Treatment of Double Default Effects (Basel Committee on Banking Supervision, 2005) illustrates unhedged hedge fund holdings and privately placed stock as inappropriate (paragraph 271).

### IV-5-3-3 Accuracy of Calculation of the Consolidated Leverage Ratio of Final Designated Parent Company

#### IV-5-3-3-1 Significance

Regarding the consolidated leverage ratio, as this is a fundamental index to display the soundness of financial affairs of an ultimate designated parent company, calculations must be done accurately.

The accuracy of the consolidated leverage ratio calculation must adequately take into account the Consolidated Leverage Ratio Notice and the purpose of the Basel Capital Accord.

#### IV-5-3-3-2 Consistency of Calculation Methods for the Consolidated Leverage Ratio

In a case where, for example, transitional measures are adopted in the Consolidated Leverage Ratio Notice and the final designated parent company is allowed some discretion related to the calculation method for the consolidated leverage ratio, a consistent calculation method must be adopted, excluding cases where a change is made based on a rational reason.

#### IV-5-3-4 Disclosing the Adequacy of Equity Capital and Other Items

(1) The aim of disclosing the adequacy of equity capital and other items based on the third pillar of International Convergence of Capital Measurement and Capital Standards and Leverage Ratio (market discipline) is to complement the first pillar (minimum capital and minimum leverage ratio requirements) and the second pillar (supervisory review process), and to maintain the soundness of the management of financial institutions through assigning rules for external market evaluations. Therefore, in cases where a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company, and calculates its consolidated leverage ratio based on Article 2 of the Consolidated Leverage Ratio Notice, makes disclosure pursuant to the Notice of Disclosure, important matters need to be appropriately disclosed in accordance with the purpose of the Notice of Disclosure, namely, the disciplining of external valuation by markets, and in light of the actual business conditions and risk profile.

(2) On the other hand, with regard to matters that are not necessarily important considering the actual business conditions and risk profile of the final designated parent company, it is undeniable that detailed disclosure of such information may instead impede the purpose of the Notice of Disclosure, namely, the disciplining of external valuation by markets. To this end, in cases where there are items that are not important in light of the actual business conditions and risk profile, it shall be acceptable to disclose the items that were not disclosed and the reasons why they were determined to not be important.

(3) With regard to information of proprietary value and information relating to confidentiality, in cases where disclosing such information may cause significant damage to the position of the final designated parent company, it shall be acceptable to disclose the items that were not disclosed and the reasons why, together with more general information about the relevant items.

(4) When checking the status of disclosure, there should not be a focus on the completeness of the items stipulated in the Notice of Disclosure; rather it needs to be checked whether the items that are important considering the actual business conditions and risk profile of the final designated parent company have been properly disclosed, and whether their content is useful for the disciplining of external valuation by markets.

(Note) For details of the supervisory viewpoints, reference shall be made, as necessary III-3-2-4-4 and III-3-2-5(2) of the Comprehensive Guidelines for Supervision of Major Banks, etc.

#### IV-5-3-5 Early Corrective Action

##### IV-5-3-5-1 Significance

In order to secure financial soundness, it is extremely important that final designated parent companies proactively work to improve their equity capital and retain a sufficient financial basis that is suited to the risks. Supervisors need to encourage the early correction of the their management by issuing necessary correction orders in a prompt and appropriate manner based on the objective standard of the consolidated capital adequacy ratio and the consolidated leverage ratio as a role of complementing the efforts of the final designated parent company.

##### IV-5-3-5-2 Supervisory Method and Actions

Early corrective action, which stipulates the specific measures in the Notice Stipulating the Category Pertaining to the Soundness of Management of a Final Designated Parent Company and its Subsidiary Corporations, etc., and the Specification of Orders According to that Category (hereinafter referred to as the “Notice of Category”), shall be managed as follows.

#### (1) Consolidated Capital Adequacy Ratio or the Consolidated Leverage Ratio Forming Basis for the Issuance of an Order

The consolidated capital adequacy ratio or consolidated leverage ratio related to the categories set forth in the tables in Article 1(1)(i) and (iii) as well as Article 4 of the Notice of Category (hereinafter referred to as the “Early Corrective Action Category”) shall be based on the following consolidated capital adequacy ratios or consolidated leverage ratios:

- (i) The consolidated capital adequacy ratio or consolidated leverage ratio reported in the consolidated financial results status report (however, after submitting the Business Report: the consolidated capital adequacy ratio or consolidated leverage ratio that was reported; and after filing a document stating the soundness of management pursuant to Article 57-17(2) of the FIEA: the consolidated capital adequacy ratio or consolidated leverage ratio that was reported)
- (ii) At times other than when (i) above has been reported: the consolidated capital adequacy ratio or consolidated leverage ratio reported by a final designated parent company following discussion between the final designated parent company and an audit firm based on the inspection results of the authorities.

(Note) The consolidated capital adequacy ratio of a final designated parent company consists of the following

three ratios: the consolidated Common Equity Tier 1 ratio, the consolidated Tier 1 Capital ratio, and the consolidated Total regulatory capital ratio, as well as the capital buffer ratio. Of this, the consolidated capital adequacy ratio, which is the standard for determining issuance of early corrective action order, is the consolidated Common Equity Tier 1 ratio, the consolidated Tier 1 Capital ratio, and the consolidated Total regulatory capital ratio.

(2) Orders Based on the Early Corrective Action Category

(i) Difference between a Category 1/Leverage Category 1 Order, a Category 2/Leverage Category 2 Order and a Category 3/Leverage Category 3 Order

The purpose of Category 1 or Leverage Category 1 order, which is “for submission and implementation of a plan deemed reasonable for ensuring the soundness of management (which, in principle, includes measures pertaining to capital enhancement),” is ensuring to steadily achieve a level above the range of the consolidated capital adequacy ratio related to Category 1 or the consolidated leverage ratio related to Leverage Category 1 as a standard for ensuring the soundness of management. Therefore, supervisors shall emphasize that, in general, the plan ensures the soundness of management, and they shall basically respect the autonomy of the final designated parent company when implementing that plan.

The purpose of Category 2 or Leverage Category 2 order “pertaining to any of the following measures which contribute to improving the capital adequacy of a final designated parent company and its subsidiary corporations, etc.” is to promptly improve a consolidated capital adequacy ratio or a consolidated leverage ratio which falls considerably below the level ensuring soundness of management. Therefore, although the individual measures shall be based on the opinions of the final designated parent company because of the need to take into account the actual management conditions of the final designated parent company, the details of the measures shall be prescribed at the discretion of the authorities. In addition, when implementing the measures, the final designated parent company will basically need to fulfill the orders for each measure.

Category 3 or Leverage Category 3 order “to select between a measure to improve the equity capital of a final designated parent company and its subsidiary corporations, etc., a measure to merge, and a measure to cease being the parent company (meaning a parent company specified in Article 57-2(8) of the FIEA; hereinafter the same shall apply in this Article and the following Article) of a relevant Special Financial Instruments Business Operator within a specified period of not more than three months, and to implement the measure pertaining to the said selection” forces a final designated parent company, whose capital adequacy is extremely low, to either immediately improve this situation or to abandon continuing business as a final designated parent company.

(ii) Period leading to improvement

The time needed to improve the consolidated capital adequacy ratio or the consolidated leverage ratio must be sufficient for the plans formulated by a final designated parent company for improving management to urgently maintain and improve the confidence of markets, etc. in the said final designated parent company. Therefore, the plans need to be plans for recovering to a level above the range of the consolidated capital adequacy ratio related to Category 1 or the consolidated leverage ratio related to Leverage Category 1 within

a period of at least one year (in principle, by the end of the following accounting period).

In cases where a final designated parent company has, based on Article 2(1) of the Notice of Category, submitted a plan deemed reasonable for ensuring improvement of the consolidated capital adequacy ratio or the consolidated leverage ratio beyond the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the Early Corrective Action Category applicable to the said final designated parent company, if supervisors issue the said final designated parent company with an order listed in the category of the same table pertaining to the consolidated capital adequacy ratio or the consolidated leverage ratio which exceeds the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the category in the table which is applicable to the said final designated parent company, period necessary to improve the abovementioned consolidated capital adequacy ratio or the consolidated leverage ratio shall not include the period for ensuring improvement of the consolidated capital adequacy ratio or the consolidated leverage ratio set forth in (3) below beyond the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the category in the table which is applicable to the said final designated parent company.

### (3) Standards for Judging the Reasonableness Prescribed in Article 2(1) of the Notice of Category

The standards for judging the reasonableness of a “plan deemed reasonable for ensuring improvement beyond the scope of the category” set forth in Article 2(1) of the Notice of Category shall be as follows:

- A plan by which, in principle, the consolidated capital adequacy ratio or the consolidated leverage ratio steadily improves beyond the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the Early Corrective Action Category which is applicable to a final designated parent company, within a period of three months, including specific capital enhancement plans aimed at sound and appropriate business operations of the said final designated parent company and by which the confidence of markets, etc. in the said final designated parent company can be secured.

(Note) In the case of capital increases, etc., the intent of the financiers, etc. needs to be clear.

### (4) Consolidated Capital Adequacy Ratio or the Consolidated Leverage Ratio Providing Basis for Order Category

In applying Article 2(1) of the Notice of Category, the “order specified in the category (excluding the Non-Applicable Category or Non-Applicable Leverage Category) of the same table not higher than the consolidated capital adequacy ratio or the consolidated leverage ratio that is expected following implementation of the plan” shall, in principle, be regarded as the order listed in the category (excluding the Non-Applicable Category or Non-Applicable Leverage Category) pertaining to the level of the consolidated capital adequacy ratio or the consolidated leverage ratio expected with certainty after three months.

### (5) Reports on the Progress of Plans, etc.

Supervisors shall require reports to be made on the progress of a plan every period (including interim periods) until implementation of the plan is complete, and shall, in principle, not issue new orders during the term of the plan unless if subsequent progress diverges considerably from plan; provided, however, that in the case of a final



designated parent company issued with Category 3 or Leverage Category 3 order, if its consolidated capital adequacy ratio or consolidated leverage ratio as a basis of the order subsequently falls within the range of the consolidated capital adequacy ratio or the consolidated leverage ratio related to Category 1/Leverage Category 1 or Category 2/Leverage Category 2, supervisors may issue the order listed in the category pertaining to the consolidated capital adequacy ratio or the consolidated leverage ratio at that point in time, and in the case of a final designated parent company issued with Category 2 or Leverage Category 2 order, if its consolidated capital adequacy ratio as a basis of the order subsequently falls within the range of the consolidated capital adequacy ratio for Category 1, or if its consolidated leverage ratio as a basis of the leverage subsequently falls within the range of the consolidated leverage ratio for Leverage Category 1, supervisors may issue Category 1 or Leverage Category 1 order at that point in time.

Furthermore, in cases where a final designated parent company has, based on Article 2(1) of the Notice of Category, submitted a plan deemed reasonable for ensuring improvement of its consolidated capital adequacy ratio or consolidated leverage ratio beyond the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the Early Corrective Action Category which is applicable to the said final designated parent company, and where supervisors have issued the said final designated parent company with an order listed in the category of the same table pertaining to the consolidated capital adequacy ratio or the consolidated leverage ratio which exceeds the scope of the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the category in the table which is applicable to the said final designated parent company, in principle, if, immediately after the time needed for procedures for a capital increase, etc. has elapsed, the consolidated capital adequacy ratio or the consolidated leverage ratio of the said final designated parent company has not reached a level at least as high as the consolidated capital adequacy ratio or the consolidated leverage ratio pertaining to the category in the table in which the order received by the said final designated parent company is listed, supervisors shall issue the order listed in the category of the table pertaining to the consolidated capital adequacy ratio or the consolidated leverage ratio at that point in time.

(6) Standards for Evaluating the Assets Listed in Article 2(2) of the Notice of Category

(i) “Securities” set forth in item (i)

The term “published closing price” set forth in Article 2(2)(i) of the Notice of Category shall be the exchange price, standard quotation or standard price, etc. The expression “value equivalent thereto calculated using a reasonable method” shall be either the appraised value acquired from a Financial Instruments Business Operator, etc. as market price information on the day of the calculation, or a value deemed reasonable based on the final designated parent company’s own method of evaluation.

In performing the calculation, the following points shall be taken into consideration:

- A. For stocks or company bonds, for which there are serious concerns about their redemption and so forth due to such circumstances as the issuing company falling into insolvency, calculations shall be made using an evaluation based on actual conditions.
- B. For securities denominated in foreign currencies, calculations shall be made using the mean TT rate on the date of the calculation to convert them into yen.

(ii) “Tangible fixed assets” set forth in item (ii)

A. Land

The appraised value (appraised within the past one year) or the appraised value deemed appropriate which has been calculated with reference given to the most recent roadside land price, posted price, benchmark land value, objective examples of sales and so forth.

B. Buildings and Movables

In principle, the book value.

(iii) “Assets other than the assets listed in the preceding two items” in item (iii)

Article 2(2)(i) of the Notice of Category and the above item (i) shall be applied mutatis mutandis to the evaluation of securities (including foreign securities) that are invested as trust property for a money trust (limited to those operated independently with a principal purpose of securities investment). Money trusts incorporating derivative transactions shall be calculated by including any unsettled valuation gains and losses pertaining to the said transactions.

(Note) In the case of a final designated parent company which has adopted International Financial Reporting Standards (IFRS) or United States Generally Accepted Accounting Principles (US-GAAP), it shall evaluate assets according to those accounting standards.

(7) Others

(i) When issuing an order pertaining to the provisions of Article 1(1)(i) and (iii) and Article 2 of the Notice of Category, supervisors shall abide by the Administrative Procedure Act and other relevant laws and regulations, and shall keep in mind that it is necessary to take appropriate procedures, such as granting opportunities for making explanations based on Article 13(1)(ii) of the same act.

(ii) Supervisors shall, in principle, require that a final designated parent company below the range of the consolidated capital adequacy ratio related to Category 1 or the consolidated leverage ratio related to Leverage Category 1 calculate the value of its assets listed in each item of Article 2(2) of the Notice of Category by the method specified in the relevant item and submit a revised balance sheet reflecting this (forms may be at its discretion).

(iii) Early corrective action is exercised on the premise that the consolidated capital adequacy ratio or the consolidated leverage ratio properly represents the financial conditions of the final designated parent company. Therefore, supervisors shall have final designated parent companies pay sufficient attention to prevent such acts as the deliberate manipulation of a consolidated capital adequacy ratio or a consolidated leverage ratio for the purpose of avoiding any early corrective action being exercised.

(8) Orders Based on the Categories Set Forth in the Table in Article 4 of the Notice of Category

With regard to the implementation of early corrective action based on Article 4 of the Notice of Category, reference shall be made, as necessary, to IV-2-2.

#### IV-5-3-6 Capital Distribution Constraint Measure

##### IV-5-3-6-1 Significance

In order to alleviate procyclicality or systemic risks in the financial system, authorities, for their part, need to encourage the maintenance of the credit functions of the final designated parent company by issuing orders for capital distribution constraint measures according to the situation in a prompt and appropriate manner based on the objective standard of the consolidated capital buffer ratio (for G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company, including the leverage buffer ratio).

##### IV-5-3-6-2 Supervisory Method and Actions

The capital distribution constraint measure scheme, which stipulates the specific measures in the Notice of Category (defined in IV-5-3-5-2) shall be managed as follows.

#### (1) Consolidated Capital Buffer Ratio or Consolidated Leverage Buffer Ratio Forming Basis for the Issuance of an Order

The consolidated capital buffer ratio or the consolidated leverage buffer ratio related to the categories set forth in the tables in Article 1(1)(ii) and (iv) of the Notice of Category (hereinafter referred to as the “Capital Distribution Constraint Measure Categories”) shall be based on the following consolidated capital buffer ratios or consolidated leverage buffer ratios:

:

- (i) The consolidated capital buffer ratio or the consolidated leverage buffer ratio reported in the consolidated financial results status report (however, after submitting the Business Report: the consolidated capital buffer ratio or the consolidated leverage buffer ratio that was reported; and after filing a document stating the soundness of management pursuant to Article 57-17(2) of the Act: the consolidated capital buffer ratio or the consolidated leverage buffer ratio that was reported)
- (ii) At times other than when (i) above has been reported: the consolidated capital buffer ratio or the consolidated leverage buffer ratio reported by a final designated parent company following discussion between the final designated parent company and an audit firm based on the inspection results of the authorities.

#### (2) Orders in Accordance with the Capital Distribution Constraint Measure Categories

- (i) Action related to Consolidated Capital Buffer Category 1 Order to Consolidated Capital Buffer Category 4 Order or Consolidated Leverage Buffer Category 1 Order to Consolidated Leverage Buffer Category 4 Order

Supervisors shall emphasize that the purpose of the plan in the “order for submission and implementation of an improvement plan deemed reasonable for recovering the consolidated capital buffer ratio including contents to constrain the amount of capital distributions” stated in the table of Article 1(1)(ii) of the Notice of Category or the plan in the “order for submission and implementation of an improvement plan deemed

reasonable for recovering the consolidated leverage buffer ratio including contents to constrain the amount of capital distributions" stated in the table of Article 1(1)(iv) of the Notice of Category is to steadily recover the consolidated capital buffer ratio or the consolidated leverage buffer ratio. Furthermore, particulars related to the capital distribution constraint shall ensure that the amount of capital distributions is restricted within the maximum amount of allowable amount of capital distributions according to the order stated in each category, and upon implementation the plan, supervisors shall basically respect the judgment of the final designated parent company on which of the events subject to restriction shall be subject to the restriction.

(ii) Allowable Amount of Capital Distributions

"Cases where there are special reasons," which are stipulated in Article 1(5) of the Notice of Category, are, for example, cases where the final designated parent company carries out new funding to raise the Common Equity Tier 1 ratio during the fiscal year in which a capital distribution constraint plan was implemented and makes payments that exceeds the allowable amount of capital distributions up to the amount that was funded.

(iii) Calculation Method of Adjusted Profit After Tax

In calculating the "amount equivalent to the amount of tax required to be paid when said equivalent amount was not recorded as expense" stipulated in Article 1(6) of the Notice of Category, calculation may be performed, as a simplified method of calculating that amount, by multiplying the amount of capital distributions that was actually recorded as expense in accounting in said previous fiscal year (excluding, however, the amount that was not included as expenses for tax purpose) by the effective statutory tax rate of the relevant previous fiscal year-end in tax payment units and adding the actual tax amount of the previous fiscal year.

(iv) Significance of Bonus

"Bonus" that is specified in Article 1(5)(v) of the Notice of Category is salaries, etc. paid separately from regular salaries, and refers to payments provided under the name of bonus, summer allowance, year-end allowance, term-end allowance, etc., or other similar payments. If it is unclear whether salaries, etc. have the nature of bonus, items such as the following shall correspond to bonus:

A. Payments based on net income

B. Payments with no predetermination of amount or standard

C. Payments with no predetermination of timing. However, excludes cases where the employment contract itself is temporary.

D. Salaries stipulated in Article 34(1)(ii) of the Corporation Tax Law (excluding payments made pursuant to provisions to continuously pay a fixed amount at a designated timing each year to those who do not receive any other regular salary.)

E. Profit-linked salaries stipulated in Article 34(1)(iii) of the Corporation Tax Law

In addition, "bonuses and other property benefits of the like" are property benefits with the above nature, regardless of name, and include, for example, temporary payments that are made in addition to salaries or retirement benefits, etc.

(v) Significance of Subsidiary Corporations, etc.

Supervisors shall basically respect the judgment of the final designated parent company concerning the presence or absence of substantiality related to the judgment of eligibility for "subsidiary corporation, etc."

stipulated in the table stated in Article 1(1)(i) of the Notice of Category. However, if a designated parent company group (refers to Designated Parent Company Groups of this Guideline; the same shall apply hereinafter in this Item and the following Item) has been formed, care shall be taken whether that subsidiary corporation, etc. has important significance, in consideration of the impact on its financial condition or management status. For example, the use of specific standards is possible: “Said subsidiary corporation, etc. shall only fall under the category of subsidiary corporation, etc. if its ratio of total assets to the consolidated total assets of the final designated parent company exceeds 2%.” However, it should be kept in mind that, even if said subsidiary corporation, etc. is small in size, if it is important operationally, whether it is included in the subsidiary corporations, etc.

(vi) Significance of Operationally Important Officers and Employees

“Operationally important” officers and employees specified in Article 1(5)(v) of the Notice of Category are selected from among recipients of a high level of remuneration, etc. from the final designated parent company or subsidiary corporation, etc., who are persons having a material effect on the business operations or assets of a final designated parent company and its major subsidiary corporations, etc. Standards described in IV-5-6-2(2)(i)B.b. and c. of this Guideline shall also be referred to upon selection.

By decision of the final designated parent company, “officers” may exclude outside directors and outside company auditors of that final designated parent company. However, such outside director or outside company auditor shall be included in “officer” if he/she is a recipient of a high level of remuneration, etc. from the final designated parent company and falls under the category of a person having a material effect on the business operations or assets of a final designated parent company and its major subsidiary corporations, etc.

(3) Submission of Plan and Reports on the Progress Thereof

Supervisors shall require a plan related to the order in accordance with the Capital Distribution Constraint Measure Categories to be submitted every period (including interim periods) and shall require reports to be made on the progress of the plan as needed.

(4) Others

(i) When issuing an order pertaining to the provisions of Article 1(1)(ii) and (iv) and Article 3 of the Notice of Category, supervisors shall abide by the Administrative Procedure Act and other relevant laws and regulations, and shall keep in mind that it is necessary to take appropriate procedures, such as granting opportunities for making explanations based on Article 13(1)(ii) of the same Act.

(ii) If the consolidated capital adequacy ratio or the consolidated leverage ratio (including the consolidated leverage buffer ratio) of the final designated parent company falls under any category of the order in accordance with the Early Corrective Action Category and the order in accordance with the Capital Distribution Constraint Measure Categories, supervisors shall issue an order including the order in accordance with either category.

IV-5-3-7 Early Warning System

### (1) Basic Concept

As a means of ensuring the soundness of the management of final designated parent companies, “early corrective action” based on the consolidated capital adequacy ratio and consolidated leverage ratio has been established pursuant to Article 57-21(3) of the FIEA. Even in the case of a final designated parent company that is not subject to this measure, continuous efforts to improve management are needed so as to maintain and further enhance its soundness. To this end, the authorities shall implement an early, administrative preventive measure (early warning system).

### (2) Hearings

- (i) Supervisors shall constantly monitor and analyze the profitability, profit management systems and other circumstances by means of hearings on financial results.
- (ii) At the hearings with top managers, which are held as necessary, supervisors shall confirm with the managers of the final designated parent company about their management strategies aimed at improving profitability, their policies for efforts aimed at business restructuring and so forth.
- (iii) In cases where a medium-term management plan or the like has been formulated for the final designated parent company, supervisors shall conduct hearings on an as-necessary basis, and examine the details of its management strategies, efforts aimed at business restructuring and so forth.

### (3) Early Warning System

With respect to a final designated parent company found to be in need of improvements in profitability on the basis of a fundamental profit index, the supervisor shall encourage steady improvements by implementing measures (i) to (iii) below and, when necessary, requiring the submission of reports based on Article 57-23 of the Act. In addition, in cases where action is deemed to be necessary in order ensure the implementation of the improvement plan, supervisors shall issue a business improvement order based on Article 57-19 of the Act.

#### (i) Analysis by authority

Supervisors shall comprehensively analyze the background and factors that led the related final designated parent company to its current risk-taking and capital equity, including not only profitability but business environment/model, and establish a hypothesis regarding issues and causes facing the final designated parent company.

#### (ii) Defining and sharing issues through dialogue

Based on the hypothesis, supervisors shall hold in-depth dialogues with the final designated parent company incorporating the final designated parent company’s self-assessment sufficiently, and define/share issues and causes thereof.

#### (iii) Supervision and dialogue towards improvement

Based on the issues shared with the final designated parent company, supervisors shall encourage the final designated parent company to develop necessary measures for improvement, including corrective actions to the identified causes. Supervisors shall follow up on the status of the measures as necessary.

## IV-5-4 Soundness Regarding Liquidity

### IV-5-4-1 Significance

In order to secure financial soundness, it is necessary to not only secure adequate equity capital but also prepare for liquidity risks. For short-term preparedness for liquidity risks, it is important to raise the company's financial strength, which would enable it to continue operations at times when funding becomes difficult, by holding sufficient liquid assets in line with the liquidity risk levels. The FSA therefore needs to grasp the liquidity risks of designated parent company groups and direct them to hold sufficient liquid assets as necessary.

From such perspective, final designated parent companies are required to use the objective standards, namely the Consolidated Liquidity Coverage Ratio (as defined in Article 2 of the Standards for Disclosing Status of Soundness Regarding Liquidity Aspects of the Soundness of Business Operation of Final Designated Parent Companies and Their Subsidiary Corporations, etc., prescribed as the standards by which final designated parent companies judge the soundness of business operations of themselves and their subsidiaries, etc. in accordance with the provisions of Article 57-17(1) of the FIEA (hereinafter the "Consolidated Liquidity Ratio Notice"; the same shall apply hereinafter); the same shall apply hereinafter) and the Consolidated Net Stable Funding Ratio (as defined in Article 73 of the Consolidated Liquidity Ratio Notice; the same shall apply hereinafter), and hold sufficient liquid assets.

### IV-5-4-2 Accuracy of Calculation of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio

#### IV-5-4-2-1 Significance

The Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio are fundamental indicators to show the soundness of liquidity held by final designated parent companies and, as such, must be calculated accurately.

Regarding the accuracy of the calculations of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, the designated parent company carefully considers the purport of the Consolidated Liquidity Ratio Notice and the Basel Capital Accord.

#### IV-5-4-2-2 Points of Attention

The designated parent company carefully examines the accuracy of the calculations of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio in accordance with the Consolidated Liquidity Ratio Notice.

#### (1) Points of Attention Regarding Cases in which a Final Designated Parent Company Formulates Specific Calculation Methods and Methods of Identifying Assets and Liabilities

In cases of applying the special clause regarding the qualifying operational deposits prescribed in Article 28 of the Consolidated Liquidity Ratio Notice, or the special clause regarding mutually related assets and liabilities

prescribed in Article 99 of the same notice that pertain to the additional collateral amount required in times of market-value changes based on the scenario method prescribed in Article 37 of the same notice and measurement of the Consolidated Net Stable Funding Ratio, out of the outflow items in the Consolidated Liquidity Coverage Ratio, a final designated parent company is required to formulate specific calculation methods or identify subject assets and liabilities within the scope of the prescribed requirements. In such cases, supervisors shall make sure that the calculation methods or the methods of identifying assets and liabilities have been formulated according to the Consolidated Liquidity Ratio Notice by checking the following points beforehand.

- (i) In cases in which a final designated parent company plans to use the special article regarding the qualifying operational deposits, whether the method to calculate the amount of the qualifying operational deposits is formulated in ways that meet the requirements, qualitative standards and quantitative standards for operational deposits.
- (ii) In cases where a final designated parent company plans to use the additional collateral amount required in times of market-value changes based on the scenario method, whether both the formulation of the stress scenario and the method to estimate the amount meets the selection standards for stress scenarios, quantitative standards and qualitative standards.
- (iii) The designated parent company meets all the requirements prescribed in Article 99 of the Consolidated Liquidity Ratio Notice if the company plans to use the special clause regarding mutually related assets and liabilities.

(2) The scope of calculations with respect to the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio

The final designated parent company appropriately considers the followings points with respect to the calculations of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, and internal controls in the scope:

- (i) The scope of "entities that are considered to be of low importance from the viewpoint of managing risks related to liquidity" in the definition of "Financial Institutions, etc."

The "Financial Institutions, etc." prescribed in Article 1(xix) of the Consolidated Liquidity Ratio Notice exclude "entities that are considered to be of low importance from the viewpoint of managing risks related to liquidity." In relation to this, supervisors shall check whether the company is engaging in inappropriate practices, such as arbitrarily excluding an entity deemed to be of importance from the definition of "Financial Institutions, etc." with the purpose of raising the Consolidated Liquidity Coverage Ratio by reducing cash outflows or of raising the Consolidated Net Stable Funding Ratio by increasing the amount of available stable funding.

- (ii) Handling of consolidated subsidiary companies, etc. that are small in scale

For small-scale consolidated subsidiaries, etc. having only a significantly small impact on the levels of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, simplified calculations are allowed as long as they are conservative, such as assuming the eligible high quality liquidity asset or the amount of available stable funding to be zero. In such cases, supervisors shall check whether the



company is engaging in inappropriate practices, such as applying the relevant calculation to a financial institution that represents a significantly large percentage of assets (debts) relative to the total consolidated assets (total consolidated debts), or applying the relevant calculation to an entity for which a large amount of cash outflows from off-balance sheet items is expected, by ignoring that probability, and categorizing it as a small-scale consolidated subsidiary, etc.

### (3) The scope of Past Liquidity Stress Periods

In judging the "Past Liquidity Stress Periods" prescribed in Article 1(xxxii) of the Consolidated Liquidity Ratio Notice, final designated parent companies are urged to look into data as far back as the late 1990s, as long as it is possible, while they are basically required to refer to data as old as 2007 (2008 in the case of companies in Japan). In this regard, supervisors shall check whether the company uses the data that are available and cover the periods that meet the requirements to be judged as past liquidity stress periods.

### (4) Confirmation of Rate of Decline in Prices, etc.

In judging Level 2A and 2B assets under the Consolidated Liquidity Ratio Notice, companies are required to confirm the extent of fall in prices or haircut rates of securities during past liquidity stress periods. Supervisors shall check if the company properly confirms credit ratings and maturity, such as making judgments through sufficient segmentation.

### (5) Appropriateness of the Classification of Cash Inflow/Outflow Items and the Outflow Rate

The Consolidated Liquidity Ratio Notice has a provision that requires a company to set a classification of cash inflow/outflow items as well as the outflow rate (amount) or the cash inflow amount, and a provision concerning the amount of available stable funding and the amount of required stable funding with regard to the Consolidated Net Stable Funding Ratio. A final designated parent company is required to properly set them and verify them. Attention should be paid to the points listed below.

- (i) Whether a final designated parent company considers the need to set an additional classification for "Less Stable Deposits" under Article 20 of the Consolidated Liquidity Ratio Notice as part of its internal controls and, has introduced an appropriate classification if needed. In addition, whether a final designated parent company has set the outflow rate as consistent with the outflow rate during past liquidity stress periods. Further, whether a final designated parent company makes sure that the possibility is sufficiently low that the outflow rate will exceed 10 percent even based on the composition of the current less-stable deposits, instead of merely applying the past outflow rate.
- (ii) Whether a final designated parent company makes an appropriate classification in consideration of internal controls for "Other Contingency Cash Outflow" prescribed in Article 52 of the Consolidated Liquidity Ratio Notice and for contingent liabilities prescribed in Article 98(iii) of the same notice. Also, whether the appropriateness of this classification is examined periodically.
- (iii) Whether the "Amount of Other Contracted Cash Outflow" prescribed in Article 59 of the Consolidated Liquidity Ratio Notice and the "Amount of Other Contracted Cash Inflow" prescribed in Article 72 of the

same notice are set appropriately with consideration of the importance of managing liquidity risks. Also, whether the appropriateness of these amounts is examined periodically.

(6) Validity of the Method of Setting Remaining Term to Maturity

In cases where a price evaluation model is used for the calculation of the remaining term to maturity when calculating the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, whether a final designated parent company understands that the model is formulated based on a certain premise and reviews the premise and the logic of the model periodically and examines the appropriateness of the probability of the estimated remaining term.

(7) Appropriateness of the Method of Allocating Securities

In cases where a source for procuring securities is unknown (such as where a source for procuring securities pledged as collateral is unknown in a short position transaction or a transaction under a repurchase agreement of securities) and an allocation method arbitrarily specified by a final designated parent company is used when calculating the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, whether the allocation method is clearly indicated in the form of a document and is implemented appropriately in accordance with that document.

(8) Consistency of Calculation Methods for the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio

Whether a final designated parent company uses consistent and conservative calculation methods in cases where the final designated parent company is allowed a certain level of discretion regarding calculation methods for the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, such as the handling of netting (referring to the offsetting of some amounts in the calculation process of cash outflow and inflow amounts) under Article 34(2) of the Consolidated Liquidity Ratio Notice, and the handling of the special clause regarding the qualifying operational deposits prescribed in Article 28 of the same notice, the scenario method prescribed in Article 37 of the same notice, and the special clause regarding mutually related assets and liabilities prescribed in Article 99 of the same notice when adopting any of these clauses or method.

IV-5-4-2-3 Supervisory Method and Actions

(1) Off-site Monitoring

Supervisors shall require final designated parent companies to submit detailed reports of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio on a regular basis in accordance with Article 57-23 of the FIEA, and hold hearings as necessary in cases where any problems are found with regard to the accuracy of the calculations.

For final designated parent companies that adopt the special clause regarding the qualifying operational deposits prescribed in Article 28 of the Consolidated Liquidity Ratio Notice, the scenario method prescribed in Article 37

of the same notice, and the special clause regarding mutually related assets and liabilities prescribed in Article 99 of the same notice, supervisors shall require them to submit reports periodically and review whether the calculation method satisfies the requirements stipulated in the same notice and whether the calculation method has not been changed from the previous reporting period.

(2) In cases where a problem is found in the accuracy of the calculations of the Consolidated Liquidity Coverage Ratio and the consolidated net stable funding ratio through the inspection or off-site monitoring as described in (1), supervisors shall instruct the company to submit a report based on Article 57-23 of the FIEA, and in cases where a serious problem is found, supervisors shall issue an order for business improvement in accordance with Article 57-19 of the FIEA.

#### IV-5-4-3 Supervisory Measures Regarding the Regulation on Consolidated Liquidity Ratio

In order to complement final designated parent companies' efforts in managing liquidity risks, supervisors shall take necessary measures in a timely and appropriate manner by using the objective standards, namely the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, and request final designated parent companies to make efforts to improve their business management.

##### IV-5-4-3-1 Supervisory Method

###### (1) Periodical Monitoring (Monthly or Quarterly)

Supervisors shall request final designated parent companies to periodically submit reports concerning the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio and shall constantly ascertain the status of their liquidity risks.

###### (i) Consolidated liquidity coverage ratio (monthly)

Supervisors shall request final designated parent companies to submit a report concerning the Consolidated Liquidity Coverage Ratio as of the reporting date, which can be either the final day or final business day of each month, in a specified format by the 10th business day of the next month. On that occasion, supervisors shall review the level of and trends of changes in the Consolidated Liquidity Coverage Ratio, and analyze the factors and background of such changes by ascertaining the composition of the numerator and denominator of the Consolidated Liquidity Coverage Ratio.

By analyzing other off-site monitoring data and financial/economic indicators, the supervisors shall also check whether there are any signals that indicate the liquidity stress in the financial system as a whole.

###### (ii) Consolidated net stable funding ratio (quarterly)

Supervisors shall request final designated parent companies to submit a report concerning the Consolidated Net Stable Funding Ratio as of the reporting date, which is the final day of each quarter. On that occasion, supervisors shall review the level of and trends of changes in the Consolidated Net Stable Funding Ratio, and analyze the factors and background of such changes by ascertaining the composition of the numerator and denominator of the Consolidated Net Stable Funding Ratio.

(Note) Although the reporting date of the Consolidated Liquidity Coverage Ratio is basically the last day of the month, it is permitted to use the final business day of the month based on the accounting rules adopted by individual final designated parent companies. Final designated parent companies shall constantly adopt the same reporting date except for cases where they change the reporting date due to reasonable grounds.

(2) Monitoring on an As-Necessary Basis

In addition to (1), supervisors shall instruct final designated parent companies to submit a report on the status of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, if needed.

IV-5-4-3-2 Supervisory Actions

(1) The Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio Serving as the Premise for Supervisory Measures

The Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio that serve as the premise for supervisory measures under (2) shall be the one reported in the periodical or as-necessary monitoring under IV-5-4-3-1.

(2) Supervisory Measures

If the Consolidated Liquidity Coverage Ratio or the Consolidated Net Stable Funding Ratio falls below the minimum required level, supervisors shall immediately instruct the company to submit a report on the reason and measures to improve the ratio, in accordance with Article 57-23 of the FIEA. If a significant improvement is deemed necessary, supervisors shall issue an order for business improvement in accordance with Article 57-19 of the FIEA.

If it is expected that the Consolidated Liquidity Coverage Ratio or the Consolidated Net Stable Funding Ratio may fall below the minimum required level at some future date, supervisors shall hold hearings to ask the company to explain the reason for such a situation and the likeliness of the situation to be improved. After the hearings with the company, if there are still issues to be fixed, supervisors shall request the company to submit a report in accordance with Article 57-23 of the FIEA, and issue an order for business improvement in accordance with Article 57-19 of the same Act, if there is the need for even more assured improvement.

However, supervisory actions should not be taken in a mechanical or uniform fashion; these actions should be taken with due regard to the details and effect of the measures taken by each final designated parent company in trying to maintain the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio respectively above the minimum-required level, and the potential impact on the financial system that may be caused by such measures.

(i) The report under Article 57-23 of the FIEA shall include the following. Supervisors shall request additional information as necessary.

A. Factors that led the Consolidated Liquidity Coverage Ratio or the Consolidated Net Stable Funding Ratio to fall below the minimum-required level (such as a decrease in some of the eligible high quality liquidity assets that can be included in the calculation or in the amount of available stable funding,

and/or an increase in the amount of some specific outflow or the amount of required stable funding, etc.), as well as their background

- B. Prospect of the timeline of when the Consolidated Liquidity Coverage Ratio or the Consolidated Net Stable Funding Ratio is expected to rise above the minimum-required level, and the expected changes in the individual elements that comprise the numerator and denominator of the ratio.
- C. Regarding the Consolidated Liquidity Coverage Ratio, the amount and types, etc. of liquid assets that are not included in the eligible high quality liquidity assets but can be used to obtain funds in emergency situations.

(Note) If a report is submitted in accordance with Article 57-23 of the FIEA, the following points can be analyzed, taking into consideration information in the report.

- a. Whether the fall in the Consolidated Liquidity Coverage Ratio or the Consolidated Net Stable Funding Ratio is mainly due to temporary causes or long-term, structural causes
  - b. Possibility that measures to maintain the minimum required levels of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio may cause a negative impact to the financial system as a whole and the channels by which such impact may be transmitted
- (ii) As regards the order in accordance with Article 57-19 of the FIEA, supervisors shall instruct the company to submit an improvement plan that is deemed reasonable and to ensure such plan is implemented properly. Such an improvement plan shall include the items listed below. In addition, supervisors shall instruct the company to submit reports on aspects such as A, B and C of (i) above and other reports, along with the improvement plan.
- A. Measures that have already been implemented and those planned to be implemented and the planned timing of their implementation
  - B. Time required to implement the improvement plan

#### IV-5-4-4 Disclosure of the Soundness Status Related to Liquidity in Business Operations

##### (1) General Points of Attention

Disclosure of the status of liquidity-related soundness in business operations aims to complement the functions of the minimum required levels of the Consolidated Liquidity Coverage Ratio and the Consolidated Net Stable Funding Ratio, financial institutions' own efforts to manage liquidity, as well as supervisory verification, and to maintain the soundness of financial institutions' business operations by bringing the market to evaluate them to realize discipline, and therefore needs to be implemented appropriately in accordance with the purport of the "Notice of the Establishment of Matters to be Included in a Document Stating the Liquidity-Related Soundness of Management by a Final Designated Parent Company in Cases Specified by the FSA Commissioner" (hereinafter referred to as the "Consolidated Liquidity Ratio Disclosure Notice"). In addition, final designated parent companies must consider ideal methods of information disclosure that are useful to users, by taking into consideration degrees of importance of the information subject to disclosure. In particular, extra caution must be taken to ensure appropriate disclosure for information whose omission has the potential to change economic decisions by the users

of the relevant information.

However, with regard to information of proprietary value and information relating to confidentiality, in cases where disclosing such information may cause significant damage to the position of a financial institution, it shall be acceptable to keep such information while only disclosing the fact that the particular items were not disclosed and the reasons therefor, together with more general information about the relevant items.

(Note) For details of supervisory viewpoints, reference shall be made, as necessary, to III-3-2-5 (2) of the Comprehensive Guidelines for Supervision of Major Banks, etc.

## (2) Qualitative Disclosure Items Regarding the Consolidated Liquidity Coverage Ratio

- (i) With regard to the "items regarding changes over time in the Consolidated Liquidity Coverage Ratio" in Article 3(3)(i) of the Consolidated Liquidity Ratio Disclosure Notice, whether the main drivers of the changes in the Consolidated Liquidity Coverage Ratio during the past two years and a qualitative explanation of their causes are provided. In addition, whether the "qualitative disclosure items regarding the Consolidated Liquidity Coverage Ratio" (those related to the final designated parent company's latest quarter and created using the format attached to the Consolidated Liquidity Ratio Disclosure Notice) are used.
- (ii) Whether the following items are entered regarding the "items related to evaluation of the levels of the Consolidated Liquidity Coverage Ratio" in Article 3(3)(ii) of the Consolidated Liquidity Ratio Disclosure Notice.
  - A. Evaluation of levels of consolidated liquidity coverage ratio by the final designated parent company
  - B. If a problem is recognized in A. above, actual countermeasures to tackle it.
  - C. If there is the possibility that an estimate of future consolidated liquidity coverage ratio by the final designated parent company may significantly diverge from the disclosed ratio, qualitative explanation of that estimate.
  - D. If an actual figure diverged significantly from the initial estimate in C., additional explanation of the reason why such a difference occurred.
- (iii) With regard to the "items related to total amount of eligible high quality liquidity assets" in Article 3(3)(iii) of the Consolidated Liquidity Ratio Disclosure Notice, whether the following items, for example, are included as necessary.
  - A. If there have been significant changes in the composition or the currencies of the eligible high quality liquidity assets in the calculation and their location, explanation of such changes
  - B. If there are significant currency mismatches in major currencies (for example, if the aggregate liabilities denominated in that currency amount to 5% or more of the financial institution's total liabilities.) between the total amount of eligible high quality liquidity assets and net cash outflows, the assessment of such mismatches and explanation of practical countermeasures to address such mismatches
- (iv) With regard to the "other items related to the Consolidated Liquidity Coverage Ratio" in Article 3(3)(iv) of the Consolidated Liquidity Ratio Disclosure Notice, whether the following items, for example, are included as necessary. Whether not only the following items, but also other important items are included.
  - A. In cases where the "special clause regarding the qualifying operational deposits" prescribed in Article

28 of the Consolidated Liquidity Ratio Notice is applied, an explanation on the following items.

- a. Scope of items under the application of the Special Clause Regarding the Qualifying Operational Deposits
  - b. The method used to estimate the amount of the qualifying operational deposits
- B. In cases where the "additional collateral amount required in times of market-value changes based on the scenario method" prescribed in Article 37 of the Consolidated Liquidity Ratio Notice is applied, an explanation of the methods used to estimate the additional collateral amount required in times of market-value changes based on the scenario method.
- C. In cases where there are important items in the "other contingency cash outflows" prescribed in Article 52, the "other contracted cash outflows" prescribed in Article 59, and the "amount of other contracted cash inflows" prescribed in Article 72 of the Consolidated Liquidity Ratio Notice, a qualitative explanation of such items.

(Note) In the breakdown of the Consolidated Liquidity Coverage Ratio (referring to daily average figures), if there are items where daily figures are not used because of their insignificance in relation to impact on the ratio and there is a practical reason (such as restriction by accounting requirements), details shall be described of the items where daily figures are not used and the reason for not using them regarding items that are deemed useful to users of such information. The items where daily figures are not used shall be reviewed periodically and, when any changes are made after the review, the reason for conducting such a change shall be described.

### (3) Qualitative Disclosure Items Regarding the Consolidated Net Stable Funding Ratio

- (i) Whether the designated parent company describes a qualitative explanation regarding the main drivers and reasons of the Consolidated Net Stable Funding Ratio in the past 3 years with respect to the requirement prescribed in Article 3(4)(i) of the Consolidated Liquidity Ratio Disclosure Notice. In addition, the company uses the format attached to the Consolidated Liquidity Ratio Disclosure Notice for the latest quarter and the preceding quarter if the company explains the "qualitative disclosure items regarding the Consolidated Net Stable Funding Ratio".
- (ii) Whether the designated parent company describes the following items if the company is compliant with the requirements prescribed in Article 99 of the Consolidated Liquidity Ratio Notice are met in Article 3(4)(ii) of the Consolidated Liquidity Ratio Disclosure Notice.
  - A. In cases of the "special clause regarding mutually related assets and liabilities" prescribed in Article 99 of the Consolidated Liquidity Ratio Notice, an explanation on the scope of items under the application and their interrelationship.
- (iii) With regard to the "other items related to the Consolidated Net Stable Funding Ratio" in Article 3(4)(iii) of the Consolidated Liquidity Ratio Disclosure Notice, whether the following items are entered.
  - A. Evaluation of the levels of the Consolidated Net Stable Funding Ratio by the final designated parent company.

- B. Practical measures against a problem if any is found in A. above, practical measures against that problem.
- C. A qualitative explanation when a designated parent company prospects that there would be a large discrepancy of the foreseeable Consolidated Net Stable Funding Ratio than what was originally disclosed.
- D. An additional explanation if the actual value largely differs from the initial perspective.

(4) Items Subject to Disclosure Regarding Management of Consolidated Liquidity Risks

- (i) Whether the structure for surely recognizing, measuring/assessing and reporting liquidity risks of the final designated parent company, etc. is described in the "items regarding the framework of the policy and procedures for liquidity risk management" in Article 3(2)(i) of the Consolidated Liquidity Ratio Disclosure Notice.
- (ii) With regard to the "items regarding indicators for management of liquidity-related risks" in Article 3(2)(ii) of the Consolidated Liquidity Ratio Disclosure Notice, whether the following indicators, etc., for example, are included regarding the views on and the status of key indicators, etc. for risk management measured/evaluated in (i), as necessary.
  - A. Liquid assets for internal risk management at financial institutions
  - B. Gaps between cash inflows and outflows classified by maturity of both on- and off-balance sheet items
  - C. Other important indicators, etc. that are monitored as part of internal risk management system
  - D. Usage of status of limitations in indicators, etc. in A.-C. above
  - E. Overview of internal stress tests and its utilization methods
- (iii) Regarding the "other items related to liquidity risk management" in Article 3(2)(iii) of the Consolidated Liquidity Ratio Disclosure Notice, whether the following items, for example, are included as necessary. Whether not only the following items, but also other important items are included.
  - A. Efforts to reduce liquidity risks
  - B. Measurement in liquidity stresses (Contingency Funding Plan ( CFP ) )

(5) Items Subject to Quarterly Disclosure at a Final Designated Parent Company

In relation to the "quantitative disclosure items regarding the Consolidated Liquidity Coverage Ratio" and the "quantitative disclosure items regarding the Consolidated Net Stable Funding Ratio" prescribed in Article 5 of the Consolidated Liquidity Ratio Disclosure Notice, a final designated parent company is required to disclose relevant information for every quarter with due regard to the purport of the Basel Capital Accord. When a company discloses such information (including past information) on a website, it is appropriate to post it in a way that enables users, including investors, to easily find where the relevant information is displayed.

It is desirable that disclosures are made immediately after the release of the securities report prescribed in Article 24(1) or (3) of the FIEA that is due on the final day or final business day of each final designated parent company's quarter, the quarterly report prescribed in Article 24-4-7(1) of the FIEA, or the semi-annual report prescribed in Article 24-5(1) of the FIEA..



#### IV-5-4-5 Disclosure of the Soundness Status Related to TLAC (companies subject to TLAC regulation)

##### (1) General Points of Attention

Disclosure of the status of TLAC-related soundness in business operations, with the aim of complementing the functions of the minimum required level in TLAC ratio, the final designated parent company's own efforts to manage itself and supervisory verification and maintaining the soundness of business operations related to the bank's total loss-absorbing and recapitalization capacities by realizing discipline through external evaluation of the market, needs to be implemented appropriately in accordance with the Notice of Disclosure, bearing in mind the following items.

In addition, a financial institution that is subject to TLAC regulation must consider ideal methods of information disclosure that are useful to users, by taking into consideration degrees of importance of the information subject to disclosure. Extra caution shall be taken to ensure appropriate disclosure is made of information whose omission has the potential to change economic decisions by the users of the relevant information.

However, with regard to information of proprietary value and information relating to confidentiality, in cases where disclosing such information may cause significant damage to the position of the bank, it shall be acceptable to keep such information by disclosing the fact that the particular items were not disclosed and the reasons why, together with more general information about the relevant items.

##### (Reference)

- “Pillar 3 disclosure requirements—consolidated and enhanced framework (Second Phase),” Basel Committee on Banking Supervision (March 2017)

##### (2) Points of Attention Regarding Individual Items to be Specified

Disclosure items related to TLAC are those listed in Article 3 (8) (including cases where Article 4 (6) applies), Article 5 (1) (x to xii) of the Notice of Disclosure. Specifically, attention must be paid to the following items.

- If there is a major change in quantitative disclosure items from the first half, provide an explanation as to why such change occurred.
- For quarterly disclosure items:
  - (i) In addition to the adequacy of equity capital and other items (refer to IV-5-3-3), companies are required to properly disclose information for TLAC as well in every quarter with due regard to the purposes of the Basel Capital Accord, based on the items defined in Article 5 of the Notice of Disclosure. When such information (including past information) is disclosed on a website, it is appropriate to be posted in ways that make it easy for users including investors, depositors, etc. to recognize where the relevant information is displayed.

Among the disclosure items defined in Article 5 of the Notice of Disclosure, if the items concerning TLAC are disclosed based on Attached Formats No. 5 or 10 of the same Notice, it is desirable that disclosures are made immediately after the release of the annual securities report prescribed based on Article 24(1) or (3)

of FIEA, the quarterly securities report prescribed in Article 24-4-7(1) of FIEA, or the semi-annual securities report prescribed in Article 24-5(1) of FIEA that is due on the final day of the quarter.

- (ii) Regarding “Specifics of Contract Terms Related to other external TLAC-eligible instruments” described in Article 5(1) (xii) of the Notice of Disclosure, in addition to the “Outline of Contract Terms Related to Other External TLAC-eligible Instruments” described in Article 5(1) (xi), the terms of the said contract related to other external TLAC-eligible instruments should be recorded in ways that make it easy for users including investors, depositors, etc. to become aware of it.

Regarding disclosure items related to other external TLAC-eligible instruments, it is desirable that the latest information on revisions or other alterations to the issue, repayment or changes to terms for such other external TLAC-eligible instruments, if made by the financial institution, be made available to users for reference.

#### IV-5-5 Control Environment for Risk Management

With regard to the control environment for risk management of designated parent company groups, in light of the size of the group and the complexity of its business operations, in addition to the evaluation points concerning the control environment for risk management of individual Type I Financial Instruments Business Operators (from IV-2-3 to IV-2-5), the following points shall also be taken into consideration:

- (i) In cases where a group-wide framework is in place for the management of market risk, credit risk, liquidity risk and other types of risk, whether the actual nature of business operations and the risk profile of overseas offices have also been taken into account in the said framework, and whether appropriate consideration is given to any risks that are unique to the overseas offices.
- (ii) In cases where a group-wide framework for risk management is applied, whether the role played by overseas offices and the management framework applied to overseas offices are appropriate in light of the positioning of overseas offices within the group as well as the actual nature of their business operations and risk profiles.
- (iii) Even in cases where profit management and risk management vertically divided for each business line are conducted on a group basis, whether a control environment has been established by which overseas offices can secure profit rationally and can manage risks appropriately. (Whether there are any overseas offices that are weak in nature, likely to record successive deficits.)
- (iv) In cases where the transactions contracted at the base in Japan are managed on the accounts of an overseas base, in particular, whether, having clarified the positioning of the relevant overseas base in the overall group, it is being managed appropriately in the group-based framework for risk management. Also, whether the transfer prices pertaining to these transactions have been set in advance between the designated parent company and the relevant overseas base, in an appropriate and rational manner.
- (v) In cases where the transactions contracted at overseas offices are managed on the accounts of the base in Japan, in addition to (iii) above, in particular, whether there is a control environment in place in which the content, risk and other aspects of the said transactions can be appropriately identified at the base in Japan.

(Note) For details of the supervisory viewpoints, reference shall be made, as necessary, to III-2-3-2-5 and III-2-

### 3-3 of the Comprehensive Guidelines for Supervision of Major Banks, etc.

#### IV-5-5-1 Integrated Control Environment for Risk Management

Supervisors shall check whether a designated parent company group, which calculates its consolidated capital adequacy ratio based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company, identifies the overall quantity of various risks involved in their individual business divisions, including risks not reflected in the consolidated capital adequacy ratio, such as interest rate risk related to assets and liabilities not included in the calculation of the value of the market risk equivalent and credit risk related to large-lot borrowers, by establishing an integrated control environment for group-wide risk management. Supervisors shall also check whether the financial instruments business group maintains a sufficient level of equity capital, in terms of both quality and quantity, in light of the overall risks identified.

(Note) For details of the supervisory viewpoints, refer to III-2-1 and III-2-3 of the Comprehensive Guidelines for Supervision of Major Banks, etc. as necessary.

#### IV-5-5-2 Control Environment for Managing Liquidity Risks

The following points shall also be taken into consideration with regard to the management of the liquidity of designated parent company group (in particular, designated parent company groups that calculate their consolidated capital adequacy ratios based on Article 2 of the Capital Adequacy Notice on Final Designated Parent Company):

- (i) Whether the designated parent company clearly specifies and periodically revises the degree of liquidity risk it can face as a group as well as the policy for managing liquidity risk, by reflecting the management policies and strategies and the fund-raising capability of the entire group, including overseas offices.
- (ii) Whether a control environment has been developed in which liquidity is accurately identified for the entire group, including overseas offices, and in which it is properly managed in cooperation with the risk management divisions. For example, whether there is a control environment in place in which, having quantified the costs of raising funds and so forth taking into account the degree that liquidity is affected during times of stress, these costs are used in the budget process, measurement of business results, approval of new products and so on.
- (iii) Whether there is a control environment in place in which the status of the assets (amount of necessary stabilization funds procured in light of the makeup, characteristics and distribution of assets) of the entire group, including overseas offices, the status of funds currently procured (the makeup, characteristics and distribution of funding sources), and the ability to raise additional funds (including the status of security against asset holdings and the potential for them to be accepted by a central bank or so forth as security) can be properly identified for each base and for each currency.
- (iv) Whether there is a control environment in place in which the status of daytime liquidity at each base can be properly identified with due consideration given to legal and administrative restrictions regarding the transfer of funds.
- (v) Whether the designated parent company, in light of the identified liquidity of the overall group, periodically checks the levels at which procurement from each financing instrument is possible, and undertakes

necessary efforts, such as increasing the diversification of the financing means and maturity dates.

- (vi) Whether the designated parent company periodically specifies the potential risks for the liquidity of the entire group, including overseas offices, by conducting stress tests in ways that also properly reflect the risk profiles of overseas offices as well as overseas market conditions.
- (vii) Whether the designated parent company, based on the results of the stress test, has clearly indicated diverse emergency financing instruments and the like for maintaining liquidity even in times of stress, and has formulated a contingency plan which prescribes specific procedures and so forth. Also, whether it periodically confirms the details of the contingency plan and makes necessary updates in order to ensure that it functions properly.
- (viii) Whether the designated parent company group's consolidated Net Stable Funding Ratio falls below the minimum required level, the company promptly reports to the supervisor.

(Note 1) It is desirable that designated parent companies make positive efforts to regularly publicize the degree of liquidity risk that the group can face, their policy for managing liquidity risk, and liquidity conditions, while also giving consideration to international best practices.

(Note 2) For details of the supervisory viewpoints, refer to III-2-3-4 of the Comprehensive Guidelines for Supervision of Major Banks, etc.

#### IV-5-5-3 Supervisory Viewpoints for the Capability to Aggregate Data Relating to Risk Management and Reporting to Board of Directors, etc.

##### IV-5-5-3-1 Significance

For financial institutions that conduct large and complicated business, it is necessary to develop management information systems and risk management practices relating to data concerning the risk management of the entire Group (hereinafter referred to as "risk data"), in order to accurately and promptly aggregate risk data and report to the Board of Directors, etc. on risk management (hereinafter referred to as "risk reporting"), from the perspective of reducing potential for loss and securing financial soundness. The improvement of such risk data aggregation capabilities and risk reporting practices of financial institutions is important in ensuring stability of the financial system. Solid risk data aggregation capabilities and risk reporting practices are also important, in particular, for financial institutions and supervisory authorities to forecast the future and examine countermeasures based thereon in times of stress or crisis, and will lead to the improved feasibility of recovery and resolution of financial institutions as well as profitability.

Internationally, compliance with the "Principles for Effective Risk Data Aggregation and Risk Reporting" to enhance risk data aggregation capabilities and risk reporting practices is required of G-SIBs and D-SIBs as follows: banks, etc. that were deemed as G-SIBs by the Financial Stability Board before 2012: by January 2016; banks, etc. that were deemed as G-SIBs after 2012: within three years after being deemed by the Financial Stability Board; D-SIBs: no later than three years after being deemed as D-SIB, based on the agreement of the Basel Committee on Banking Supervision (see the following note). In Japan, it is necessary to continue efforts for the establishment of an IT infrastructure and process as well as the development and improvement of practices related to risk data

aggregation and risk reporting in consideration of international moves, with the aim of improving the risk management practices and decision-making processes of financial institutions.

“Principles for Effective Risk Data Aggregation and Risk Reporting,” the Basel Committee on Banking Supervision, January 2013.

#### IV-5-5-3-2 Supervisory Viewpoints and Supervisory Method and Actions

Based on the agreement of the Basel Committee on Banking Supervision, supervisors shall, with regard to G-SIBs or D-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company, monitor the implementation of efforts toward the development and improvement of IT infrastructure and process as well as practices relating to risk data aggregation and risk reporting, so that they can comply with the “Principles for Effective Risk Data Aggregation and Risk Reporting” by no later than three years from the announcement of their being so deemed, and promptly aggregate and report at the entire Group level information that is necessary for reporting to the Board of Directors, etc. and authorities. In doing so, supervisors shall take the following points into consideration in particular.

##### (1) Comprehensive Governance Framework and IT Infrastructure

- (i) Whether other viewpoints in the guidelines for supervision or a strong governance framework consistent with the principles and guidelines stipulated by the Basel Committee on Banking Supervision are introduced with regard to risk data aggregation capabilities and risk reporting practices.
- (ii) Whether the data structure and IT infrastructure related to risk data aggregation capabilities and risk reporting practices are designed, established and maintained in view of responses in times of stress or crisis as well as in normal times.

##### (2) Risk Data Aggregation Capabilities

- (i) Whether risk data that satisfy the accuracy and integrity that are deemed necessary in reporting in normal times and in times of stress or crisis are being prepared. In addition, whether the majority of data automatically aggregated in order to minimize the possibility of error.
- (ii) Whether all major risk data are captured and aggregated on a Group consolidated basis. In addition, does the framework enable aggregation by business unit, group company, type of asset held, industry and region of exposure, and other important classification so that concentration and generation of exposure and risk can be identified and reported.
- (iii) Whether the latest risk data are aggregated on a timely basis while satisfying the accuracy, integrity, coverage and applicability that are deemed necessary. For reference, it is necessary to pay attention that the specific timing of risk data aggregation should be decided based not only on the importance of the risk data in the risk profile of the entire financial institution, the nature and potential volatility of the risk, and the reporting frequency in both normal times and in times of stress or crisis, in view of the foregoing.
- (iv) Whether a framework is in place to enable aggregation of risk data that correspond to the various non-regular and as-necessary requests including responses in times of stress or crisis, changes in internal control

necessity, and requests from the supervisory authorities.

### (3) Risk Reporting

- (i) Whether the risk report accurately reflects the aggregated risk data. In addition, whether the financial institution carries out the necessary validations concerning the reported contents.
- (ii) Whether the risk report covers all of the important risks of the financial institution. In addition, whether the depth and scope of the report are consistent with the size and complexity of operations, risk profile, and the requests from the recipient of the risk report such as the Board of Directors, etc.
- (iii) Whether the risk report comprehensively conveys useful information in a clear and concise manner according to the needs of the recipient of the risk report.
- (iv) Whether the Board of Directors decides the frequency of preparation and distribution of the risk report based on the necessity of the Board of Directors, etc., the nature and volatility of risks subject to report, as well as importance from the perspective of effective and efficient decision-making and sound risk management. In addition, whether the frequency of preparation and distribution in times of stress or crisis is greater than in normal times.
- (v) Whether the risk report is appropriately distributed to the recipients of the risk report such as the Board of Directors, etc., while ensuring confidentiality.

#### IV-5-5-4 Credit Risk Management for Large Borrowers

##### IV-5-5-4-1 Significance

The criteria for judging the adequacy of the status of equity capital are not especially designed to protect financial institutions from an excessive loss due to a sudden default of a single counterparty. Accordingly, from the perspective of complementing said criteria, designated parent company groups also need to put in place a framework for measuring and managing large credit exposures.

From such perspective, final designated parent companies shall be required to measure and manage large credit exposures appropriately using the objective standard of the limits on credit exposure for final designated parent companies (referring to the limits on credit exposure for final designated parent companies specified in Article 1 of the Regulatory Notice of Standards for Indicating Status of Soundness Regarding Large Exposure Prescribed as the Standards by which Final Designated Parent Companies Judge the Soundness of Their and Their Subsidiaries' Business Operations; the same shall apply hereinafter).

##### IV-5-5-4-2 Main Supervisory Focus

(1) Whether the board of directors selects large borrowers that may exert significant influence on business operations based on a reasonable standard and monitors the statuses of their credit and financial conditions on an ongoing basis. When credit provision to a single borrower is 5% or more of the final designated parent company's Tier 1 Capital, whether final designated parent companies provide credit risk management for the large borrower taking into

consideration the amount of credit provision to an entity deemed to have an economically interdependent relationship (Note) with the borrower.

(Note) An entity deemed to have an economically interdependent relationship is that found by the final designated parent companies to have any of the following relationships with its borrower(s): However, when an entity, which has any of the following relationships, can avoid financial problems or a chain reaction of defaults by finding other business partners or new funding sources in a timely manner, the entity does not fall under the category of those deemed to have an economically interdependent relationship.

- A case where 50% or more of an entity's annual gross revenue or gross expenditure arises solely from transactions with another entity (for example, when an entity who owns residential or commercial real estate depends 50% or more of their annual gross revenue on rent from another entity)
- A case where an entity bears all or part of the credit granted to another entity by such means as providing guarantee, and when a claim for the guarantee is exercised, the entity may fall into default
- A case where most of the products of an entity are sold to another entity and said other entity is a significant client that cannot be replaced easily
- A case where an entity has provided a loan to another entity and the expected funds for repayment are the same funds and said other entity has no other sufficient income source for repayment
- A case where an entity's financial problem may cause a difficult situation for another entity from the perspective of timely loan repayment in full
- A case where an entity's insolvency or default may be related to another entity's insolvency or default
- A case where multiple entities depend most of their fund procurement on a single funder, and none of them can find other funders in the event of that funder's default

(2) Whether important sectors for risk management, such as those with similar risk profiles (specific business types, company groups, countries, regions, loan products, etc.), are internally defined in an appropriate manner. Additionally, whether the breakdown of positions and risks by business type, country, region, etc. is appropriately ascertained.

(3) Whether the control environment has been developed to diversify credit risks in accordance with the internal definition of sectors, for example, by setting a credit limit by portfolio.

(4) From the perspective of recognizing credit risks and making responses at an early stage, whether the control environment has been developed to control the amount of credit provision depending on credit risks, for example, by appropriately setting contract terms, such as the security, guarantee, and grace period, in accordance with the characteristics and risk levels of borrowers and transactions.

(Note) Regarding credit risk management for counterparties to derivatives transactions, in particular, the "Supervisory Focus Points and Actions in Light of the Losses Resulting from the Default of a U.S. Investment Fund" issued by the FSA (April 20, 2022) shall also be referred to as necessary.

(5) When managing the credit-granting to funds or securitization products, whether final designated parent companies identify the parties concerned (including originators, fund managers, and providers of protections such as liquidity support for investment vehicles, CDS, and guarantees) who can be an additional risk factor inherent in the structure itself other than the underlying asset, and, based on that understanding, manages credit for large borrowers. More specifically, whether final designated parent companies consider (i) managing the total sum of credit-granting, etc. to the structures it is investing in when there are additional risk factors common to these structures, and (ii) managing the credit-granting, etc. to the structures relevant to the parties concerned who can be an additional risk factor, together with the credit-granting, etc. to those concerned.

Note that final designated parent companies do not always need to manage the above-mentioned parties as an additional risk factor. For example, when the assets managed by funds are not managed separately from those of management entities and other funds, final designated parent companies need to consider implementing credit risk management combined with credit-granting to management entities and other funds. Moreover, when the ABCP program in which final designated parent companies are investing relies on credit and liquidity enhancements by the same sponsor company, or when the same party provides protections, such as CDS and guarantee, to synthetic-type securitization products, final designated parent companies need to consider the necessity of managing sponsor companies and protection providers as large borrowers.

(6) Whether stress tests are conducted, and whether analyses are conducted for scenarios wherein a large amount of loss occurs in the measurement of credit risks.

#### IV-5-5-4-3 Supervisory Method and Actions

##### (1) Off-site Monitoring

Supervisors shall require final designated parent companies to submit detailed reports on the status of compliance with the limits on credit exposure for final designated parent companies on a regular basis in accordance with Article 57-23 of the FIEA. When finding any problem, such as that the total amount of credit provision granted to any borrower exceeds the limits on credit exposure for final designated parent companies, supervisors shall hold hearings as necessary regarding the prospect of resolving the excess of the limit, etc.

(2) In cases where a problem is found in the status of compliance with the limits on credit exposure for final designated parent companies through the inspection or off-site monitoring as described in (1), supervisors shall instruct the final designated parent company to submit a report based on Article 57-23 of the FIEA, and in cases where a serious problem is found or where the necessity of confirmed improvement is found, supervisors shall issue an order for business improvement in accordance with Article 57-19 of the FIEA.

##### (3) Approval of Excess of the Limits on Credit Exposure

(i) When an application for approval was filed as referred to in the proviso to Article 1(1) of the Regulatory Notice of Standards for Indicating Status of Soundness Regarding Large Exposure Prescribed as the Standards



by which Final Designated Parent Companies Judge the Soundness of Their and Their Subsidiaries' Business Operations, supervisors shall screen whether there are any unavoidable reasons for exceeding the limits on credit exposure, such as that the person who received credit provision has conducted a merger or has received the transfer of business.

When granting an approval, in principle, supervisors shall request the final designated parent company to submit a plan for resolving the excess of the limits on credit and have it report the status of implementing the plan on a regular basis, except for a case where the excess will be resolved by the end of the accounting period (including the end of the interim accounting period).

(ii) Cases where an approval is to be granted under circumstances where "there are otherwise unavoidable reasons as found appropriate by the FSA Commissioner" as referred to in Article 6(1)(vi) of the Regulatory Notice of Standards for Indicating Status of Soundness Regarding Large Exposure Prescribed as the Standards by which Final Designated Parent Companies Judge the Soundness of Their and Their Subsidiaries' Business Operations include, for example, cases where there are any of the circumstances set forth in A to C below and it is found that the soundness of the final designated parent company would not be impaired.

A. When credit provision is to be granted based on legal obligations

B. In the case of reorganization of a financial group or reconstruction of a business model, when it is found necessary for achieving the purpose of said reorganization, etc.

C. When it is credit provision to specific securitization products issued by a government agency, etc. and the necessity of exceeding the limits on credit exposure is found for that agency

When there are any of the circumstances set forth in A to C above and an approval is to be granted as referred to in the proviso to Article 1(1) of the Regulatory Notice of Standards for Indicating Status of Soundness Regarding Large Exposure Prescribed as the Standards by which Final Designated Parent Companies Judge the Soundness of Their and Their Subsidiaries' Business Operations, a plan for resolving the excess of the limits on credit exposure shall not be requested, irrespective of the provisions of (i) above.

#### IV-5-6 Compensation Structure

##### IV-5-6-1 Points of Attention Regarding Compensation Structures

It is possible for a designated parent company group to design and operate its compensation structure by giving consideration to international employment and compensation practices. On the other hand, depending on that design and operation, it could result in increased incentives for officers and employees to take risks, and if this tendency becomes excessive, it could lead to serious problems, such as for the group's overall risk management.

Internationally as well, at the Financial Stability Board and other forums, discussion has been advanced on the design and operation of the compensation structures of financial institutions. The upshot is that designated parent company groups need to ensure that compensation structures do not lead to officers and employees taking excessive risks while also giving consideration to these international trends. In light of this, the supervisory authorities shall supervise the compensation structures of these groups with due consideration of the following points while also taking into account, inter alia, international guidelines published by the Financial Stability Board (Note) In

performing actual supervision, supervisors shall also take into account the size of the group, the complexity of its business operations and its establishment of overseas offices, and shall be mindful of not applying these guidelines in a mechanical and uniform fashion.

In addition to the risk of officers and employees being provoked into taking excessive risks with regard to the compensation structure, supervisors shall also take due care with regard to whether any similar risks are noticeable with regard to employment practices, personnel evaluation systems and the like. Also, in light of the fact that senior managers are charged with governance and other important responsibilities and that they receive compensation for this, it should be kept in mind that they are duly required to conduct appropriate management.

(Note) “FSF Principles for Sound Compensation Practices,” Financial Stability Forum (April 2009)

“FSB Principles for Sound Compensation Practices. Implementation Standards,” Financial Stability Board (September 2009)

“Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices—Application of Compensation Practices to Mitigate Misconduct Risk,” Financial Stability Board (March 2018)

(1) Role of the Compensation Committee, etc.

- (i) With regard to the compensation structure for group officers and employees, whether an appropriate control environment has been developed, which includes a committee to monitor the condition of that and a body or other organization by which the necessary checks of the management team can be exercised to ensure the appropriate design and operation of the compensation structure (hereinafter referred to as the “compensation committee, etc.”). Also, whether the necessary authority, systems and so forth have been secured so that the compensation committee, etc. can exercise the monitoring and checking function independently from the sales divisions, etc. (including officers in charge of sales).
- (ii) Whether the compensation committee, etc. has confirmed that the overall level of compensation is consistent with the present state and future forecasts of financial soundness of the entire group, and that it will not have a material impact on the future adequacy of equity capital.
- (iii) Whether the compensation committee, etc. pays sufficient attention to the perspectives of risk management, such as whether it cooperates closely with the risk management division regarding the evaluation of the appropriateness of the design and operation of the compensation structure.
- (iv) Whether the compensation committee, etc., through monitoring how the compensation structure is operated, checks whether any problems have arisen, such as compensation being excessively linked to short-term earnings or being overly reflective of performance.

(2) Consistency between Compensation Structure and Risk Management, etc.

- (i) Whether the compensation of employees in the risk management divisions and compliance divisions is determined independently from other business divisions, and whether such compensation appropriately reflects the importance of their responsibilities. Also, whether, in addition to the degree to which risk management and legal compliance goals are achieved, compensation-related performance for these employees is measured in a

way which primarily reflects the degree of their contribution to the establishment of a control environment for risk management and a control environment for legal compliance.

- (ii) Whether the productivity-linked portion of compensation for officers and employees (as for employees, those employees who have a significant influence on the overall risk-taking of the group; hereinafter the same shall apply in IV-5-6) is appropriate given their responsibilities and the actual scope of their work, and in light of the policies concerning the financial soundness of the entire group and the degree of risk that the group can face.
- (iii) In cases where a considerable portion of the compensation for officers and employees is linked to productivity, whether the design takes into account the response to financial risks that could arise before the compensation is finalized (estimates of the required equity capital and liquidity requirements).
- (iv) Whether the productivity-linked portion of compensation for officers and employees has been designed to decrease to a significant degree in the event of poor business results.
- (v) Whether methods of paying compensation which emphasize the creation of more long-term corporate value (for example, payments in stock or the granting of stock options) and methods of paying compensation which also take into account the period of time up until risks are actualized (for example, setting fixed-period transfer restrictions in cases where payments are made in stock, setting exercise periods if stock options are granted, or redemptions in the event compensation payments are carried over if business results are poor) have been adopted according to the responsibilities of officers and employees and the actual scope of their work.
- (vi) With regard to a compensation structure that could adversely affect risk management (such as guaranteed minimum bonuses paid across two or more years, or a system of large retirement allowances), whether appropriate improvement measures have been examined and implemented.
- (vii) Even in cases where a compensation structure has been designed which is consistent with risk management, whether a control environment has been developed for properly monitoring and checking the risk of acts been conducted by officers or employees which could compromise the intent of that design (such as transactions which are likely to reduce risks superficially).

#### IV-5-6-2 Disclosure of the Compensation Structure

##### (1) General Points of Attention

Giving due consideration to the purpose of ensuring that compensation structures do not lead to officers or employees taking excessive risks through the disciplining of external valuation by markets and investors, and thereby maintaining the soundness of the management of financial institutions, compensation structures need to be properly disclosed for the items prescribed in the Public Notice of the Specifying Matters Pertaining to the Remuneration to Be Specified by the FSA Commissioner as Having a Material Impact on the Business Operations or Assets of Ultimate Designated Parent Companies and its Subsidiary Corporations Pursuant to Article 208-26(v) of the Cabinet Office Order on Financial Instruments Business, etc. (hereinafter referred to as the “Notice of Remuneration”).

However, with regard to information which, if made public, could cause considerable harm to the competitive position of the financial institution, or information which identifies individuals and which, if made public, could

unduly harm the rights and interests of the individuals, or information relating to the confidentiality of the financial institution, it shall be acceptable to keep such information to more general descriptions and to state the reasons why. Furthermore, in cases where there are no items corresponding to the items prescribed in the Notice of Remuneration, it shall be acceptable to state that there are no relevant items.

(Note) For details of supervisory viewpoints, reference shall be made, as necessary, to III-3-2-5 (2) of the Comprehensive Guidelines for Supervision of Major Banks, etc.

(Reference)

- “Pillar 3 disclosure requirements for remuneration” , Basel Committee on Banking Supervision (BCBS) (July 2011)
- “Pillar 3 disclosure requirements - consolidated and enhanced framework” , BCBS (March 2017)

## (2) Points of Attention Regarding Individual Items to be Specified

(i) With regard to the “relevant officers” and “relevant employees” prescribed in item(ii)(a) of the Notice of Remuneration as being subject to disclosure (hereinafter referred to as “relevant officers and employees ” in this paragraph (2)), whether they have been stated appropriately, mindful of the following points for example.

### A. Scope of “relevant officers”

- a. Whether appropriate comments have notes have been appended in cases where outside directors or outside company auditors are excluded from “relevant officers.”
- b. Whether persons who retired during the most recent business year have been included.

### B. Scope of “relevant employees”

- a. Scope of “major consolidated subsidiaries”

Whether the ultimate designated parent company has selected the scope of “major consolidated subsidiaries” taking into account the importance of their effect on the group’s financial conditions and management performance, so as not to compromise the purpose of disclosing the compensation structure or interfere with the rational judgment of investors. Furthermore, whether the selection process for major consolidated subsidiaries and an explanation on the scope of the selected major consolidated subsidiaries have been stated appropriately. For example, descriptions using specific criteria are possible: “A subsidiary shall only fall under the category of major consolidated subsidiary if its ratio of total assets to the total consolidated assets of the designated parent company group exceeds 2%.” However, it should be kept in mind whether important subsidiaries in management are included in the major consolidated subsidiaries even if the subsidiaries are small in size.

- b. Scope of “recipients of a high level of remuneration”

- i) In selecting the “recipients of a high level of remuneration” whether selections are made by setting appropriate and rational standards suited to the actual conditions, using the average value of remuneration received by relevant officers as the basis, and where necessary, taking into account such factors as changes in past performance. Furthermore, whether the grounds for setting those standards and the reasonableness thereof have been stated appropriately. For example, in cases

where the remuneration received by the relevant officers has decreased as a result of the event that performance metrics are weak, it could be possible to set an adjusted standard for “recipients of a high level of remuneration” taking into account such factors as changes in past performance. However, in such cases, whether appropriate notes have been appended on the reasonableness of those standards.

ii) With regard to the scope of “remuneration” whether the scope includes economic benefits received as exchange for executing his/her duties and for labor regardless of the name (for example, payments, wages, salaries, allowances, bonuses). In cases where a relevant officer concurrently holds the post of an employee and his/her salaries as an employee are material, those salaries should be included the scope of “remuneration”.

c. Scope of “persons having a material effect on the business operations or assets of a ultimate designated parent company and its major consolidated subsidiaries”

Whether persons that have a material effect on the business operations or assets of the group have been selected based on an understanding of the risk-taking circumstances of the relevant employees.

Furthermore, whether an appropriate explanation has been given for the method of selection.

(ii) Whether the following details, for example, have been included as “the name, organizational structure and matters pertaining to the duties of the committee or other major organ which determines the remuneration of relevant officers and relevant employees and which supervises the payment of remuneration and the execution of other business pertaining to remuneration” prescribed in item (ii)(a) of the Notice of Remuneration.

A. Establishment of a compensation committee (name, members, authority, and duties of the compensation committee and other measures for the compensation committee to exercise its monitoring and checking function independently from the operational divisions (including officers in charge of operations) (scope of the regions, business divisions or relevant officers and employees subject to monitoring and checking by the compensation committee)).

B. In cases where the compensation committee requests or outsources advice on remuneration to an external consultant, the name of the external consultant and the purpose and outline of that request or outsourcing.

C. In cases where the risk management division cooperates with the compensation committee in assessing the appropriateness of the design and operation of the compensation structure, the circumstances of that cooperation.

D. Total amount of “remuneration” paid to members of the compensation committee (not needed if it is difficult to separate the amount associated with duties related to the committee) and the number of meetings held.

(iii) Whether the following details, for example, have been included as “matters related to assessment of the appropriateness of the design and operation of the system of remuneration for relevant officers and relevant employees” prescribed in item (ii)(b) of the Notice of Remuneration.

A. In cases where a policy (including policies regarding types and offering forms of the remuneration) has been stipulated for determining the remuneration of relevant officers and employees, an outline of the policy and its scope of application (scope of the regions, business divisions or relevant officers and

- employees to which the policy applies) and the rationale for adopting such policy.
- B. An explanation of the types of persons included in the relevant officers and employees and the number of persons in each category (for example, a breakdown of the relevant officers and the relevant employees and a description of each category).
  - C. In cases where there has been a material change to the design and operation of the compensation structure, an overview of any changes that were made, the reasons for those changes and their impact on remuneration.
  - D. In cases where it has been confirmed that the overall level of remuneration is consistent with the present state and future outlook of financial soundness for the designated parent company group, and that it will not have a material effect on the future adequacy of equity capital, an explanation of this.
  - E. In cases where, through monitoring how the compensation structure is operated, it has been confirmed that there are no problems such as compensation being excessively linked to short-term earnings or being overly reflective of performance, an explanation of this.
- (iv) Whether the following details, for example, have been included as “matters related to the consistency between risk management and the system of remuneration for relevant officers and relevant employees” prescribed in item (ii)(c) of the Notice of Remuneration.
- A. In cases where the compensation structure for relevant officers and employees in the risk management and compliance divisions is designed and operated independently from other managed and monitored business divisions, an explanation of this. (In particular, an explanation about whether the measurement of performance related to the remuneration of relevant officers and employees in the risk management and compliance divisions appropriately reflects the importance of their responsibilities, and whether it also reflects the degree to which risk management and legal compliance are achieved plus the degree of their contribution to the establishment of a control environment for risk management and a control environment for legal compliance.)
  - B. In cases where risks are taken into account when determining the remuneration of relevant officers and employees, an outline of the types of risks considered and the methods for measuring, assessing and considering the risks. (In cases where there have been material changes since the previous business year, including an outline of that.)
- (v) Whether the following items, for example, are included as “matters related to the link between performance and the remuneration of relevant officers and employees” prescribed in item (ii)(d) of the Notice of Remuneration.
- A. In cases where a considerable portion of the remuneration for relevant officers and employees is linked to performance:
    - a. In cases where, when determining the performance-linked portion of remuneration for relevant officers and employees, consideration is given to the responsibilities of the relevant officers and employees and the actual scope of their work and to the policies concerning the financial soundness of the group or the degree of risk that the group can bear, an outline of the methods used for considering these.

- b. An outline of the methods used to reflect the performance of the group, securities companies, business divisions or the relevant officers and employees in remuneration and the methods used to measure performance.
  - c. In cases where payment of remuneration linked to performance is deferred, an explanation that the design takes into account responses to financial risks that could occur before the amount of the remuneration is finalized (estimates of the equity capital and liquidity requirements).
  - d. An outline of measures for decreasing the performance-linked portion in the event that performance metrics are weak (particularly, an explanation on the criteria for determining “weak” performance metrics).
  - e. Even in cases where a compensation structure has been designed which is consistent with risk management, such as using risk-adjusted profit in calculating the amounts of remuneration, an outline of the control environment for properly monitoring and checking the risk of acts been conducted by relevant officers and employees which could compromise the intent of that design (such as transactions which are likely to reduce risks temporarily or superficially)
- B. In cases where a compensation structure has been granted which could adversely affect risk management (such as guaranteed minimum bonuses paid across two or more years, or large retirement allowances that are disproportionate to performance or risk conditions), an outline of the improvement and corrective measures.
- C. In cases where types of remuneration that emphasize the creation of more long-term corporate value (for example, payments in stock or the granting of stock options) and forms of remuneration offered which also take into account the period of time up until risks are actualized (for example, setting fixed-period transfer restrictions in cases where payments are made in stock, setting exercise periods if stock options are granted, malus, or reduction of deferred remuneration or clawbacks if performance metrics are weak) have been adopted in line with the responsibilities of relevant officers and employees and the nature of their work, policy and overview of the remuneration system (if the ratio of variable remuneration that is deferred differs among divisions to which related officers and employees belong, an explanation of the factors considered to determine such ratios).
- (vi) Whether the “Qualitative Disclosure Items” prescribed in the Notice of Remuneration are recorded following the format provided in the Attached List of Formats to the Notice of Remuneration.
  - (vii) Whether other important matters regarding the system of remuneration, if any, are properly stated as “matters of reference for the structure of remuneration” prescribed in item (ii)(e) of the Notice of Remuneration.

#### IV-5-7 Supervisory Method and Actions

(1) With regard to group-based governance, appropriateness of business operations, appropriateness and sufficiency of equity capital, control environments for risk management, and compensation structures, supervisors shall conduct hearings on a periodic and ongoing basis on the group’s response to identified issues in light of international trends and other factors. Supervisors shall actively utilize frameworks of cooperation with overseas authorities, and shall

conduct in-depth hearings regarding any issues related to overseas offices that are consequently identified.

(2) Supervisors shall strive to identify the financial soundness of a group by requiring the designated parent company to submit reports regarding the following items, for example, based on Article 57-23 of the FIEA.

In cases where it is deemed that a group needs to make improvements regarding its financial soundness, supervisors shall strive to understand the situation by holding in-depth hearings based on the submitted report, and they shall urge the group to make voluntary improvements.

- (i) The risk management policy of the designated parent company group. (Any changes must be reported immediately.)
- (ii) The policy for budget allocation and financing adopted by the designated parent company group. (The report must be made each fiscal year.)
- (iii) In the case of a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 3 of the Capital Adequacy Notice on Final Designated Parent Company, a report to the effect that the consolidated capital adequacy ratio of the designated parent company group has fallen below 8%. (The report must be made immediately if the ratio falls below 8%.)
- (iv) In the case of a final designated parent company that calculates its consolidated capital adequacy ratio based on Article 4 of the Capital Adequacy Notice on Final Designated Parent Company, a report to the effect that the consolidated capital adequacy ratio of the designated parent company group has fallen below 140%. (The report must be made immediately if the ratio falls below 140%.)

(3) In cases where offsite monitoring, inspection results, notifications of problematic conduct or the like mentioned in (1) above reveal a problem in the business operation or internal control environment of the designated parent company group, supervisors shall require the submission of a report based on Article 57-23 of the FIEA, as necessary (excluding the items listed in (2)).

(4) In light of the reports mentioned in (2) and (3) above, in cases where it is deemed necessary for improvement, supervisors shall also take such action as issuing an order for business improvement based on Article 57-19 and other provisions of the FIEA.



## IV-6 Treatment of Special Financial Instruments Business Operator Groups

### IV-6-1 Basic Concept

From the perspective of making Financial Instruments Business Operator Groups, which are engaged in large and complex businesses as a group, subject to regulation and supervision on a consolidated basis, it has been stipulated that large Financial Instruments Business Operators shall be subject to the consolidated regulation and supervision of the Financial Instruments Business Operator and of its subsidiary corporations, etc. (“downstream consolidation”).

IV-2 shall be applied *mutatis mutandis* to the financial soundness of Special Financial Instruments Business Operator Groups subject to this downstream consolidation.

A “Special Financial Instruments Business Operator Group” refers to a group comprised of a Special Financial Instruments Business Operator and its subsidiary corporations, etc.

(Note) For the consolidated capital adequacy ratio that forms the basis for issuing a Special Financial Instruments Business Operator Group with early corrective action, which stipulates the specific measures in a Notice Stipulating the Category Pertaining to the Soundness of Management of a Special Financial Instruments Business Operator and its Subsidiary Corporations, etc., and the Specification of Orders According to that Category, refer to IV-5-3-4-2(1) as necessary.

### IV-6-2 Supervisory Method and Actions

(1) Supervisors shall, where necessary, conduct hearings on a periodic and ongoing basis on group-based financial soundness.

(2) Supervisors shall require Special Financial Instruments Business Operators to submit reports on the following items, for example, based on Article 56-2(1) of the FIEA, and they shall strive to identify the financial soundness of the group.

In cases where it is found a group needs to make improvements regarding its financial soundness, supervisors shall strive to understand the situation by holding in-depth hearings based on the submitted report, and they shall encourage the group to make voluntary improvements.

A report to the effect that the consolidated capital adequacy ratio of the Special Financial Instruments Business Operator Group has fallen below 140%. (The report must be made immediately if the ratio falls below 140%.)

(3) In cases where offsite monitoring, inspection results, the reporting of problematic conduct or the like mentioned in (1) above reveal a problem in the business operation or internal control environment of the Special Financial Instruments Business Operator Group, supervisors shall, as necessary, require the submission of a report based on Article 57-10 of the FIEA (excluding the items listed in (2)).

(4) In light of the reports mentioned in (2) and (3) above, in cases where it is deemed necessary for improvement, supervisors shall also take such action as issuing a business improvement order based on Article 51 of the FIEA.

#### IV-7 Treatment of Type I Financial Instruments Business Operators which are the Japanese Base of a Foreign Holding Company, etc. Group

As far as Foreign Holding Company, etc. Groups (referring to financial groups the business of which is managed by a foreign holding company, etc.; hereinafter the same shall apply in IV-7) are concerned, if a problem comes to light concerning governance or the risk management conducted by group headquarters, etc. (referring to a company which is in a position to manage and control the overall group or each of the group companies, including the business base in Japan; hereinafter the same shall apply in IV-7), then there is a chance that a Type I Financial Instruments Business Operator which is the group's business base in Japan will also be directly affected. There was a financial institution group which had expanded business operations using excessive leverage while relying on the market for a considerable portion of its financing. Given that it had pursued inordinate short-term profits under a system of inadequate risk management, it faced the prospect of financial soundness and liquidity problems, and hence had a serious impact on the business continuity of the group's Type I Financial Instruments Business Operator based in Japan.

Therefore, with regard to Type I Financial Instruments Business Operators, which are the Japanese bases of Foreign Holding Company, etc. Groups, when conducting supervision in line with the items described in IV-1 through IV-4, supervisors shall also give due consideration to the following points.

The circumstances of Foreign Holding Company, etc. Groups vary widely, and reflecting the diversity of risk profiles and the process by which they spread, the control environments for managing entire groups also have differing characteristics. With regard to the roles played by business bases in Japan, while there are some which have reasonable staff and asset sizes, and others which have developed high-risk business models, there are others that are small in terms of both staff and assets and that specialize primarily in services intended for their respective home countries. Moreover, in cases where a Type I Financial Instruments Business Operator, which is a business base in Japan, assumes the form of a branch office of a foreign corporation, attention also needs to be given to such characteristics as that the business operator may be directly subordinate to a foreign corporation to which Japan's Financial Instruments and Exchange Act and other relevant laws, regulations and rules may not directly apply. In light of this, in performing actual supervision, supervisors shall pay due consideration to the managerial characteristics of each group and the operational characteristics of their business bases in Japan, and they shall be mindful of not applying these guidelines in a mechanical and uniform fashion.

##### IV-7-1 Governance

The following points shall also be taken into consideration with regard to the governance of Type I Financial Instruments Business Operators which are the Japanese bases of Foreign Holding Company, etc. Groups:

- (i) Whether the significance of establishing the business base in Japan and its positioning within the group have been made clear in the group-wide management policy, plans and so forth formulated by group headquarters, etc. Whether the business strategy and business plan for the base in Japan are consistent with the group-wide policy and plans, and whether they are sustainable.
- (ii) Whether the division of responsibility between the group headquarters, etc. and the management team at the base in Japan can be clarified, and whether the authority given by group headquarters, etc. to the

management team at the base in Japan is needed for ensuring the appropriate operation of the base in Japan. Also, whether authority and responsibility have been properly allocated within the base in Japan as well to enable the management team to conduct proper governance.

- (iii) Whether there is a control environment in place in which the internal audit division of the base in Japan can conduct internal audits appropriately while taking into consideration the nature of business operations and the risk profile of the base in Japan. Also, whether the management team of the base in Japan has implemented appropriate measures in light of the results of the internal audits and so forth.
- (iv) Whether the internal control environment of the base in Japan is adequate in light of the positioning of the Japanese base within the group and the relevant business strategy and business plan, and is also taking into account the actual nature of business operations and the risk profile.
- (v) Whether the group headquarters, etc., having identified the operational and financial condition of the base in Japan, and having fully understood the profile of risks faced by the base in Japan, properly identify the status of risks and take necessary actions.
- (vi) Whether the management team at the base in Japan checks whether there are any inadequacies in light of (i) through (v) above, and whether it responds appropriately in discussion with group headquarters, etc. as necessary.

#### IV-7-2 Appropriateness of Business Operations

The following points shall also be taken into consideration with regard to the appropriateness of business operations of Type I Financial Instruments Business Operators which are the Japanese bases of Foreign Holding Company, etc. Groups:

(Note) For the appropriateness of business operations and so forth in cases where, in addition to a Type I Financial Instruments Business Operator, the business base in Japan has also established a bank, etc., and where officers and employees concurrently hold positions at both, refer separately to IV-3-1-4.

- (i) Whether the base in Japan has, in order to ensure thorough compliance with the FIEA and other relevant laws, regulations and rules, established an appropriate control environment for legal compliance, for example, ensuring necessary staffing and developing rules and regulations. In particular, in view of the possibility that the group headquarters, etc. may not be well acquainted with Japan's FIEA and other relevant laws, regulations and rules as well as trade practices in Japan, whether actions have been taken, such as allocating officers and employees who are adept in these matters.
- (ii) Whether the business operator continuously checks how adept officers and employees at the base in Japan are in the FIEA and other relevant laws, regulations and rules, and whether it has developed a control environment for education and training to be appropriately conducted as necessary.
- (iii) From the viewpoint of preventing violations of the law and inappropriate business operations, whether there is a control environment in place in which the division of roles between the group headquarters, etc. and the base in Japan is clarified, and in which the base in Japan can properly exercise the functions of checking and supervising the sales division, etc.
- (iv) Whether the business operator has developed a control environment wherein, in cases where a problem at

the base in Japan has been identified, information is promptly shared between the group headquarters, etc. and the base in Japan and necessary actions are taken swiftly, and reports are made immediately to the Japanese and other relevant supervisory authorities.

#### IV-7-3 Appropriateness and Sufficiency of Equity Capital

The following points shall also be taken into consideration with regard to the appropriateness (quality) and sufficiency (quantity) of the equity capital of Type I Financial Instruments Business Operators which are the Japanese bases of Foreign Holding Company, etc. Groups:

- (i) Whether the necessary control environment has been developed at the group headquarters, etc. for properly identifying the financial conditions of the base in Japan and for ensuring the appropriateness and sufficiency of equity capital.
- (ii) As for business bases in Japan where intra-group transactions have reached a considerable magnitude, when ensuring the appropriateness and sufficiency of equity capital of the base in Japan, whether consideration has also been given to the appropriateness and sufficiency of group-wide equity capital.
- (iii) When conducting a stress test or formulating a contingency plan on a group basis concerning the appropriateness and sufficiency of equity capital, whether the business operator appropriately reflects the risk profile of the base in Japan as well as the Japanese market conditions.
- (iv) When examining the appropriateness and sufficiency of equity capital of the base in Japan, whether, among the risks relating to transactions that are conducted using the accounts of an overseas base, the business operator has also appropriately reflected those risks that could potentially make it back to the base in Japan.

#### IV-7-4 Control Environment for Risk Management

With regard to the control environment for risk management of Type I Financial Instruments Business Operators which are the Japanese bases of Foreign Holding Company, etc. Groups, in light of the size of the group and the complexity of its business operations, in addition to the evaluation points concerning the control environment for risk management of individual Type I Financial Instruments Business Operators which are business bases in Japan (from IV-2-3 to IV-2-5), the following points shall also be taken into consideration:

- (i) In cases where a group-wide framework is in place for the management of market risk, credit risk, liquidity risk and other types of risk, whether the actual nature of business operations and the risk profile of the base in Japan have also been taken into account in the said framework, and whether appropriate consideration is given to any risks that are unique to the base in Japan.
- (ii) In cases where a group-wide framework for risk management is applied, whether the role played by the Japanese base and the management framework applied to the Japanese base are appropriate in light of the positioning of the Japanese base within the group as well as its actual nature of business operations and risk profile.
- (iii) Even in cases where profit management and risk management vertically divided for each business line are conducted on a group basis, whether a control environment has been established by which the Japanese base can secure profit rationally and can manage risks appropriately. (Whether the Japanese base is weak in nature,

likely to record successive deficits.)

- (iv) In cases where the transactions contracted at the base in Japan are managed on the accounts of an overseas base, in particular, whether, having clarified the positioning of the Japanese base in the overall group, the base in Japan is playing an appropriate role in the group-based framework for risk management. Also, whether the transfer prices pertaining to these transactions have been set in advance between the group headquarters, etc. and the base in Japan, in an appropriate and rational manner.
- (v) In cases where the transactions contracted at overseas offices are managed on the accounts of the base in Japan, in addition to (iv) above, whether there is a control environment in place in which the content, risk and other aspects of the said transactions can be appropriately identified and appropriately managed at the base in Japan in particular.

#### IV-7-4-1 Control Environment for Managing Liquidity Risk

The following points shall also be taken into consideration with regard to control environments for managing liquidity risk at Type I Financial Instruments Business Operators which are the Japanese bases of Foreign Holding Company, etc. Groups:

- (i) Whether the necessary control environment has been developed at the group headquarters, etc. for properly identifying the financial conditions of the base in Japan and for ensuring the appropriateness and sufficiency of liquidity.
- (ii) Whether a Type I Financial Instruments Business Operator, which is the Japanese base of a foreign group, properly identifies the supply of liquidity from each of the group companies to the Japanese bases within the group, and undertakes necessary efforts in order that the appropriateness and sufficiency of the liquidity of the bases in Japan can be ensured.
- (iii) In particular, as for business bases in Japan where intra-group transactions have reached a considerable magnitude, when ensuring the appropriateness and sufficiency of the liquidity of the base in Japan, whether consideration has also been given to the appropriateness and sufficiency of group-wide liquidity. Also, in light of the potential impacts on the liquidity of the overall group at times of stress, whether necessary actions have been taken, such as the formulation of a contingency plan, based on the assumed number of days that the base in Japan could continue business.
- (iv) When conducting a stress test or formulating a contingency plan on a group basis concerning the appropriateness and sufficiency of liquidity, whether the business operator appropriately reflects the risk profile of the base in Japan as well as the Japanese market conditions.
- (v) When examining the appropriateness and sufficiency of the liquidity of the base in Japan, whether, among the risks relating to transactions that are conducted using the accounts of an overseas base, the business operator has also appropriately reflected those risks that could potentially make it back to the base in Japan.

#### IV-7-5 Compensation Structure

With regard to the design and operation of the compensation structures of Foreign Holding Company, etc. Groups, in the strictest sense, the authorities in the home-country should be conducting appropriate supervision on

a group basis to prevent the incentives for officers and employees to take risks from becoming excessive.

On the other hand, from the perspective of cooperating appropriately with the supervision conducted by home-country authorities, supervisors shall also monitor the design and operation of the compensation structures of Type I Financial Instruments Business Operators which are business bases in Japan. In particular, in cases where there is an apparent risk of officers or employees at a base in Japan being provoked into taking excessive risks, supervisors shall examine the risk management issues in greater depth, and shall take necessary actions, such as actively taking up the issue with the home-country authorities.

(Note) For details of the supervisory viewpoints for conducting the said monitoring, refer to IV-5-6 above as necessary.

#### IV-7-6 Supervisory Method and Actions

(1) With regard to the governance, appropriateness of business operations, appropriateness and sufficiency of equity capital, control environment for risk management, and the compensation structure of Type I Financial Instruments Business Operators which are business bases in Japan, supervisors shall conduct hearings, as necessary, on a periodic and ongoing basis, while also giving consideration to the characteristics of the business operation of the relevant base in Japan. Also, seizing the opportunity to talk directly with group headquarters, etc., supervisors shall strive to share their perceptions of any issues affecting the entire group or the base in Japan. Furthermore, supervisors shall actively utilize frameworks of cooperation with overseas authorities, and shall conduct in-depth hearings pertaining to a group's response to its base in Japan for any group-wide issues and so forth that are consequently identified.

(2) In cases where offsite monitoring, inspection results, notifications of problematic conduct or the like mentioned in (1) above reveal a problem in the business operation or internal control environment of a Type I Financial Instruments Business Operator which is a business base in Japan, supervisors shall require the submission of a report based on Article 56-2(1) or (2) of the FIEA, as necessary. Furthermore, in cases where it is deemed necessary for improvement, supervisors shall also take such action as issuing an order for business improvement based on Article 51 and other provisions of the FIEA.

## IV-8 Ensuring Smooth Execution of Orderly Resolution

### IV-8-1 Significance

Based on the experience of the recent global financial crisis, international efforts have been made to develop a framework for a rapid and orderly resolution of global systemically important financial institutions.

The efforts are aimed at ending the so-called "too-big-to-fail" problem, which refers to the issue whereby national authorities are not able to resolve globally active banks and have no option but to rescue them by injecting public funds due to the concern that the unordered failure of such financial institutions would have an extremely serious adverse effect on financial and economic systems in a number of countries.

At the G20 Cannes Summit in November 2011, Key Attributes of Effective Resolution Regimes for Financial Institutions (the "Key Attributes") submitted by the Financial Stability Board (FSB) was endorsed as a new international standard for resolution regimes. The Key Attributes requires that financial institutions that could be systemically important or critical if they fail be subject to an effective resolution regime that meets certain conditions. Furthermore, at the G20 Antalya Summit in November 2015, the Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution (hereinafter referred to as the "TLAC Term Sheet," the general term for the Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs, additionally announced by the Financial Stability Board in July 2017) submitted by the FSB was endorsed.

Based on these international agreements, authorities in major jurisdictions have been taking necessary steps to build legal frameworks for orderly resolution of financial institutions. In Japan, the Deposit Insurance Act was revised in June 2013 and enforced in March 2014, introducing the Measures for Orderly Resolution of Assets and Liabilities of Financial Institutions for the Purpose of Ensuring Financial System Stability. In addition, the FSA's approach to introduce the TLAC framework subject to Japanese Global Systemically Important Financial Institutions was announced (The FSA's Approach to Introduce the TLAC Framework, first version announced in April 2016, revised in April 2018), and TLAC regulations were adopted in March 2019 by newly developing the Standards for Disclosing Status of Soundness Regarding Total Loss-absorbing and Recapitalization Capacity Determined as the Standard for a Final Designated Parent Company to Judge the Soundness of the Management of the Final Designated Parent Company and its Subsidiary Corporations, etc., Based on the Stipulations of Article 57-17 (1) of the Financial Instruments and Exchange Act (hereinafter, "TLAC Pillar 1 Notice"). In addition, the FSA also started to apply TLAC regulations as the host authority supervising Material Sub-groups of foreign G-SIBs in March 2020 by newly providing for the Measures to Ensure Continuous Implementation of Business with the Parent Company as Prescribed by the Commissioner of the Financial Services Agency as the Operational Control System to Be Established by a Financial Instruments Business Operator, etc. Whose Parent Company Is a Foreign Company Designated by the Commissioner of the Financial Services Agency Based on the Stipulations of Article 70-2(5) of the Cabinet Office Order on Financial Instruments Business, etc. (hereinafter, "Foreign Securities Companies TLAC Notice").

Nevertheless, efforts with the system are not sufficient to resolve the "too big to fail" issue. The efforts of financial institutions during non-crisis times are necessary. In Japan, in addition to formulating plans to defend against arriving at failure from a crisis, this also requires financial institutions to have a capability to increase



resolvability (Note 1) in the event that an institution should reach failure (“crisis preparedness,” hereinafter).

The above-mentioned Key Attributes stipulates the authorities of each country to evaluate the resolvability of financial institutions and to require the relevant financial institutions to improve their resolvability when necessary. In Japan, the Deposit Insurance Act revision in June 2013 stipulates, “The Prime Minister (omission) may, when a need for orderly resolution of assets and liabilities of the Financial Institution, etc. arises and they find that measures necessary for the smooth implementation thereof have not been taken, order the Financial Institution, etc. to take the relevant measures to the extent necessary by a specified time (Article 137-4).”

In consideration of the above, the financial institutions are required to take actions to ensure the smooth operation of orderly resolutions. (Note 2) The FSA will supervise the actions of the financial institution, while bearing in mind that there are differences in the priority placed on the required crisis preparedness and time frame for establishing the preparedness depending on the importance of the financial institution to the system. Also, where it is necessary to ensure the smooth operation of orderly resolution, actions other than those listed below may be required based on international discussions.

(Note 1) Resolvable financial institutions are identified as safeguarding business that is important to the financial system while avoiding considerable disorder to the financial system, not carrying the risk of taxpayer losses, and for which it is feasible and credible to carry out failure resolution for the financial institution.

(Note 2) Orderly resolutions in IV-8 include but are not limited to the failure resolutions used in the Specified Measures Under Item (ii) stipulated in Article 126-2(1)(ii) of the Deposit Insurance Act.

## IV-8-2 Development of Recovery and Resolution Plans

### IV-8-2-1 Background

When a financial institution which conducts large and complex operations faces a crisis, not only the financial institution itself but also the financial system as a whole is likely to face a severe disruption. It is therefore important to prevent such crises to the greatest extent possible, as part of the crisis management through the supervisory process.

In view of the above, at the international level, an agreement at the Financial Stability Board (see the following note) calls on jurisdictions to put in place a process to develop robust and credible “Recovery and Resolution Plans (RRPs)” for global systemically important financial institutions (G-SIFIs) and financial institutions whose failure is assessed by its home authority to have a potential impact on financial stability.

Taking into account those developments at the international level, it is necessary to continue the ongoing process to develop and maintain RRP in Japan.

(Note) Financial Stability Board “Key Attributes of Effective Resolution Regimes for Financial Institutions” November 2011.

### IV-8-2-2 Supervisory Focus, Approaches, and Actions

(1) Taking into account the agreement at the Financial Stability Board, the FSA expects to require, pursuant to

Article 57-23 of the FIEA, financial institutions designated as G-SIFIs (including G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company) and where necessary other systemically important financial institutions each to develop and submit a recovery plan once a year or when important changes have been made to its business and group structure. Taking note that the contents of a recovery plan could vary depending on the group structure or the business model of the financial institution, the FSA expects to examine, taking into account the discussions at the Financial Stability Board, whether a recovery plan contains at least the items listed below:

- (i) Outline of the recovery plan
  - A. Relevance of the recovery plan for the financial institution; and
  - B. Governance arrangements to develop the recovery plan;
- (ii) Preliminary information for developing the recovery plan
  - A. Overviews of the business and the group structure; and
  - B. Risk management systems at normal times with respect to capital adequacy and liquidity;
- (iii) Triggers for the implementation of the recovery plan
  - A. Identification of trigger events that are expected to be hit at a stage sufficiently early enough for the financial institution to respond to the crisis preemptively (including quantitative and qualitative triggers with respect to each of capital adequacy and liquidity);
  - B. Stress tests and reverse stress tests with severer stress than for usual stress testing (including system-wide and firm specific stress scenarios);
  - C. Internal decision-making process concerning both a judgment of the trigger(s) being hit and actions to be taken thereafter; and
  - D. Relationship between: risk management operations in business as usual depending on crisis stages; and those at the time of the recovery plan being implemented;
- (iv) Overview of legal entities, overseas branches, and business units in the group
  - A. A profile of each of the legal entities and overseas branches
    - a. Business overview, financial information, and systemic importance (importance for the group and criticality for the financial system, both of which are to be analyzed based on the market shares and other relevant information of the legal entities and overseas branches); and
    - b. Strategic relevance of the legal entities and branches located in overseas;
  - B. Interconnectedness among main legal entities, overseas branches, and business units
    - Within-group capital relations, transactions, guarantee relations, and interdependency of IT systems; identification of subsidiaries which provide services to business units that provide critical functions; and personnel relations;
- (v) Analysis of recovery options
  - A. Assessment of effectiveness, appropriateness and sufficiency (including quantitative assessment) of recovery options (measures to improve the capital situation and those to secure sufficient liquidity) for each of the stress scenarios; and
  - B. Points to be taken into account at the execution of the recovery options and feasibility analysis thereof;

(vi) Other items

A. Management information systems

List of information necessary for development of the recovery plan and implementation of the recovery options; and the time needed to access to those information

(2) Taking into account the agreement of the Financial Stability Board, the FSA will develop resolution plans for financial institutions designated as G-SIFs (including G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company) and where necessary other systemically important financial institutions. The FSA expects to update the resolution plans and assess the resolvability once a year or when important changes have been made to the business and the group structure of the financial institution.

#### IV-8-3 Measures to Ensure the Effectiveness of Stay Decision in Agreements Governed by Foreign Laws

##### IV-8-3-1 Background

The amendment of the Deposit Insurance Act (hereinafter referred to as the “DIA”) in June 2013 has provided the Prime Minister with a power to make a decision that a “Clause on Specified Cancellation, etc.” in an agreement, meaning a clause which provides Specified Cancellation (“Specified Cancellation, etc.” defined in Article 137-3(2) of the DIA) that is to be triggered by an application of “Related Measures, etc.” defined in Article 137-3(1) of the DIA, is null and void for a period set out in Article 137-3 (1) of the DIA (such a decision is hereinafter referred to as a “Stay Decision”). In the above conjunction, the 2013 amendment revised the provisions in Article 131 of the DIA with respect to special provisions for procedures of creditor protection. In order to avoid a severe disruption to Japan’s financial system, Type I Financial Instruments Business Operators to which Specified Confirmation set out in Article 126-2 (1) of the DIA is applicable and which conduct securities-related business (those listed in Section (2)(iii) of the DIA) are required to ensure that the effectiveness of Stay Decisions and special provisions for procedures of creditor protection set out in Article 131 of the DIA (hereinafter collectively referred to as the “Effectiveness of Stay Decision”) extend to agreements governed by laws other than Japanese law.

##### IV-8-3-2 Main Supervisory Focus

In light of the development at the global level aimed at ensuring the effectiveness of temporary stay on early termination rights in agreements governed by foreign laws, the FSA expects to set the following items as its supervisory focus in examining the firms’ controls on agreements governed by laws other than Japanese law (see Note), taking into account the circumstances of individual transactions.

(Note) Designated Parent Companies and Special Financial Instruments Business Operators are required to take the necessary measures at their group level.

##### (1) Supervisory Focus with respect to Conclusion of an Agreement

The FSA expects to examine whether a Financial Instruments Business Operator, etc. has taken necessary actions to ensure, regardless of the counterparties’ jurisdictions, that the Effectiveness of Stay Decision applies to an

agreement governed by laws other than Japanese law, where the Financial Instruments Business Operator, etc. concludes or materially amends the agreement or enters into a transaction based on the existing agreement, provided that the new or the existing agreement, as the case may be, contains a Clause on Specified Cancellation; is agreed with any counterparty other than central counterparties (CCPs); and is with respect to “Subject Transactions” which refers to, among the transactions listed in Article 35-18 of Ordinance for Enforcement of the Deposit Insurance Act as “transactions of instruments that have a market price at an exchange or other markets and their equivalent transactions” over-the-counter derivative transactions, financial and other derivative transactions, the sale or purchase of securities on condition of repurchase or resale, the lending and borrowing of securities, the trading of bonds with options, forward foreign exchange transactions, over-the-counter commodity derivative transactions, and similar transactions, including transactions entered into for the purpose of collateralizing these transactions.

(Note) Actions to comply with the requirements above include:

- (i) Adhering to an internationally common protocol aimed at ensuring the Effectiveness of Stay Decision on agreements governed by laws other than Japanese law and confirming that the counterparty has adhered to such a protocol; and
- (ii) Indicating clearly in the agreement that the Effectiveness of Stay Decision applies to the Subject Transactions.

## (2) Supervisory Focus with respect to Existing Contracts

Firms that are required to take the actions set out in (1) are also expected to take those actions, as necessary, with respect to existing contracts of Subject Transactions which include a Clause on Specified Cancellation and are governed by laws other than Japanese law (excluding the cases where the firm enters into a new transaction based on the existing agreement), taking into account the significance of the potential systemic impact that may be caused by the non-enforceability of the Effectiveness of Stay Decision to the agreement.

### IV-8-3-3 Supervisory Approaches and Actions

Based on the supervisory focus above, the FSA expects to conduct in-depth reviews on the relevant management and control of Type I Financial Instruments Business Operators that conduct securities-related businesses. Where necessary, the FSA also expects to require Designated Parent Companies or Type I Financial Instruments Business Operators engaged in securities-related business, to submit a report to the FSA, pursuant to Article 57-23 of the FIEA and Article 136 of the DIA, or pursuant to Article 56-2 of the FIEA and Article 136 of the DIA, respectively.

If any material impediment to ensuring smooth execution of orderly resolution is identified as a sequel of requiring the submission of a report, the FSA expects to consider issuing, a business improvement order pursuant to Article 57-19 of the FIEA and an order pursuant to Article 137-4 of the DIA to the Designated Parent Company; and a business improvement order pursuant to Article 51 of the FIEA and an order pursuant to Article 137-4 of the DIA to the Type I Financial Instruments Business Operator engaged in securities-related business.

### IV-8-4 Measures to Ensure Operational Continuity of Critical Functions to Financial System in Orderly

## Resolution

### IV-8-4-1 Significance

Ensuring operational continuity of critical functions provided by a financial institution in resolution is a necessary condition for executing orderly resolution of the financial institution without causing systemic risks. Discussion at the global level has been placing a particular emphasis on this point. In the resolution regime in Japan, the Specified Measures Under Item (ii), which was introduced by the amendment of the Deposit Insurance Act in June 2013, has put in place measures that enable transfer of critical functions to a bridge institution and by doing so continued provision of these functions, in view of preventing severe disruptions to the financial markets in Japan which may be caused by discontinuation of critical functions to financial system.

However, given the current business environment in which financial institutions' activities are largely integrated with various services provided by intra-group or third party service providers, ensuring continuity of critical functions in the process of resolution necessitates continuity of provisions of services (e.g. IT infrastructures) and access to financial market infrastructures (e.g. central counterparties) that are indispensable for provision of the critical functions even in the process of orderly resolution.

Taking into account the above and relevant guidance (Note) issued by the FSB, financial institutions are required to take measures to ensure operational continuity of critical functions to financial system in orderly resolution.

(Note) Financial Stability Board's Guidance on Arrangements to Support Operational Continuity in Resolution (August 2016), Guidance on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution (July 2017), etc.

### IV-8-4-2 Main Supervisory Focus, Approaches and Actions

JFSA requires financial institutions designated as G-SIFIs (including G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company) and where necessary other systemically important financial institutions to take actions set out below that aim at ensuring operational continuity of critical functions to financial system in orderly resolution, taking into consideration the firms' systemic significance and other relevant factors affecting their resolvability. The supervisory approaches to be taken are the same as those provided in IV-8-3-3.

#### (1) Identification of critical functions

Firms should identify critical functions (activities performed for third parties where failure would lead to severe disruption of the financial system) that an entity or entities in the group of a firm provide, taking into account the guidance issued by the FSB and analyses on their subsidiaries – analyses that firms conduct as part of its recovery planning pursuant to IV-8-2-2 (1) (iv) A.

(Note) Financial Stability Board's Guidance on Identification of Critical Functions and Critical Shared Services (July 2013)

#### (2) Ensuring continuity of critical shared services (CSS)

Firms should take measures set out below for ensuring operational continuity of critical functions via continuity

of provision of services that support the critical functions.

- (i) Firms should identify critical shared services (“CSS”: activities performed for a firm that provides a critical function or an entity in the group of the firm where failure would lead to the inability to or the serious impediments to the ability to perform the critical function; CSS may be performed within the group or outsourced to third parties) associated with their critical functions. Identification is expected to be based on: firms’ in-depth analyses on each of the critical functions identified pursuant to (1) above; and identification of intra-group service providers that provide services to business units with critical functions – analyses that firms conduct as part of recovery planning pursuant to IV-8-2-2 (1) (iv) B.
- (ii) For each of the CSS identified pursuant to (i) above, if the agreement with a provider of the CSS is such that the provider possibly terminates provision of the CSS on the ground that the recipient of the CSS or an entity in the group of the recipient enters into orderly resolution or becomes subject to measures that accompany orderly resolution e.g. change of controls, the firm should make contractual arrangements to ensure that the provision of the service is continued even when resolution measures are taken with respect to the firm.

An example of such contractual arrangements is to document in the master agreement or a separate memorandum of understanding that the provider shall not terminate the agreement pursuant to termination clauses in the master agreement on the ground of application of those resolution measures with respect to the recipient, provided that there is no default in the payment obligations.

- (iii) Firms should make arrangements with respect to financial resources to ensure operational continuity of CSS. This includes measures to financially ensure that:
  - A. Intra-group providers of CSS are capable of providing the CSS through the process of orderly resolution; and
  - B. The recipient of CSS is capable of satisfying the payment obligation associated with provision of CSS to third-party providers through the process of Orderly Resolution.

### (3) Ensuring Continuity of Access to Critical FMI Services

Firms should take measures set out below for ensuring operational continuity of critical functions via continuity of access to financial market infrastructures (FMIs) that support the provision of critical functions.

- (i) Firms should identify critical FMI services (clearing, payment, securities settlement and custody services provided by FMIs such as central counterparties, settlement service providers, central securities depositories and custodians, the discontinuation of which is expected to lead to the inability to or the serious impediments to the ability to perform the critical function; critical FMI services include services to which firms indirectly participates via an intra-group or a third-party direct participant) associated with the critical functions, based on in-depth analyses on each of the critical functions identified pursuant to (1) above.
- (ii) Firms should maintain information for each of the critical FMI services regarding: the expected financial and non-financial requirements/conditions for continued access to the service, including those required by the relevant direct participant in cases where firms indirectly participate to critical FMIs; and the information on the credit facilities that they may receive, if any, in association with the critical FMI services (e.g. credit

facilities provided by direct participants in cases where a firm indirectly participate to critical FMIs).

- (iii) Firms should engage with providers of critical FMI services to understand how they are likely to respond to the firm at the time when the firm or an entity in the group of the firm enters into orderly resolution or becomes subject to measures that accompany orderly resolution e.g. change of controls. Such responses may include termination or continuation of the service and, if any, additional requirements e.g. additional margin requirements.
- (iv) Firms should develop contingency plans for ensuring continued access to critical FMI services in orderly resolution. A contingency plan should include, at a minimum:
  - A. Information obtained through the process set out in (i) to (iii). above;
  - B. How the firm would meet the additional requirements that the critical FMI service provider is likely to require for continued access to the service, if any of such requirements are identified in (iii) above;
  - C. How the firm would meet the financial requirements for continued access;
  - D. Governance arrangements to implement the contingency plan; and
  - E. Impact analysis on the ability of the firm to continue performing its critical functions that may be caused by suspension of access to critical FMI services despite the countermeasures in B. and C. above, and, if possible, alternative measures taken to mitigate the impact.

#### IV-8-5 Development of Liquidity Monitoring and Reporting Capabilities toward Smooth Execution of Orderly Resolution

##### IV-8-5-1 Significance

For the purpose of smooth execution of orderly resolution, it is essential for a firm in resolution to be able to monitor at a granular level their liquidity information such as liquidity needed through the process of a resolution and the information on liquid assets that can be used to meet the needs. For example, continuation of critical function in orderly resolution necessitates estimation of the location and the amount of liquid assets that can be used for satisfying the payment obligation to providers of CSS and posting margin to critical FMI service providers. For resolution authorities, in determining that a financial institution is at the point of non-viability, it is vital that the financial institution in resolution has capabilities to report to the authorities on their liquidity shortfalls within an appropriate timeframe.

In view of the above, and towards ensuring smooth execution of orderly resolution, financial institutions are required to enhance their capabilities to monitor and report liquidity information, while taking also into account the guidance developed by the FSB(Note).

(Note) The FSB “Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank (“G-SIB”)” (August 2016)

##### IV-8-5-2 Main Supervisory Focus, Approaches and Actions

JFSA requires financial institutions designated as G-SIFIs(including G-SIBs designated by the Capital Adequacy Notice on Final Designated Parent Company) and where necessary other systemically important financial

institutions to have in place liquidity monitoring and reporting capabilities to estimate the amount and the location of liquid assets available at the time of resolution, taking into consideration the firms' systemic significance.

Such capabilities include those that enable the firm to estimate and report timely to the authorities the amount of high-quality liquid assets (HQLA; meaning High Quality Liquid Assets in Article 1 (xiv) of Regulatory Notice on the Consolidated Liquidity Coverage Ratio) that can be freely transferable among companies and jurisdictions, taking into account local regulatory requirements and restrictions of internal control, by material operating entities and branches of the group and by major currencies.

The supervisory approaches to be taken are the same as those provided in IV-8-3-3.



## IV-8-6 Adequacy of Loss-absorbing Capacity

### IV-8-6-1 Appropriateness, Sufficiency, and Preciseness of Loss-absorbing Capacity

#### IV-8-6-1-1 Significance

The TLAC Term Sheet requires global systemically important banks (G-SIBs) to have sufficient Total Loss-Absorbing Capacity (TLAC). The purpose of the TLAC Term Sheet is to facilitate the orderly resolution of a G-SIB when it fails in a manner that minimises impacts on financial stability without exposing taxpayers to loss and ensures the continuity of its critical functions by imposing the losses on shareholders and creditors, in addition to meeting the recapitalisation needs of the G-SIB.

More concretely, under the resolution regime envisaged by the TLAC Term Sheet, an entity to which resolution tools are assumed to be applied by the relevant authority ("Resolution Entity") is supposed to raise a loss-absorbing and recapitalisation capacity from external sources and distribute it to its material sub-groups during normal times. At the time of a stress, following the relevant authority's determination that one or more of the material sub-groups have reached the point of non-viability (PONV), losses incurred to them would be passed to the Resolution Entity. While this could lead to a resolution of the Resolution Entity, the material sub-groups are expected to continue their business as usual. Under this resolution regime, in cases where cross-border resolution plans are executed, close co-operation between the home and the host authorities would be essential.

#### IV-8-6-1-2 Major Supervisory Viewpoints and Supervisory Method and Actions

##### (1) The FSA's Response to TLAC Regulations as Home Authority

###### (i) Financial Institutions Subject to TLAC Regulations

G-SIBs specified by the Notice are subject to TLAC requirements in Japan, in light of the TLAC Term Sheet. In addition, for internationally active financial groups, entry into resolution of one or more of their foreign subsidiaries could result in their losses passed to the parent entity, potentially leading to a resolution of the group as a whole. Provided that they have particular systemic significance to the Japanese financial system if they fail, a sufficient level of loss-absorbing capacity available at the time of resolution should be ensured, as the need for addressing the so-called "too big to fail" problem is markedly high for such financial groups. In such a case, the FSA considers it necessary to include certain non-G-SIBs in the scope of the requirements for maintaining sufficient loss-absorbing and recapitalisation capacity.

Accordingly, in Japan, in addition to G-SIBs specified by the Notice, among D-SIBs specified by the Notice, the FSA applies the TLAC requirements to financial institutions (collectively referred to as "Covered SIBs") of particular need for a cross-border resolution arrangement and of particular systemic significance to Japanese financial system if they fail.

Regarding the financial institution groups selected as Covered SIBs, abiding by the desired resolution strategies discussed below, groups in Japan subject to failure resolution (hereinafter, "Domestic Resolution Groups") as well as companies subject to failure resolution located in the country that must receive the

aggregate loss when carrying out resolution (hereinafter, “Domestic Resolution Entities”) are designated based on the TLAC Pillar 1 Notice, and are responsible for the arrangement and maintenance of external TLAC as well as the distribution of internal TLAC.

When a financial institution group is newly selected or designated, sufficient time beforehand shall be taken for consideration, taking into consideration the adequacy of said group’s equity capital and their fundraising framework. Furthermore, in consideration of the time needed to arrange from the market the external TLAC necessary to reach the required level, the intention to apply Japan’s TLAC requirements shall be announced beforehand to the said financial institution group, together with the desired resolution strategies of said financial institution group.

(Note) Concerning foreign G-SIB groups designated for resolution strategies where an MPE approach is desirable, in a case where a Japanese Final Designated Parent Company is designated as a resolution entity upon consulting with the relevant foreign authorities, it is conceivable that the above (i) shall apply with the necessary modifications and that the domestic resolution entity as well as the domestic resolution group may be considered for designation based on the TLAC Pillar 1 Notice.

(ii) Selection of Preferred Resolution Strategy

The resolution strategies for systemically important financial institutions are broadly based on two stylised approaches: (i) SPE (Single Point of Entry) resolution, in which resolution tools are applied to the ultimate holding company by a single national resolution authority, and (ii) MPE (Multiple Point of Entry) resolution, in which resolution tools are applied to different parts of the group by two or more resolution authorities acting in a coordinated way.

\*FSB, Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies, July 2013

When determining preferred resolution strategies for Covered SIBs, either the SPE Approach or the MPE Approach is selected to take into account resolvability based on their organizational structure as financial groups, including interconnectedness and interdependency within the groups. If the SPE Approach is selected, ordinarily, the domestic resolution entity shall be the ultimate holding company of said financial institution group, and domestic resolution group shall conform to the said financial institution group.

Even when a preferred resolution strategy has been selected, it should be noted that in each case consideration should be given to the actual circumstances of the Covered SIB when deciding what kind of resolution will actually be performed.

(iii) Adequacy of External TLAC

To execute preferred strategy effectively in resolution, a Resolution Entity and its subsidiaries shall restructure its flow of funding during business as usual for the purpose of ensuring the Resolution Entity's loss-absorbing capacity and enable such losses ultimately to be absorbed by the Resolution Entity's shareholders and creditors.

In consideration of the above, in the TLAC Pillar 1 Notice, domestic resolution entities of Covered SIBs are required to satisfy a minimum required level of capital and liabilities recognized as having loss-absorbing capacity as external TLAC.

## A. Required Level

### a. Timing of Application

If a domestic resolution entity of the said financial institution group has become a G-SIB specified by the Notice on or after April first, 2019, they will be subject to application of the TLAC requirements after three years from the time of being specified as a G-SIB in the Notice. In such a case, the minimum required external TLAC ratio on a risk-weighted asset basis of the consolidated domestic resolution group at the time of commencement of application shall be 18%, and the minimum required external TLAC ratio on an overall exposure basis shall be 6.75% (complete TLAC application).

Also, if a D-SIB specified by the Notice on or after April first, 2019 newly becomes Covered SIBs, for domestic resolution entities of the said financial institution group, the minimum required external TLAC ratio on a risk-weighted asset basis of the consolidated domestic resolution group at the time of commencement of application shall be 16%, and the minimum required external TLAC ratio on an overall exposure basis at the time of commencement of application shall be 6% (phased TLAC application). After three years the minimum required external TLAC ratio on a risk-weighted asset basis of the consolidated domestic resolution group shall be 18%, and a minimum required external TLAC ratio on an overall exposure basis shall be 6.75% (complete TLAC application).

Meanwhile, if the FSA Commissioner separately designates a ratio as the minimum required external TLAC ratio on an overall exposure basis pursuant to the proviso to Article 1(xi) of the TLAC Pillar 1 Notice, that ratio is to be adopted.

However, the application of the above is not to be carried out in a mechanical or uniform manner, but rather it is necessary to bear in mind the time period necessary for the said financial institution group to respond to TLAC requirement and the specifics and effect of the countermeasures adopted by domestic resolution entities in order to reach the minimum level of external TLAC ratio as well as the impact those countermeasures will have on the financial system.

### b. Evaluating External TLAC Adequacy

- (i) When evaluating external TLAC adequacy, Covered SIBs need to analyze not only external TLAC quantity, but also external TLAC quality, at least with regard to the following points:
  - Other external TLAC-eligible instruments satisfy all the criteria prescribed in the TLAC Pillar 1 Notice, and adequately reflect the spirit of the TLAC Term Sheet.
  - Domestic resolution entities have not loaned the funds required for acquisition to the holders of other external TLAC-eligible instruments either directly or indirectly, and said other external TLAC-eligible instruments have not been acquired by subsidiaries, etc. of said domestic resolution entity.
  - Until March 30, 2022, among Additional Tier 1 instruments and Tier 2 instruments, if they were issued by a subsidiary, etc. established overseas or they were issued by Material Sub-group, and they carry a provision for conversion into common stock under specified circumstances or other similar provision, permission has been granted by the relevant authorities to include such capital-raising instruments in external TLAC.
- (ii) External TLAC is only intended to facilitate loss absorption and recapitalization in the case of

failure. It is more important for a financial institution to maintain plenty of equity capital at normal times in order to ensure soundness. Priority must not be placed on increasing external TLAC, as situations that deteriorate the quality and quantity of equity capital are essentially the same as failure, and must therefore be avoided.

However, if Covered SIBs fail, it is possible that Common Equity Tier 1 capital and Additional Tier 1 instruments (hereinafter “Going Concern capital”) will not be sufficient for loss absorption and recapitalization, so Covered SIBs should not rely solely on this Going Concern capital. Rather, they should maintain adequate amounts of Tier 2 instruments and other external TLAC-eligible instruments (hereinafter collectively referred to as “Gone Concern capital, etc.”).

Furthermore, losses incurred by shareholders in the event of a financial institution failure are, based on the principle of shareholders’ limited liability, limited to the amount they invested, and particularly at times of crisis, there is a risk of moral hazard, so creditors need to influence decision making by financial institutions through supervision. Moreover, because the interest payments, etc. on liabilities tend to rise as an issuer approaches a crisis, issuers can be expected to issue liabilities at normal times, which will give them more of an incentive to prevent themselves falling into a crisis.

Therefore, external TLAC adequacy must be assessed based on the sufficiency of Gone Concern capital, etc.

Specifically, the wording of the TLAC Term Sheet shall also be taken into account, and if, for example, Gone Concern capital, etc. exceeds around 33% of the required level for external TLAC, an incentive is maintained for the financial institution to reduce risk at normal times so as to avoid falling into a crisis, and the financial institution would be regarded as having loss-absorbing and recapitalization capacity in a time of crisis. If, however, it is lower than 33%, continuous monitoring shall be performed to ensure that the financial institution is taking adequate steps to enhance its loss-absorbing and recapitalization capacity at times of crisis, such as by formulating and executing plans to externally raise Gone Concern capital, etc. and establishing a corporate governance framework to prevent moral hazard from occurring.

c. Measures to Ensure Maintenance of Adequate External TLAC

- Based on the aforementioned evaluation of external TLAC adequacy, domestic resolution entities need to take appropriate measures to ensure the maintenance of adequate external TLAC, both qualitatively and quantitatively.
- Domestic resolution entities need to properly manage the composition of external TLAC instruments to ensure that they can maintain adequate external TLAC even if their access to capital markets is temporarily impeded, such as by ensuring that their maturities are not concentrated in specific periods.
- Regarding other external TLAC-eligible instruments and the amount that can be arranged in the event that there is a shortage of other external TLAC, domestic resolution entities need to perform evaluations and consideration in advance based on the possibility that during, for example, periods in which their valuation in the capital markets has deteriorated or their performance has worsened as a result of unforeseen losses being incurred, they could find it more difficult than usual to raise funds.

#### d. Supervisory Measures

If the external TLAC ratio drops below the minimum required external TLAC ratio on an overall exposure basis, a demand shall be made to promptly report the reason for this and measures to improve the external TLAC ratio pursuant to Article 57-23 of the FIEA. Furthermore, if specific improvements are deemed to be necessary, a business improvement order pursuant to Article 57-19(1) of the FIEA shall be issued.

Note that when calculating the minimum required external TLAC ratio on a risk-weighted asset basis, if external TLAC is inadequate, the capital buffer will first be allocated to external TLAC, so if the external TLAC ratio is lower than the minimum required external TLAC ratio on a risk-weighted asset basis, the capital buffer will already be zero, and soundness can be expected to be restored in accordance with external outflow restriction measures (which may, if equity capital has fallen below the required level, be used in conjunction with an early corrective action order). Such supervisory responses must not be implemented mechanically and uniformly. Instead, they need to take account of the period required to comply with TLAC regulations, the action the Final Designated Parent Company is taking to maintain the minimum level of external TLAC ratio and Gone Concern capital, etc., the effect of this action, the impact of this action on the financial system, and so on.

#### B. Confirmation of Eligibility of External TLAC-eligible Instruments

In connection with the evaluation of external TLAC adequacy, with regard to other external TLAC-eligible instruments, if, for example, a report has been received concerning borrowing or bond issuance in accordance with a report demand order pursuant to Article 57-23 of the FIEA, it shall be confirmed, by taking the following points into account and in light of the TLAC Pillar 1 Notice and the TLAC Term Sheet, whether this is eligible as other external TLAC-eligible instruments from a regulatory point of view:

- a. The following points shall be taken into account with regard to other external TLAC-eligible instruments in the form of unsecured senior debt as stipulated in the proviso to Article 4(3)(ii) of the TLAC Pillar 1 Notice:
  - In order to deem that a creditor of an issuing domestic resolution entity is structurally subordinate to creditors of other companies in the group of said domestic resolution entity (hereinafter referred to as “structurally subordinate”), the proportion of the total amount of unsecured senior debt and excluded liabilities that are legally or economically equivalent or subordinate to this debt (hereinafter referred to as the “excluded liability ratio”) to the total existing external TLAC of the issuer itself (the amount presented in the net assets section of the issuer’s balance sheet plus liabilities constituting the issuer’s TLAC-eligible Additional Tier 1 instruments plus liabilities constituting TLAC-eligible Additional Tier 2 instruments plus other external TLAC-eligible instruments) must generally not exceed 5%.
  - The excluded liability ratio shall be based on the following excluded liability ratios:
    - (i) Excluded liability ratio as reported in financial statements (interim financial statements if mid-term)

- (ii) Excluded liability ratio as reported in business report
  - (iii) If an excluded liability ratio is published pursuant to the law or financial instruments exchange rules, this reported excluded liability ratio
  - (iv) In periods other than those in which reports were made pursuant to (i) through (iii) above, the excluded liability ratio as reported ad hoc by the domestic resolution entity concerned based on the results of inspections by authorities, etc.
- Once a domestic resolution entity has been deemed to be structurally subordinate, if there is a risk of the excluded liability ratio exceeding 5%, a demand shall be made to promptly report the reason for this and measures to prevent decrease of the excluded liability ratio pursuant to Article 57-23 of the FIEA. Furthermore, in the event of the excluded liability ratio exceeding 5%, after confirming whether the domestic resolution entity needs to remain structurally subordinate, a business improvement order pursuant to Article 57-19(1) of the FIEA shall be issued.
  - To ensure orderly resolution, even if the excluded liability ratio of a domestic resolution entity is 5% or under, the utmost care shall be taken to avoid the assumption of unsecured senior debt that does not constitute an excluded liability and is not eligible as external TLAC. To that end, a demand shall be made to the domestic resolution entity to report the total amount of non-TLAC-eligible liabilities toward non-group third parties in its financial statements (interim financial statements if mid-term).
  - As stated in IV-8-6-2-2(i)C, it may, during orderly resolution, be impossible to receive payment for all or part other external TLAC-eligible instruments in the form of unsecured senior debt through bankruptcy resolution proceedings. To ensure that the holders fully understand this risk before purchasing the instruments, the contract, issuance summary, or other attached documents (prospectus, etc.) shall clearly state this risk. Furthermore, the seller shall provide adequate explanations to prospective purchasers as necessary in accordance with their level of understanding, etc.
- b. If contract terms concerning redemption, etc. have been specified in accordance with Article 4(3)(viii) of the TLAC Pillar 1 Notice, regarding advance confirmation of the domestic resolution entity's option of redemption, etc., the provisions of the TLAC Pillar 1 Notice shall be taken into account. Furthermore, the statements concerning equity capital in III-2-1-1-3(3) of the Comprehensive Guidelines for Supervision of Major Banks, Etc. shall be applied, with "other external TLAC" being substituted for "equity capital" when reading them.
- c. If there are provisions for adherence to the laws of a foreign country in accordance with Article 4(3)(iX) of the TLAC Pillar 1 Notice, a demand shall be made, as necessary, to submit a written legal opinion and related documents of a legal specialist concerning the ability of the issuing domestic resolution entity to make effective use for loss absorption and recapitalization.
- C. Judgment of Eligibility for Intentional Holdings of Other External TLAC-eligible Instruments of Other Financial Institutions, etc.

The mutual and intentional holding of other external TLAC-eligible instruments (including cases equivalent thereto; same hereinafter in C.) for the purpose of enhancing the external TLAC ratio within

the financial system results in Ultimate Designated Parent Companies and other financial institutions, etc. booking total loss-absorbing capacity, etc. that is devoid of substance, and this causes the financial system to become fragile. Therefore, under the Basel Accord, in Article 8(6), etc. of the Consolidated Capital Adequacy Ratio Notice, if Covered SIBs and other financial institutions, etc. are deemed to intentionally hold other external TLAC-eligible instruments of said other financial institutions etc. in order to mutually enhance their external TLAC ratios, and if said other financial institutions, etc. are deemed to intentionally hold other external TLAC-eligible instruments of said Covered SIBs (hereinafter referred to as “intentional crossholding”), the amount of the other external TLAC-eligible instruments must be deducted from equity capital (Tier 2 capital) as an equity capital adjustment item. Based on IV-5-3-2-1(1), which concerns intentional crossholding of capital instruments, intentional crossholding shall specifically refer to the following cases:

- Cases where Covered SIBs make a promise with other financial institutions, etc. (not limited to deposit-taking institutions in Japan) to hold each other’s other external TLAC-eligible instruments with the primary objective of cooperating with each other to mutually strengthen their total loss-absorbing capacity, etc., and in conjunction with this, Covered SIBs hold other external TLAC-eligible instruments of other financial institutions, etc. and said other financial institutions, etc. hold other external TLAC-eligible instruments of Covered SIBs

#### (iv) Internal TLAC Adequacy

Domestic resolution entities are required to allocate as internal TLAC loss-absorbing capacity, etc. acquired through external TLAC to Material Sub-groups within the domestic resolution entity’s group (including subsidiaries’ groups) based on factors such as the sizes of the Material Sub-groups.

##### A. Selection of Material Sub-group for Internal TLAC Allocation

The purpose of internal TLAC is to concentrate losses suffered by Material Sub-groups (including subsidiaries’ groups; same hereinafter in (iv)) within the resolution entity’s group on the holding company, etc. so as to ensure that systemically important operations performed by the said Material Sub-groups can continue even during failure resolution. In light of this, it is also necessary in Japan to require domestic subsidiaries that are above a certain size, that could generate losses to a degree that could push the domestic resolution entity’s group into a crisis, and that perform systemically important operations to possess capacity as Material Sub-groups to concentrate losses through internal TLAC.

Specifically, based on the TLAC Term Sheet, (i) below shall be used as the primary criterion and (ii) below shall be used as a supplementary criterion when selecting Material Sub-groups to be covered:

Criterion (i): Its risk-weighted assets, overall exposure, or operating income exceeds 5% of the total for the group

(Note) If no account called “operating income” exists under the accounting standards applied, the account that presents total earnings under the accounting standards, etc. applied shall be used instead.

Criterion (ii): In Japan’s financial system, the systemic importance of the operations the said subsidiary performs and the likelihood that losses would be incurred to the degree that the

continuation of systemically important operations would be impeded

Selected domestic Material Sub-groups are designated as internal TLAC allocation recipients from the domestic resolution entity pursuant to the TLAC Pillar 1 Notice.

Selectees shall be reviewed once every year, and a demand shall be made for the submission of a report detailing data submitted as of March 31 each year, in principle. Furthermore, if there has been a change in the group structure, a demand shall be made for the submission of the projected figures before the change as early as possible.

Note that overseas Material Sub-groups will be selected by the authorities in the jurisdiction in which they were established, so the FSA shall consult with relevant overseas authorities as necessary.

## B. Required Level

### a. Timing of Application to Financial Institutions Designated as Covered SIBs on or after April 1, 2019

Regarding domestic Material Sub-groups of a financial institution group that has become a “G-SIB specified by the Notice” or whose “D-SIB specified by the Notice” has newly become an Covered SIB on or after April 1, 2019, application shall commence on the same date that application of the minimum level of external TLAC for the domestic resolution entity of the said financial institution group commenced.

Furthermore, regarding domestic Material Sub-groups newly designated on or after April 1, 2019, application of the required amount of internal TLAC shall commence approximately three years after designation.

### b. Internal TLAC Level Adjustment Coefficient

In the case of a domestic Material Sub-group, based on the capital adequacy requirement applied to the said Material Sub-group, the required external TLAC level is calculated on the assumption that the said Material Sub-group was the domestic resolution entity. This figure is then multiplied by the internal TLAC level adjustment coefficient determined by the FSA, which lies within the range of 75% to 90%, to calculate the required amount of internal TLAC.

When determining the internal TLAC level adjustment coefficient, with regard to a domestic Material Sub-group, because its resolution will generally be completed domestically and because it can be continuously supervised as a group at normal times by Japanese authorities, there is little need for advance allocation of its loss-absorbing capacity, etc. Therefore, the internal TLAC level adjustment coefficient of a domestic Material Sub-group shall generally be set at 75%, and then adjustments shall be made based on the need for advance allocation in light of (1) a preferred resolution strategy for the group and (2) the systemic importance, capital structure, business model, etc. of the said Material Sub-group.

Once determined, the internal TLAC level adjustment coefficient shall be reviewed as necessary after being prescribed in the TLAC Pillar 1 Notice.

Regarding foreign Material Sub-groups, the authorities in the jurisdiction in which the said Material Sub-group was established will take the lead in determining the internal TLAC level adjustment coefficient, so the Japanese authorities will likely consult with the relevant overseas authorities as



necessary. If an overseas authority has determined and applied a required amount of internal TLAC without prior involvement by the Japanese authorities, until the crisis management group (CMG) of the financial institution has consulted with the relevant overseas authorities and agreement has been established, the standard shall not constitute a “standard based on standards concerning minimum required amount of internal TLAC” as prescribed in Article 2(3) of the TLAC Pillar 1 Notice.

c. Measures for Evaluating Internal TLAC Adequacy and Maintaining Sufficient Internal TLAC

- Regarding measures for evaluating internal TLAC adequacy and maintaining sufficient internal TLAC, statements in (1)(iii)A.b(i) and c (excluding the matters concerning the acquirer) shall be applied, with “internal TLAC” being substituted for “external TLAC” when reading them.
- If there are Basel III-eligible and Additional Tier 1 instruments and Tier 2 instruments held by third parties outside the group, it is possible that the conversion of the said instruments into equity would lead to a change in the control structure of the Material Sub-group, which could affect its management, administration, etc. Therefore, it would be preferable for such capital instruments to not be converted into stock when triggered, but instead for the principal to be reduced.
- If a domestic resolution entity does not directly allocate internal TLAC to Material Sub-group, but instead allocates it indirectly through another subsidiary, it is essential that when the Material Sub-group has been recognized as effectively bankrupt and the internal TLAC principal has been reduced, etc. (hereinafter referred to as “internal TLAC triggering”), the loss is ultimately transferred to the domestic resolution entity. Allocation through an entity that is not the parent company, etc. of the Material Sub-group shall generally not be permitted unless, for example, there will be no change in the control relationship as a result of internal TLAC triggering.
- For hybrid debt capital instruments issued to a domestic resolution entity or its subsidiary corporation, etc. by Material Sub-group to qualify as internal TLAC-eligible capital, it shall be kept in mind that it is essential that there be a special clause stipulating that if the Material Sub-group has been recognized as effectively bankrupt, the principal be reduced, etc. Furthermore, for the purpose of maintaining the debt hierarchy, it shall be kept in mind that with regard to hybrid debt capital instruments of Material Sub-groups held by a domestic resolution entity since before the application of the TLAC regulations, contract terms shall be changed as necessary, and that with regard to the distribution of residual assets of Material Sub-groups and the repayment of or changes in descriptions of debt when failure resolution procedures are performed, it is essential that there be a provision for subordination of debt constituting other internal TLAC-eligible instruments.

d. Surplus TLAC

Regarding external TLAC issued by a domestic resolution entity, the amount does not necessarily be allocated as internal TLAC, so a situation could arise in which a domestic resolution entity has a surplus. The treatment of such surpluses (so-called “surplus TLAC”) shall be studied on an ongoing basis, taking into account the progress of the international discussion and the approaches being adopted in each country.

e. Supervisory Measures

After taking into account whether the required amount of internal TLAC has been satisfied, if there is deemed to be a risk that the loss-absorbing capacity etc. would be insufficient if Material Sub-group was no longer able to continue as a going concern, a demand shall be made to promptly report this. Furthermore, if further improvements are deemed to be necessary, a business improvement order, etc. shall be issued to the domestic resolution entity, and additional allocation of internal TLAC shall be demanded.

#### C. Confirmation of Eligibility of Internal TLAC Instruments

In connection with the evaluation of internal TLAC adequacy, it shall be confirmed, by taking the following points into account and in light of the TLAC Pillar 1 Notice and the TLAC Term Sheet, whether other internal TLAC-eligible instruments are eligible as other internal TLAC-eligible instruments from a regulatory point of view:

- If contract terms concerning redemption, etc. have been specified in accordance with Article 7(3)(ix) of the TLAC Pillar 1 Notice, regarding advance confirmation of redemption, etc. at the Material Sub-group's option, the provisions of the TLAC Pillar 1 Notice shall be taken into account. Furthermore, the statements concerning equity capital in III-2-1-1-3(3) of the Comprehensive Guidelines for Supervision of Major Banks, Etc. shall be applied, with "other internal TLAC" being substituted for "equity capital" when reading them.

#### (2) The FSA's Response to TLAC Regulations as Host Authority

In order to ensure orderly execution of cross-border resolution, the TLAC Term Sheet provides that G-SIBs' Material Sub-groups incorporated outside the home jurisdiction must have a mechanism in place to pass the Sub-group's losses to the resolution entity with legal certainty.

In light of this, the FSA, as host authority, applies internal TLAC regulations also to foreign G-SIBs' Material Sub-groups in Japan.

##### (i) Selection of Material Sub-groups Subject to Application of Internal TLAC Regulations

(1) In light of the purpose of internal TLAC stated in (iv)A., it is also necessary in Japan to require foreign G-SIBs' subsidiaries incorporated under Japanese laws and regulations that perform systemically important operations, that are above a certain size, and that could generate losses to a degree that could push the entire group into a crisis (hereinafter referred to as "foreign G-SIBs' Material Sub-groups in Japan") to possess capacity as Material Sub-groups to concentrate losses through internal TLAC.

Specifically, based on the TLAC Term Sheet, (i) below shall be used as the primary criterion and (ii) below shall be used as a supplementary criterion when selecting Material Sub-groups to be covered:

Criterion (i): Its risk-weighted assets, overall exposure, or operating income exceeds 5% of the total for the group

Criterion (ii): In Japan's financial system, the systemic importance of the operations the said subsidiary performs and the likelihood that losses would be incurred to the degree that the continuation of systemically important operations would be impeded

Financial Instruments Business Operators, etc. selected as foreign G-SIBs' Material Sub-groups in Japan are

designated to maintain the prescribed internal TLAC with their parent companies pursuant to the Foreign Securities Companies TLAC Notice, after consulting with relevant overseas authorities, including the home authority, as necessary.

Selectees shall be reviewed once every year, and, based on Article 56-2 of the FIEA, a demand shall be made for the submission of a report detailing data submitted as of March 31 each year, in principle. Furthermore, if there has been a change in the group structure, a demand shall be made for the submission of the projected figures before the change as early as possible.

(ii) Adequacy of Internal TLAC

A. Required Level

a. Timing of Application

Regarding foreign G-SIBs' Material Sub-groups in Japan newly designated by the Foreign Securities Companies TLAC Notice on or after April 1, 2020, application of the required amount of internal TLAC shall commence approximately three years after designation. However, the period until the commencement of application could be shortened as a result of consultation with the home authority, etc.

b. Internal TLAC Level Adjustment Coefficient

In the case of a foreign G-SIB's Material Sub-group in Japan, based on the capital adequacy requirement applied to said Material Sub-group, the required external TLAC level is calculated on the assumption that said Material Sub-group was the domestic resolution entity. This figure is then multiplied by the internal TLAC level adjustment coefficient determined by the FSA, which lies within the range of 75% to 90%, to calculate the required amount of internal TLAC.

In this regard, while development of the resolution system in each country has seen progress, the degree of progress differs by jurisdiction, and the risks involved in implementation of resolution have not been completely eliminated. Therefore, the internal TLAC level adjustment coefficient for foreign G-SIBs' Material Sub-groups in Japan shall be determined in accordance with the need for advance allocation in consideration of resolvability based on the reliability of the financial group's preferred resolution strategy and the state of each country's development of a failure resolution system.

c. Measures for Evaluating Internal TLAC Adequacy and Maintaining Sufficient Internal TLAC

When evaluating internal TLAC adequacy, a Financial Instruments Business Operator, etc. which is a foreign G-SIB's Material Sub-group in Japan needs to analyze not only internal TLAC quantity, but also internal TLAC quality, at least with regard to the following points. In addition, based on this evaluation of internal TLAC adequacy, it needs to take appropriate measures to ensure the maintenance of adequate internal TLAC, both qualitatively and quantitatively.

- Other internal TLAC-eligible instruments satisfy all the criteria prescribed in the Foreign Securities Companies TLAC Notice, and adequately reflect the spirit of the TLAC Term Sheet.
- The Material Sub-group has not loaned the funds required for acquisition to the parent company which will be the holder of other internal TLAC-eligible instruments either directly or indirectly.
- If a resolution entity does not directly allocate internal TLAC to the Material Sub-group, but instead allocates it indirectly through another subsidiary, it is essential that when internal TLAC triggering

occurs, the loss is ultimately transferred to the resolution entity. Allocation through an entity that is not the parent company, etc. of the Material Sub-group shall generally not be permitted unless, for example, there will be no change in the control relationship as a result of internal TLAC triggering.

- For hybrid debt capital instruments issued to a resolution entity or its subsidiary corporation, etc. by the Material Sub-group to qualify as internal TLAC-eligible capital, it shall be kept in mind that it is essential that there be a special clause stipulating that if the Material Sub-group has been recognized as effectively bankrupt, the principal be reduced, etc. Furthermore, for the purpose of maintaining the debt hierarchy, it shall be kept in mind that with regard to hybrid debt capital instruments of the Material Sub-groups held by a resolution entity since before the application of the TLAC regulations, contract terms shall be changed as necessary, and that with regard to the distribution of residual assets of the Material Sub-groups and the repayment of or changes in descriptions of debt when failure resolution procedures are performed, it is essential that there be a provision for subordination of debt constituting other internal TLAC-eligible instruments.

#### d. Supervisory Measures

After taking into account whether the required amount of internal TLAC has been satisfied, if there is deemed to be a risk that the loss-absorbing capacity, etc. would be insufficient if the foreign G-SIB's Material Sub-group in Japan was no longer able to continue as a going concern, a demand shall be made to promptly report this. Furthermore, if further improvements are deemed to be necessary, a business improvement order, etc. shall be issued to the Material Sub-group, and additional allocation of internal TLAC shall be demanded.

#### B. Confirmation of Eligibility of Internal TLAC Instruments

(1)(iv)C. shall be applied *mutatis mutandis* to whether, in connection with the evaluation of internal TLAC adequacy, other internal TLAC-eligible instruments are eligible as other internal TLAC-eligible instruments from a regulatory point of view.

### IV-8-6-2 Orderly Resolution Using TLAC

#### IV-8-6-2-1 Significance

If a Material Sub-group of a financial institution group subject to TLAC regulations is finding it difficult to continue to perform systemically important functions as a result, for example, of a deterioration in its financial condition, and the authorities have determined that it cannot increase its capital by selling assets, receiving an injection from its parent company, or other alternative means, as an ultimate means, it is expected to restore its soundness by internal TLAC triggering regarding Material Sub-group.

As a result of losses being concentrated in the resolution entity due to internal TLAC triggering, if the authorities have deemed that the financial institution group requires failure resolution, the Material Sub-group itself will be allowed to remain in business, with the shareholders and bondholders of the resolution entity bearing the losses.

Below are specific examples of orderly resolution procedures involving TLAC in Japan.

#### IV-8-6-2-2 Specific Examples of Procedures

##### (1) The FSA's Response as Home Authority

##### (i) Crisis at Domestic Material Sub-group of Covered SIBs

The following steps A-D could be envisaged as a possible means of resolution using TLAC based on the SPE approach. A-C would be implemented rapidly over the weekend when operations are not being performed, in order to avoid market turmoil, and the assumption is that the Material Sub-group will continue to operate as normal.

(Note) While an announcement of a preferred resolution strategy by the relevant authority is expected to increase transparency for market participants, credibility of resolution regime, and feasibility of timely resolution, exact measures to be taken shall be determined by the relevant authorities on a case-by-case basis considering the actual condition of the Covered SIB in its resolution phase. Accordingly, instead of applying the Specified Measures Under Item (ii) to the Domestic Resolution Entity under the SPE resolution strategy, for example, the Prime Minister may confirm the necessity to take "Specified Measures Under Item (i)" as set forth in Article 126-2, paragraph (1), item (i) of the Deposit Insurance Act (DIA) with respect to the Domestic Resolution Entity, or may confirm the necessity to take Specified Measures Under Item (i) or "Measures Under Item (i)" as set forth in Article 102, paragraph (1), item (i) of the DIA with respect to the Material Sub-groups in Japan.

##### A. Loss Absorption Using Internal TLAC of Domestic Material Sub-group

Given that internal TLAC triggering could have a substantial impact on the financial institution group, it needs to be kept in mind that internal TLAC triggering with respect to a domestic Material Sub-group shall be limited to situations in which even if the supervisory authorities issues a business improvement order to the domestic Material Sub-group, there is no prospect of improvement in its financial condition, and it would be difficult or impossible for the Material Sub-group to restore its soundness through, for example, assistance from group companies and there are no appropriate alternatives, or the level of urgency is high as the Material Sub-group's financial condition has deteriorated suddenly and there is no time to issue a business improvement order or employ alternative means.

If internal TLAC triggering is selected due to unavoidable circumstances, with regard to internal TLAC allocated to a domestic Material Sub-group that has incurred losses, steps shall be taken to transfer said losses at the domestic Material Sub-group to the domestic resolution entity.

Specifically, if the FSA has deemed that the domestic Material Sub-group has or may have liabilities in excess of assets or be insolvent (including cases in which the resolution entity and Material Sub-group have informed the FSA that the said Material Sub-group has or may have liabilities in excess of assets or be insolvent), factors such as the availability of aforementioned alternative means, the level of urgency, etc. have been taken into account, and among the orders prescribed in Article 57-19(1) of the FIEA, an order for the restoration of soundness, including increasing capital and restoring liquidity at the Material Sub-group through the use of internal TLAC, has been issued to the domestic resolution entity (when the Material Sub-group has been recognized as effectively bankrupt), the principal shall be reduced or converted to equity in accordance with

the terms of the internal TLAC (loan agreement, etc.) (Note 1).

Before issuing an order, consideration shall be given to whether it would be difficult or impossible for the domestic Material Sub-group to restore its soundness through, for example, assistance from group companies. Furthermore, when an order has been issued, this shall be made public.

Even if internal TLAC triggering has occurred, it is possible, depending on the financial condition, etc. of the holding company and the group as a whole, that failure resolution for the group as a whole, as prescribed in B onwards, will not be performed (Note 2). In such cases, care shall be taken to ensure adequate communication with the markets so as to prevent any misconception that failure resolution for the group as a whole is to be commenced.

(Note 1) Regarding the meaning of “when the Material Sub-group has been recognized as effectively bankrupt,” orders issued by the FSA pursuant to Article 57-19(1) of the FIEA shall state that a financial crisis has been deemed to have occurred with the specified domestic Material Sub-group, and shall include the wording, “order for the restoration of soundness of Material Sub-group using internal TLAC” (therefore orders pursuant to Article 57-19(1) of the FIEA will not fall under “when the Material Sub-group has been recognized as effectively bankrupt” if they do not state that the FSA has deemed that a financial crisis has occurred with the specified domestic Material Sub-group, or if they do not include the wording “order for the restoration of soundness of Material Sub-group using internal TLAC”).

(Note 2) For example, this could include cases where no more measures will be taken under the Deposit Insurance Act with respect to the domestic resolution entity or the Material Sub-group, and cases where the Prime Minister may confirm the necessity to take "Specified Measures Under Item (i)" as set forth in Article 126-2, paragraph (1), item (i) of the DIA with respect to the Domestic Resolution Entity, or may confirm the necessity to take Specified Measures Under Item (i) or "Measures Under Item (i)" as set forth in Article 102, paragraph (1), item (i) of the DIA with respect to the Material Sub-groups in Japan.

#### B. Specified Confirmation by the Prime Minister

In the case of that internal TLAC triggering has occurred, when the Domestic Resolution Entity which absorbed the losses from the Material Sub-group fulfils the requirements for the application of Specified Measures Under Item (ii) as set forth in the DIA, the Prime Minister shall confirm the necessity to take Specified Measures Under Item (ii) (Article 126-2(1)(ii) of the same Act) and issue an Injunction Ordering Specified Management (Article 126-5 of the same Act) following deliberation by the Financial Crisis Response Council with regard to the Domestic Resolution Entity (i.e. the Non-viable Holding Company).

In the case of specified confirmation, etc., Basel III-eligible Additional Tier 1 instruments and Tier 2 instruments issued by the Non-viable Holding Company will be written off or converted into equity under the terms and conditions of such instruments prior to other liabilities including the External TLAC eligible debt liabilities.

In addition, a movable or claim pertaining to the business of the Non-viable Holding Company that shall be succeeded to the Specified Bridge Financial Institution, etc. under C below (limited to those designated by the Prime Minister) may not be seized pursuant to Article 126-16 of the DIA.

(Note) With regard to Covered SIBs, Additional Tier 1 instruments in the form of debt liabilities issued by Domestic Resolution Entity on and after March 31, 2013 will also be fully or partially written down or converted into equity when the consolidated Common Equity Tier 1 ratio that is calculated under the Pillar 1 Notices falls below 5.125%.

#### C. Transference of Business

The Non-viable Holding Company transfers its business (including shares of Material Sub-group held by the Non-viable Holding Company) related to systemically important transactions to the Specified Bridge Financial Institution, etc. (Article 126-34(3) of the DIA) incorporated by the Deposit Insurance Corporation of Japan (DICJ) with the permission of the court in lieu of the extraordinary resolution of the shareholders' meeting pursuant to Article 126-13, paragraph (1), item (iii) of the DIA, under a decision by the Prime Minister that the Specified Bridge Financial Institution, etc. should carry out the Specified Assumption of Business, etc. in order to succeed to the business of the Non-viable Holding Company pursuant to Article 126-34, paragraph (1), item (ii) of the DIA.

At this point, it is expected that the obligation (including those with under a year until maturity) of the External TLAC eligible debt liabilities will not be transferred to the Specified Bridge Financial Institution, etc., and the Non-viable Holding Company continues to be the obligor of such liabilities.

(Note) The Specified Bridge Financial Institution, etc. will transfer its business to financial institution(s) within two years in principle after the Specified Confirmation with regard to the Domestic Resolution Entity by the Prime Minister (Article 126-37, Article 96, paragraph (1) and Article 126-3 of the DIA).

#### D. Court Insolvency Proceedings of the Non-viable Holding Company

After transferring its business under (iii) above, the DICJ files a petition for the commencement of bankruptcy proceedings against the Non-viable Holding Company. It is expected that the Non-viable Holding Company will enter into "liquidation proceedings" (in particular, bankruptcy proceedings) through which the company will be dissolved, not into "reconstruction procedures" through which business continuity will be attempted.

In this case, creditors of the Non-viable Holding Company, including the holders of the External TLAC eligible debt liabilities, will receive liquidating distributions within the scope of the Bankruptcy Estate under the Bankruptcy Act or relevant laws, and thus will absorb the losses in the bankruptcy proceedings.

#### (ii) Crisis at Foreign Material Sub-group of Covered SIBs

In the case of a foreign Material Sub-group of Covered SIBs, the authorities in the jurisdiction in which the foreign Material Sub-group was established shall determine whether to perform internal TLAC triggering. When this decision is being made, it is likely that in accordance with the TLAC Term Sheet, a certain period will be established, during which it will be necessary to ascertain whether the Japanese authorities approve. In such a case, it shall be decided whether approval will be given after taking into account whether with assistance, etc. from group companies, it would be possible to restore the soundness of the Material Sub-groups.

Even if internal TLAC triggering regarding foreign Material Sub-groups has occurred, it is possible, depending on the financial condition, etc. of the holding company and the group as a whole, that failure resolution for the group as a whole, as prescribed in (i)B onwards, will not be performed. In such cases, care shall be taken to ensure adequate communication with the markets so as to prevent any misconception that failure resolution for

the group as a whole is to be commenced.

## (2) The FSA's Response as Host Authority

As in (1) above, also with respect to a foreign G-SIB's Material Sub-group in Japan, it needs to be kept in mind that internal TLAC triggering shall be limited to situations in which even if the supervisory authorities issues a business improvement order to the domestic Material Sub-group, there is no prospect of improvement in its financial condition, and it would be difficult or impossible for the Material Sub-group to restore its soundness through, for example, assistance from group companies and there are no appropriate alternatives, or the level of urgency is high as the Material Sub-group's financial condition has deteriorated suddenly (including a case where the entire financial group has fallen into a crisis) and there is no time to issue a business improvement order or employ alternative means.

If internal TLAC triggering is selected due to unavoidable circumstances, with regard to internal TLAC allocated to the Material Sub-group, steps shall be taken to concentrate said losses at the Material Sub-group to the group's resolution entity. In this case, the FSA will contact the relevant overseas authorities in advance insofar as practically possible, and discuss the steps to be taken after providing related information.

Specifically, if the FSA has deemed that the Material Sub-group has or may have liabilities in excess of assets or be insolvent (including cases in which the Material Sub-group has informed the FSA that the said Material Sub-group has or may have liabilities in excess of assets or be insolvent), and among the orders prescribed in Article 51 of the FIEA, an order for the restoration of soundness, including increasing capital and restoring liquidity at the Material Sub-group through the use of internal TLAC, has been issued to the Material Sub-group (when the foreign G-SIB's Material Sub-group in Japan has been recognized as effectively bankrupt), the principal shall be reduced or converted to equity in accordance with the terms of the internal TLAC (loan agreement, etc.) (Note).

In determining whether the Material Sub-group has or may have liabilities in excess of assets or be insolvent, the FSA shall also take into account factors such as the financial conditions of the entire group.

Before issuing an order, consideration shall be given to whether it would be difficult or impossible for the Material Sub-group to restore its soundness through, for example, assistance from group companies. In making the determination, the FSA shall give notice to the foreign home authority, and confirm whether they consent to the internal TLAC triggering by setting a period of not less than 24 hours but not longer than 48 hours after the time of the notice, in principle. If the home authority gives consent within the prescribed period or if the prescribed period passes after the time of the notice, the FSA determines that it would be difficult or impossible for the Material Sub-group to restore its soundness through, for example, assistance from group companies.

However, if failure resolution proceedings have commenced in the home country or internal TLAC triggering has occurred in another jurisdiction, and urgency is found in light of the status of the financial group and the impact on the Japanese financial system, etc., the period for confirming the consent could be shortened or the procedure for confirming the consent could be omitted as an exception.

When notifying the home authority of internal TLAC triggering, the FSA will also notify the relevant overseas authorities participating in the crisis management group (CMG) of the financial institution insofar as practically



possible.

(Note) Regarding the meaning of “when the foreign G-SIB’s Material Sub-group in Japan has been recognized as effectively bankrupt,” orders issued by the FSA pursuant to Article 51 of the FIEA shall state that a financial crisis has been deemed to have occurred with the specified foreign G-SIB’s Material Sub-group in Japan, and shall include the wording, “order for the restoration of soundness of Material Sub-group using internal TLAC” (therefore orders pursuant to Article 51 of the FIEA will not fall under “when the foreign G-SIB’s Material Sub-group in Japan has been recognized as effectively bankrupt” if they do not state that the FSA has deemed that a financial crisis has occurred with the specified foreign G-SIB’s Material Sub-group in Japan, or if they do not include the wording “order for the restoration of soundness of Material Sub-group using internal TLAC”).

## **V. Supervisory Evaluation Points and Various Administrative Procedures (Type II Financial Instruments Business)**

### V-1 Governance (Type II Financial Instruments Business)

Supervisors shall pay attention to the following points when examining the governance of Financial Instruments Business Operators (limited to Type II Financial Instruments Business Operators; the same shall apply in V).

#### V-1-1 Officers of Financial Instruments Business Operators

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly takes account of the following eligibility requirements in the decision-making process regarding proposals for the appointment of its officers:

- (i) A person who does not meet any of the ineligibility criteria (Article 29-4(1)(ii)(a) to (i) of the FIEA) and who did not meet any of them at the time of registration.
- (ii) A person who has not violated laws and regulations of the FIEA regarding financial instruments business or related business operations, or a person who has not been subjected to administrative actions taken based on laws and regulations.
- (iii) A person who has not damaged the interests of investors in relation to the conduct of the investment advisory and agency business and the investment management business.
- (iv) A person who has not engaged in an illegal or markedly inappropriate act, under particularly grave circumstances, regarding financial instruments business.

##### (2) Supervisory Method and Actions

In cases where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 29-4(1)(ii)(a) to (i) of the FIEA, or is found to have done so at the time when the business operator obtained registration under Article 29 of the FIEA, or where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 52(1) (vii) and (ix) and (x) of the FIEA, supervisors shall consider taking actions such as ordering the dismissal of the said officer based on Article 52(2) of the FIEA.

In addition, they shall hold an in-depth hearing regarding the decision-making process concerning the proposal for the appointment of the said officer and, when necessary, require the submission of a report based on Article 56-2(1) of the FIEA. Furthermore, supervisors shall consider taking actions such as issuing an order for business improvement, if the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem and the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

#### V-1-2 Adequate Staffing, etc. for Properly Conducting Financial Instruments Business

### (1) Major Supervisory Viewpoints

Supervisors shall examine whether Financial Instruments Business Operators are adequately staffed to properly conduct financial instruments business (limited to Type II financial instruments business; the same shall apply to V), in light of V-3-1 and whether the operators have established the system/structure necessary for operating financial instruments business appropriately.

### (2) Supervisory Method and Actions

Provisions under V-3-1 are part of a comprehensive set of elements that should be taken into consideration when supervisors examine whether a Financial Instruments Business Operator is adequately staffed to properly conduct financial instruments business, etc. Even if an officer or an employee is deemed to not meet the requirements, it should not automatically lead to the conclusion that the Financial Instruments Business Operator is not adequately staffed, etc. The important thing is, first and foremost, that Financial Instruments Business Operators strive to ensure on their own responsibility that they are adequately staffed, etc. in light of those requirements and other elements.

However, supervisors shall hold in-depth hearings regarding Financial Instruments Business Operators' view on their staffing, etc. and their decision-making process concerning the proposed appointments of officers and employees, in cases where a Financial Instruments Business Operator is deemed to have failed to take those elements into consideration sufficiently in the said decision-making process, and where it is deemed to be necessary and appropriate from the view point of protecting public interest and investors to hold such hearings. In addition, they shall require the submission of reports based on Article 56-2(1) of the FIEA when necessary.

Supervisors shall consider taking actions such as issuing an order for business improvement under Article 51 of the FIEA in cases where the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem as a result of the examination of the submitted report, and where the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

Furthermore, when the Financial Instruments Business Operator is deemed to not be adequately staffed to properly conduct financial instruments business, etc. as a result of the examination of the submitted report, supervisors shall consider taking necessary measures, including issuing an order for business suspension based on Article 52(1) of the FIEA.

It should be noted that if the Financial Instruments Business Operator is an individual person, supervisors shall examine the qualifications of the person from the above viewpoints, and as with the case of a corporation, they shall judge whether the person is sufficiently qualified, etc. to properly operate financial instruments business and take necessary supervisory actions.

## V-2 Appropriateness of Business Operations (Type II Financial Instruments Business)

### V-2-1 Appropriateness of Business Operations Related to Securities Equivalents Sales Business

#### V-2-1-1 Control Environment for Customer Solicitation and Explanations

##### (1) Points of Attention Regarding Notification of Necessary Information Related to Delivery of Securities Equivalents and Other Matters

When securities equivalents sellers, etc., (hereinafter referred to as “self-offering companies”), business operators engaging in Article 28(1)(ii) of the FIEA (hereinafter referred to as “securities equivalent sellers”), or business operators engaged in business regarded as Type II financial instruments business based on Article 29-5(2) of the FIEA (hereinafter referred to as “deemed Type II financial instruments business”; the same shall apply hereinafter)) have failed to properly notify customers of the following items, the situation shall be deemed to fall under the category of “situations in which information necessary for customers with regard to the status of delivery and other matters regarding the customers’ securities transactions is deemed not to have been properly provided,” as specified under Article 123(1)(viii) of the FIB Cabinet Office Ordinance.

- (i) Items that must be specified in writing when a contract is signed under Article 37-4(1) of the FIEA must be notified to customers.
- (ii) Items that must be specified in the report on the outstanding balance of transactions as specified under each item of Article 108(1) of the FIB Cabinet Office Ordinance.
- (iii) In addition to the items described in (i) and (ii) above, items related to the delivery of cash and securities (excluding cases where the transaction does not involve the direct delivery of cash and securities between the customer and the Financial Instruments Business Operator, such as when the delivery of cash is made through a financial institution and when the delivery of securities is made through a transfer settlement.) must be notified to customers.

##### (2) Points of Attention Regarding Solicitation of Investment Trusts

Given that investment trusts are instruments that are solicited and sold to a broad range of customer groups, including ordinary customers who do not have sufficient expert knowledge and experiences, it is important to correctly grasp customer needs taking into consideration their stages of life, status of their assets, purpose of their investment, etc. and provide products that meet such needs, and conduct solicitation that is appropriate according to the customer’s knowledge, experience and investment intention.

In addition, building an organizational structure for solicitation and sales that supports customers' stable asset building while expanding investment trust assets under management is likely to help business operations related to securities equivalents sales business build a stable profit structure that is not vulnerable to market fluctuations.

Therefore, supervisors shall, regarding solicitation of investment trust products, conduct supervision by paying particular attention to the following points, for example.

- (i) Whether the following points are explained in an easy-to-understand manner at the time of solicitation of

investment trust products in relation to costs incurred by customers (excluding specified investors; ; hereinafter the same shall apply in (ii)-(iii) ), such as commission on sales of investment trusts.

- A. The rates of commission on sales, and the amounts of commission on sales that varies in accordance with the amount being purchased, of the investment trusts to be solicited (a rough estimate shall be provided if the exact figure is not available at the time of solicitation.).
  - B. Costs incurred by customers after purchasing the investment trusts under solicitation (including, for instance, trust fees (real contribution rates including the asset management costs of the destination funds of investment in cases of investment trusts using a fund-of-funds strategy), the value of assets retained in the trust, etc.)
- (ii) With respect to dividends on investment trusts, whether it is explained to customers in an easily understandable manner, that all or part of the dividends may correspond to a partial repayment of principal.
  - (iii) Given that multi-currency funds involve not only a risk that the price of the invested asset will fluctuate but also the complex risk of currency fluctuation, when entering a contract with a customer that has no experience in investing in multi-currency funds, whether the securities company, etc. takes measures, such as receiving a written confirmation from the customer to the effect that he/she has understood the product characteristics and risk profile, and keeping it.
  - (iv) IV-3-1-2(3) shall be applied mutatis mutandis to points of attention regarding sales through solicitation targeting elderly customers.
  - (v) IV-3-1-2(8) shall be applied mutatis mutandis to points of attention regarding the solicitation of transactions that use the NISA Program.
  - (vi) IV-3-1-2(9) shall be applied mutatis mutandis to points of attention regarding sale of investment trusts, etc. which invest in assets other than specified assets.

### (3) Points of Attention Regarding Explanation of Important Items Related to Investment Trust Switching

Solicitation of frequent switches to other investment trusts may not necessarily lead to the customer's stable and effective asset building due to such factors as increased costs arising from additional commissions on sales and, in terms of asset management, and potential declines in investment results arising from an increase in cancellations shortly after establishing a new fund that lead to failure to efficiently manage the assets. In light of this, it is necessary to provide detailed explanations to customers on the characteristics of investment trusts related to switching between them and the advantages and disadvantages associated with the relevant switching even when there is a rationale for switching in light of customers' investment goals, market trends, etc., to enable customers to judge whether there is a need to make such switching after they have fully understood these points.

Reflecting these considerations, in cases where a securities equivalents seller, etc., has failed to provide explanations regarding the information necessary for customers to make a judgment as to whether there is a rationale for the switching of investment trusts or investment corporations (hereinafter referred to as "investment trusts, etc."), including the consistency of the switching and customers' investment purposes, in accordance with each customer's depth of understanding, and when it is found that it has failed to establish an internal control system for conducting effective verification, the situation shall be deemed to fall under the category of "situations in which explanations

regarding important items related to switching have not been provided to customers in the solicitation for switching of investment trust beneficiary certificates, etc.," as specified under Article 123(1)(ix) of the FIB Cabinet Office Ordinance. The information necessary for customers to make a judgment as to whether there is a rationale for switching may include roughly calculated profit and loss of the investment trust, etc. to be cancelled and comparisons of merchantability and expenses between the investment trust, etc. to be cancelled and that to be newly acquired, in addition to general items to be explained in relation to sale of investment trusts, etc., but it shall be noted that explanations may vary by case depending on each customer's knowledge, experience, status of assets, investment purposes, and the characteristics of relevant investment trusts, etc.

#### (4) Points of Attention Regarding Sale of Funds

##### (i) Points of Attention Regarding Responsibility for Providing Explanations Concerning Funds

Article 2(2)(v) and (vi) comprehensively define collective investment schemes (funds) and the rights to interests therein. Business operators which conduct sales, solicitation, offering and private placement activities related to such rights may include those which were not subject to supervision by the authorities before the enforcement of the FIEA, and those which handle funds that lack sufficient transparency and liquidity to enable investors to identify and evaluate their actual state.

In light of this, in cases where a securities equivalents seller or a self-offering company handles such rights, supervisors shall pay attention to whether it provides investors with sufficient explanations regarding the key points of association contracts, businesses in which relevant funds are involved and risks regarding rights based on the contracts.

In particular, when the actual state of a securities equivalents seller's business fits the description of the Multilevel Marketing activities as specified under Article 33(1) of the Act on Specified Commercial Transactions, supervisors shall pay attention to whether appropriate explanations based on the same act and the FIEA are provided and, when necessary, take appropriate actions in cooperation with the Ministry of Economy, Trade and Industry and other relevant organizations. In addition, the supervisors shall pay attention to whether the case constitutes a violation of the Act on Prevention of Pyramid Schemes, and when a violation is suspected, take appropriate actions, such as providing information to police and other relevant organizations.

##### (ii) Points of Attention Regarding Provision of Documents Prior to Signing Contracts

With regard to "Characteristics of contracts regarding buy or sell, or other transactions on holdings in businesses eligible for business-style investment" prescribed in Article 92-2(1)(iii) of the FIB Cabinet Office Ordinance, specifically, (1) Overview of businesses eligible for investment to which funds invested by customers are assigned, (2) that customers themselves need to make judgment on the actual use of the funds they invested and the status of account balance based on information obtained from the individuals operating the business to which the investment is made, and (3) that documents shall show that there is no guarantee on the profitability of the business to which the investment is made.

#### (5) Points of Attention Regarding Sale of Securitization Products (Assurance of Traceability of Securitization

## Products)

Securities equivalents sellers include business operators engaging in the activities specified under Article 28(2)(ii) of the FIEA with regard to the trust beneficiary rights as specified under Article 2(2)(i) and (ii) of the FIEA (hereinafter referred to as “trust beneficiary rights sellers”). It is important that regarding trust beneficiary rights handled by trust beneficiary rights sellers, which have the same nature as securitization products, information related to the underlying assets is also properly communicated to investors. With this in mind, in the case of trust beneficiary rights sellers who handle the sale, etc. of trust beneficiary rights, supervisors shall pay attention to the following points, in accordance with the self-regulatory regulations of the Japan Securities Dealers Association, entitled “Regulations Concerning the Distribution, etc. of Securitized Products.”

It should be noted that even if trust beneficiary rights sellers play only a limited role in transactions, such as acting as a sales agent, it is desirable that they provide support where possible as long as they deal with investors.

- (i) Whether before selling securitization products, the trust beneficiary rights seller collects information regarding the contents of the underlying assets, the status of originators’ continuous retention of the risks and the risks involved therein and conducts sufficient analysis to provide appropriate explanations.
- (ii) Whether the trust beneficiary rights seller has established the internal procedures and rules necessary for providing information regarding the risks involved in the underlying assets and liquidity risks not reflected in credit ratings, rather than relying exclusively on credit ratings, when they sell securitization products.
- (iii) Whether the trust beneficiary rights seller has established the internal procedures and rules necessary for providing information in ways that enable customers investing in securitization products to trace information regarding the contents of the underlying assets and the risks involved therein, if requested to do so by the investors.
- (iv) Whether the trust beneficiary rights seller has developed a control environment for evaluating and calculating theoretical prices and quickly informing customers of them, even when it is difficult to determine market prices. Whether trust beneficiary rights sellers avoid evaluating and calculating theoretical prices in an arbitrary manner, so as to refrain from giving priority to promoting the arbitrary use of the information for specific purposes.

## (6) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the control environment for customer solicitation and explanations of a securities equivalents seller, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities equivalents seller etc., by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the securities equivalents seller, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities equivalents seller etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

## V-2-1-2 Discretionary Trading Contracts, etc.

### (1) Points of Attention Regarding Discretionary Trading Contracts with Foreign Securities Companies

When supervisors have received a notification for the signing of a contract based on Article 16(1)(viii)(b) of the Cabinet Office Ordinance Regarding Definitions, they shall pay attention to the following points:

- (i) Whether the division that executes transactions regarding the said agreement is clearly separated from the divisions that receive and execute orders for other brokerage transactions.
- (ii) Whether it is ensured that account documents are compiled in ways to enable the identification of transactions related to the said agreement.

### (2) Scope of Specified Agreements by Securities Equivalents Sellers, etc.

Specified agreements as prescribed under Article 123(1)(xiii)(b) and (c) of the FIB Cabinet Office Ordinance include the following agreements:

- (i) Agreements regarding prices higher (in the case of sell orders) or lower (in the case of buy orders) than the specified prices (including prices determined with a prescribed method).
- (ii) An appropriate range determined with a specified price as a base point.
- (iii) Agreements regarding the determination of prices at the discretion of securities equivalents sellers, etc., on the condition that they follow the best execution practice (so-called CD order) in daily trading.
- (iv) Targeting of prices determined through a prescribed method such as volume weighted averaging (so-called VWAP target order).

### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the transactions, as specified under Article 123(1)(xiii)(a) to (e) of the FIB Cabinet Office Ordinance of a securities equivalents seller, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities equivalents seller, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the securities equivalents seller, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities equivalents seller, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider taking necessary actions, including issuing an order for business suspension based on Article 52(1) of the FIEA.

## V-2-1-3 Measures to Prevent Misrecognition

### (1) Points of Attention Regarding Measures to Prevent Securities Equivalents Sellers, etc., from Being Misrecognized as Other Financial Institutions

In cases where the securities equivalent seller, etc. conducts business operations, with its headquarters or sales



branches located in a building also occupied by another financial institution, supervisors shall examine whether the securities equivalents seller, etc. provides sufficient explanations regarding the following matters to customers, from the viewpoint of preventing customers from misrecognizing the said securities equivalents seller, etc. as the said financial institution.

- (i) The securities equivalents seller, etc. and the financial institution sharing the building are different corporations.
- (ii) Products and services provided by the securities equivalents seller, etc. are different from those provided by the said financial institution.

## (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding misrecognition prevention measures taken by a securities equivalents seller, etc., through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the securities equivalents seller, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2 (1) of the FIEA. When the securities equivalents seller, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the securities equivalents seller, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 52 (1) of the FIEA.

### V-2-1-4 Segregated Management of Investments Through Crypto-and Other Assets, etc.

When a securities equivalents seller, etc. conducts purchase and sale, etc. of rights pertaining to equity in a collective investment scheme (fund), the invested or contributed money needs to be managed separately from own property of the person conducting business by using the invested or contributed money, based on Article 40-3 of the FIEA and Article 125 of the FIB Cabinet Office Ordinance.

In addition, when crypto-and other assets are invested or contributed, the securities equivalents seller, etc. needs to appropriately manage the crypto-and other assets by entrusting the management to a crypto-asset exchange service provider or a trust company, etc. Therefore, supervisors shall oversee whether the securities equivalents seller, etc. appropriately confirms the control environment, etc. for reducing the risk of leakage developed by the outsourced crypto-asset exchange service providers or trust company, etc.

## V-2-2 Appropriateness of Business Operations Related to Market Derivatives Business Operators

### V-2-2-1 Control Environment for Legal Compliance

If market derivatives business operators (business operators which engage in the activities specified under Article 28(2)(iii) of the FIEA; the same shall apply hereinafter) are to gain the trust of investors, thereby building trust in the derivatives trading market, it is important that they strive to manage their business operations in an appropriate manner while strictly complying with laws, regulations and various business rules, and fully recognizing

their roles as derivatives market players.

Market derivatives business operators' control environments for legal compliance shall basically be examined based on the supervisory viewpoints and method specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules established by self-regulatory organizations.

In cases where a market derivatives business operator receives a deposit of money from a customer for currency-related market derivatives transactions, etc. (referring to the activities specified in Article 143(3)(i) and (iii) of the FIB Cabinet Office Ordinance; the same shall apply hereafter), since such an action constitutes securities, etc. management business, it should be kept in mind that the business operator needs to register as a Type I financial instruments business. IV-3-3-1 shall be applied mutatis mutandis to the points of attention and supervisory methods regarding the control environment for legal compliance in cases where the market derivatives business operator manages currency-related market derivatives transactions, etc. without depositing the money deposited by customers in an exchange.

#### V-2-2-2 Control Environment for Customer Solicitation and Explanations

##### (1) Points of Attention Regarding Advertisements, etc.

- (i) Whether the market derivatives business operator uses descriptions that could cause misunderstandings regarding domestic derivatives markets, for which it can act as a broker, and overseas derivatives markets.
- (ii) In cases where losses exceeding the amount of cash margin and other deposits may arise due to rapid market movements despite the Loss-Cutting Rule, whether the market derivatives business operator properly indicates this risk in the advertisement.
- (iii) Whether the market derivatives business operator has forced customers to continue attending seminars and similar events despite their expression of unwillingness to do so (including cases where it has effectively forced them to do so). It should be kept in mind that this kind of practice shall be deemed to meet the provision of Article 38(vi) of the FIEA (known as "prohibition of re-solicitation").

##### (2) Points of Attention Regarding Explanation Documents

"The Key Points of the Status of Internal Control" shall describe specific arrangements and procedures for handling complaints and inquiries from customers and for conducting internal audits.

##### (3) Points of Attention Regarding the Distribution of Notices of Warning Concerning the Solicitation Methods, etc. for Market Derivatives Transactions

IV-3-3-2(3) shall be applied mutatis mutandis to the points of attention regarding market derivatives business operators issuing alerts to customers when conducting market derivatives transactions.

##### (4) Points of Attention Regarding Provision of Pre-Contract Documents

- (i) The "reasons for the possibility of a loss exceeding the principal amount," as specified under Article

82(iv)(b) of the FIB Cabinet Office Ordinance shall include a rapid market movement that could cause a loss exceeding the principal amount despite the Loss-Cutting Rule.

- (ii) The “reasons for the termination of the relevant financial instruments transaction contract,” as specified under Article 82(viii) of the FIB Cabinet Office Ordinance shall include items related to the Loss-Cutting Rule.
- (iii) The “types and calculation methods of cash margin and other deposits to be made by customers with regard to the relevant derivatives transactions, etc.,” as specified under Article 93(1)(iv) of the FIB Cabinet Office Ordinance shall include items related to minimum margin deposits.
- (iv) Regarding currency-related transactions, the “major terms and other basic items regarding derivatives trading,” as specified under Article 93(1)(vii) of the FIB Cabinet Office Ordinance shall include items related to the method of determining prices of financial instruments, etc., and the Swap Point. In cases where the Swap Point may be either received or paid by customers and where a loss may arise, these possibilities shall be properly indicated.

#### (5) Points of Attention Regarding the Accountability of Currency-Related Market Derivatives Business Operators

IV-3-3-2(4)(vi) shall be applied mutatis mutandis to points of attention regarding matters to be explained in cases where a currency-related market derivatives business operator manages the money deposited by customers without depositing it in an exchange. Also, IV-3-3-2(4)(vii) shall be applied mutatis mutandis to points of attention regarding explanations on loss-cut transactions that are conducted by currency-related market derivatives business operators.

#### (6) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a market derivatives business operator’s control environment for customer solicitation and explanations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the market derivatives business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the market derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the market derivatives business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### V-2-2-3 Exercise of Checking Function against Investors

Provisions in IV-3-2-3 (4) shall apply mutatis mutandis to market derivatives operators.

#### V-2-2-4 Discretionary Trading Contracts, etc.

#### (1) Points of Attention Regarding Discretionary Trading Contracts with Foreign Financial Futures Companies

When supervisors receive a notification from a market derivatives business operator for the signing of a contract based on Article 16(1)(viii)(b) of the Cabinet Office Ordinance Regarding Definitions, they shall pay attention to the following points:

- (i) Whether the division that executes transactions regarding the said contract is clearly separated from the divisions that receive and execute orders for other brokerage transactions.
- (ii) Whether it is ensured that account documents are compiled in ways to enable the identification of transactions related to the said contract.

## (2) Scope of Specified Agreements by Market Derivatives Business Operators

Specified agreements under Article 123(1)(xiii)(b) and (c) of the FIB Cabinet Office Ordinance include the following agreements:

- (i) Agreements regarding rewards and contracted values higher or lower than the specified rewards and contracted values (including rewards and contracted values determined with a prescribed method)
- (ii) Agreements regarding an appropriate range determined with a specified reward or a contracted value as a base point.
- (iii) Agreements regarding the determination of rewards and contracted values at the discretion of market derivatives business operators on the condition that they follow the best execution practice in daily trading.

## (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a market derivatives business operator's practices, as specified under Article 123(1)(xiii)(a) to (e) of the FIB Cabinet Office Ordinance through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the market derivatives business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA, while paying consideration to the above viewpoints. When the market derivatives business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the market derivatives business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

V-2-2-5 Control Environment for Managing Risk Related to Currency-Related Market Derivative Transactions, etc.

Regarding currency-related market derivatives transactions (referring to currency-related market derivatives transactions prescribed in Article 123(3) of the FIB Cabinet Office Ordinance) and currency-related foreign market derivatives transactions (referring to currency-related foreign market derivatives transactions prescribed in Article 123(5)) made with customers, managing one's own risks is important, and therefore the provisions of IV-3-3-5(4) and (8)(ii) shall be applied mutatis mutandis to the establishment of control environments for risk management and to the execution of business.

### V-2-3 Appropriateness of Business Operations Related to Deemed Type II Financial Instruments Business

Deemed Type II financial instruments business is defined as the handling of private placements made with qualified investors, with little risk of the securities being transferred from the acquirer to a person other than a qualified investor. Therefore, the management of customer attributes and so forth is important.

To this end, supervisors shall check, with due consideration of the following points, whether customer attributes and so forth are being managed with respect to deemed Type II financial instruments business.

(1) Case of handling private placement of electronically recorded transferable rights that must be indicated on securities, etc.

- (i) Whether the business operator confirms that the customer is a qualified investor.
- (ii) Whether the business operator confirms that the solicitation for acquisition is confined to private placements.
- (iii) Whether the business operator compiles and stores internal records on the confirmed details.
- (iv) Whether the business operator takes technical measures that make it impossible to transfer, to a person other than a qualified investor, property value on which the electronically recorded transferable rights that must be indicated on securities, etc. that are subject to private placement are indicated.  
(Note) Measures that make it impossible to transfer to a person other than a qualified investor could include, for example, a measure where transfer of property value on which electronically recorded transferable rights that must be indicated on securities, etc. are indicated requires advance approval of the issuer or the Financial Instruments Business Operator handling private placement, and the transfer does not take effect unless the person giving the approval appropriately confirms in advance that the transferee is a qualified investor.
- (v) Whether the business operator confirms the effectiveness of the measures referred to in (iv) above.
- (vi) Whether the business operator examines the implementation status of (i) through (v) above by means of internal audits and so forth.
- (vii) Whether the business operator has established internal rules on the procedures involved in (i) through (vi) above.

(2) Cases other than (1)

- (i) Whether the business operator confirms that the customer is a qualified investor.
- (ii) Whether the business operator confirms that the solicitation for acquisition is confined to private placements.
- (iii) Whether the business operator compiles and stores internal records on the confirmed details.
- (iv) Whether the business operator confirms that the matters listed in each item of Article 16-5 of the FIB Cabinet Office Ordinance have been stipulated in any contracts for the transfer of securities.
- (v) Whether the business operator confirms the fulfillment of the contract details set forth in (iv) above.
- (vi) Whether the business operator examines the implementation status of (i) through (v) above by means of

internal audits and so forth.

- (vii) Whether the business operator has established internal rules the procedures involved in (i) through (vi) above.

#### V-2-4 Appropriateness of Business Operations Related to Financial Instruments Business Operators Who Provide Service of Handling Electronic Public Offerings

##### V-2-4-1 Basic View on Financial Instruments Business Operators Who Provide Service of Handling Electronic Public Offerings

Financial instruments business operators who provide service of handling electronic public offerings are required to provide appropriate information through the Internet in order to protect investors, as information on the Internet is expected to influence investment decisions of investors. Supervisors shall oversee such business operators by paying attention to the following points.

##### V-2-4-2 Appropriateness of Service of Handling Electronic Public Offerings

When a Financial Instruments Business Operator handles public offering, secondary distribution or private placement, or solicit sales transactions for specified investors, involving securities that are prescribed in each item of Article 3 of the FIEA or those that are not listed on a financial instruments exchange, by a method using an electronic data processing system or that using communications technology, such an act constitutes a service of handling electronic public offerings. Verification of the appropriateness of business operations by Financial Instruments Business Operators that provide services of handling electronic public offerings shall be conducted by paying attention to the following points.

##### V-2-4-2-1 Control Environment for Legal Compliance

The control environment for legal compliance by Financial Instruments Business Operators that provide services of handling electronic public offerings shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules established by self-regulatory organizations.

##### V-2-4-2-2 Control Environment for Customer Solicitation and Explanations

Financial Instruments Business Operators who provide service of handling electronic public offerings shall pay attention to whether they are providing investors with sufficient explanation regarding the key points of association contracts, the businesses in which relevant funds are involved and the risks regarding rights based on the contracts.

##### V-2-4-2-3 Provision of Information Intended to Protect Investors

In providing services of handling electronic public offerings, Financial Instruments Business Operators that provide such services are required to put information that may have material impact on investors' investment decisions on a website such operators set up, and maintain such information accessible to investors during the period

in which electronic public offerings are being made. As such, the following points shall be taken in consideration regarding services of handling electronic public offerings.

(1) Posting of trade names, etc.

In providing services of handling electronic public offerings, whether items required to be included in a sign as specified in Article 36-2(1) of the FIEA are posted in a noticeable location on the website. In cases of Type 2 Small-Amount Electronic Public Offering Services Operator (as specified in Article 29-4-3(2) of the FIEA; the same shall apply herein after), whether such an operator posts items prescribed in Article 29-4-3(3) of the FIEA in a noticeable location on the website.

(2) Representation of Items That Can Have Material Impact on Investors' Judgment

Providers of services handling electronic offerings are required to maintain information prescribed in Article 146-2(3) of the FIB Cabinet Office Ordinance in a form accessible to investors on their website. Posting of the relevant information shall be examined by paying attention to the following points.

- (i) Whether the relevant information is displayed clearly and accurately in locations that are easy to see on the website. Also whether appropriate and easy-to-understand descriptions are made, from the viewpoint of protecting investors.
- (ii) Whether the operator is making efforts not to impair the ability of investors to understand by, for example, first displaying important information that has material impact on their judgment, in light of purposes of posting relevant information on the website as well as aims of provisions regarding method of indicating relevant information
- (iii) Whether relevant information is displayed on the website in ways in which investors can access its location easily during the period in which the service of handling electronic public offerings is being provided

V-2-4-3 Appropriateness of Electronic-Application-Style Services of Handling Electronic Public Offerings

Financial Instruments Business Operators providing a service of handling electronic public offerings under the electronic application style are required to maintain a system to ensure appropriate screening of the issuer's business plan and appropriate provision of information, as well as provide information regarding the Financial Instruments Business Operators themselves. The appropriateness of services handling electronic public offerings in electronic application style shall be checked by paying attention to V-2-4-2 and the following points.

V-2-4-3-1 System to Control Operations

(1) Appropriate Screening Regarding Business Plan, Etc., of Issuer

Whether appropriate rules are introduced regarding screening of items specified in Article 70-2(2)(iii) of the FIB Cabinet Office Ordinance, and meaningful screening is accurately conducted. Also whether a system to accurately verify the results of such screening is in place. In addition, whether a system is in place to ensure

appropriate screening can be conducted to make sure the business plan is based on rational reasoning and that a reasonable target amount is set for the offering in view of the said business plan and the issuer's financial status

## (2) Points of Attention Regarding Level of Offer Target and Handling of Subscribed Amount

(i) Whether representations are made to avoid misunderstanding by investors on the "method to handle subscribed amount when the target of amount of offer is not reached or such a target is exceeded" prescribed in Article 70-2(2)(iv) of the FIB Cabinet Office Ordinance. Examinations, for example, shall be conducted by paying attention to the following points.

A. When securities are issued even though the subscribed amount failed to reach the target, whether the reason is clearly presented that issuance of the said securities is deemed rational in view of the issuer's business plan and the purpose of the funds being raised so as to prevent misunderstanding on the part of investors

B. When the subscribed amount exceeds the target of the offer and the securities are issued for the higher amount, whether the purpose of the funds being raised to the amount exceeding the amount of offering target and the possible impact the amount exceeding the amount of offering target may have on the details of the issuer's business plan are clearly explained in ways that prevents misunderstanding on the part of investors.

(ii) In cases where the securities are issued only when subscription reaches the target subscription amount, whether "measures have been taken to ensure that the issuer will not receive the payment of subscription price (including an amount similar thereto; the same applies in item (vii) and Article 83(1)(vi)(d)) before the target subscription amount is achieved" as prescribed in Article 70-2(2)(v) of the FIB Cabinet Office Ordinance, for example, by providing notice of the account into which subscribed amounts are paid when the total subscribed amount reaches the target subscription amount.

## (3) Points of Attention Regarding Cancellation of Application

Whether there are measures in place to ensure investors can retract their application or cancel the contract with the issuer with regard to public offering or private placement of securities handled in services handling electronic public offerings in an electronic application style, etc.

When judging whether the above-mentioned measures are employed to a satisfactory degree, the following points, for example, shall be considered.

(i) Whether applicants can retract their application unconditionally during the application cancellation period. For example, whether the Financial Instruments Business Operator providing a service of handling electronic public offerings in the electronic application style, in facing a retraction of application, may be able to claim payment of a penalty (regardless of what this is called, for example, damages, fees, etc.) for the said retraction

(ii) Whether clear representation is made that investors can retract their application during a specified period as well as about necessary information for retracting an application (such as the method for retraction, procedure, contact information and how to get refunded on the payment of subscription amount that have



already been paid, etc.)

#### (4) Ensuring Provision of Information About Status of Business Operation

Whether measures are taken to ensure that the issuer periodically provide the customer with information about the former's operational status (such a measure can be, for example, a scheme in which the Financial Instruments Business Operator providing a service of handling electronic public offerings in the electronic application style receives reports on the issuer's operational status, and disclose them to investors by posting them on the said Financial Instruments Business Operator's website or sending them by email.

#### V-2-4-4 Appropriateness of Type 2 Small-Amount Electronic Public Offering Services

Part of the registration requirements for Type 2 Small-Amount Electronic Public Offering Services (prescribed under Article 29-4-3(4) of the FIEA; the same shall apply hereinafter) has been relaxed for the Type II Financial Instruments Business for Financial Instruments Business Operators who handle Electronic Public Offering Services that meet requirements including that the issued amount of the securities (referring to securities specified under Article 29-4-3(4) of the FIEA; the same shall apply in V-2-4-4) issued is small. The appropriateness of Type 2 Small-Amount Electronic Public Offering Services shall be checked in accordance with V-2-4-2 and V-2-4-3, as well as by paying attention to the following points.

##### V-2-4-4-1 Control Environment for Customer Solicitation and Explanations

###### (1) Supervisory viewpoints

As services by Type 2 Small-Amount Electronic Public Offering Services Operators for public offerings or private placement of securities are provided only through the method utilizing communications technology as specified in each item of Article 6-2 of FIB Cabinet Office Ordinance, such operators are banned from soliciting acquisition of securities using methods other than the specified one. (For example, they cannot use solicitation using phone calls or visits customers individually.) It should be noted, therefore, that Type 2 Small-Amount Electronic Public Offering Services Operators soliciting acquisition using methods other than the specified one do not qualify for the special clause of Article 29-4-3 of the FIEA, resulting in such operators operating Type II Financial Instruments Business without registration under the FIEA.

###### (2) Supervisory Method and Actions

If a Type 2 Small-Amount Electronic Public Offering Services Operator is found to be handling public offering or private placement of securities using methods other than that utilizing the communications technology specified in each item in Article 6-2 of the FIB Cabinet Office Ordinance, supervisors shall conduct in-depth hearing and, if necessary, instruct submission of a report in accordance with provisions of Article 56-2(1) of FIEA to look into status of spontaneous efforts to improve the situation at such operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the operator is deemed

to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### V-2-4-4-2 Points of Attention Regarding Total Issued Amount of Securities

##### (1) Basic Points to Consider

Whether the Type 2 Small-Amount Electronic Public Offering Services Operator has taken necessary and appropriate measures to prevent the total issued amount of securities of which it handles public offering or private placement from exceeding 100 million yen and investors acquiring relevant securities (excluding specified investors; same(2)and(3)) from paying in excess of 500,000 yen

When judging whether the above-mentioned measures are employed to a satisfactory degree, the following points, for example, shall be considered.

- (i) Whether the operator has checked to see if the issuer of securities for public offering or private placement, in relation to calculation method based on provisions of Article 16-3(1) of the FIB Cabinet Office Ordinance, issued the same type of instrument through a different Financial Instruments Business Operator in the past one-year period before the day the said public offering or private placement is started or using a method specified in Article 2(8)(vii) of FIEA (along with the specific amount of issuance if the issuer is found to have done so) by means of an appropriate method before starting to solicit acquisition of the securities, such as by examining documents showing calculations and, if necessary, questioning the issuer.
- (ii) Whether the operator has checked to see if the investor in securities for public offering or private placement, in relation to calculation methods based on provisions of Article 16-3(2) of the FIB Cabinet Office Ordinance, has acquired the same type of securities issued by the same issuer in the past one-year period before the day the said public offering or private placement is started (and that the operator has confirmed the specific acquisition value of such securities if it is possible to obtain the figure), using an appropriate method.

##### (2) Points of Attention When Service Becomes Disqualified for Type 2 Small-Amount Electronic Public Offering Services Operators

It should be noted that if the total amount of issued securities for public offering or private placement that are handled by a Type 2 Small-Amount Electronic Public Offering Services Operator exceeds 100 million yen or the person acquiring the said securities pay more than 500,000 yen, such a service becomes disqualified from the special clause of Article 29-4-2 of FIEA, resulting in the said Type 2 Small-Amount Electronic Public Offering Services Operator providing services under the Type II Financial Instruments Business.

##### (3) Supervisory Method and Actions

If a Type 2 Small-Amount Electronic Public Offering Services Operator is found to be handling public offering or private placement of securities whose issuance totals 100 million yen or more or the amount paid by the person acquiring the said securities exceeds 500,000 yen, supervisors shall conduct in-depth hearing and, if necessary,

request submission of reports based on provisions of Article 56-2(1) of FIEA to look into status of spontaneous efforts to improve the situation at such an operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

#### V-2-5 Appropriateness of Business Operations Related to Financial Instruments Business Operators That Handle Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

(1) Financial instruments business operators that handle electronically recorded transferable rights that must be indicated on securities, etc. are required to appropriately develop a control environment from the viewpoint of investor protection in light of the high degree of freedom in the design of electronically recorded transferable rights that must be indicated on securities, etc. and their transferability. Supervisors shall oversee such business operators by applying mutatis mutandis V-2-1 or V-2-3, as well as IV-3-6.

(Note) In the case where the Financial Instruments Business Operator provides electronic public offering services, supervisors shall also refer to V-2-4.

(2) A person needs to satisfy the requirements prescribed in Article 9-2 of the Cabinet Office Ordinance Regarding Definitions in order to be a holder of electronically recorded transferable rights that must be indicated on securities, etc. that are excluded from electronically recorded transferable rights based on Article 9-2 of the Cabinet Office Ordinance Regarding Definitions (hereinafter referred to as "electronically recorded transferable rights excluded from application"), for which public offering can be conducted by a Financial Instruments Business Operator. Therefore, management of attributes of the customer that is to become a holder and the scheme of transfer of the rights, etc. are important. In particular, supervisors shall confirm whether the Financial Instruments Business Operator conducts management of customer attributes, etc. by paying attention to the following points:

- (i) In issuing or transferring electronically recorded transferable rights excluded from application, whether the issuer or the Financial Instruments Business Operator handling the rights, etc. confirms in advance that the person who is to hold the rights, etc. satisfies the requirements prescribed in Article 9-2(1)(i) of the Cabinet Office Ordinance Regarding Definitions.
- (ii) In transferring property value pertaining to electronically recorded transferable rights excluded from application, whether the business operator confirms each time that the technical measures for which a request from the person holding the rights and the approval of the issuer of the rights are required have been taken. In addition, it should be kept in mind that those requirements are not regarded to be satisfied if it is provided in a contract, etc. that when a request for transfer of rights, etc. reaches the issuer, it is deemed that the issuer has given the approval, or if a scheme is used to treat that the issuer's approval is automatically deemed to

have been given when a transfer contract is concluded.

- (iii) Whether the business operator compiles and stores internal records on the confirmed details.
- (iv) Whether the business operator confirms the effectiveness of the measures referred to in (i) and (ii) above.
- (v) Whether the business operator examines the implementation status of (i) through (iv) above by means of internal audits and so forth.
- (vi) Whether the business operator has established internal rules on the procedures involved in (i) through (v) above.

#### V-2-6 Actions to Take When Acquiring Information Regarding Continuity of Business

Not only a juridical person but also an individual may operate a financial instruments business. In addition, since there are no financial requirements for engaging in this business, other than the minimum capital requirement (or the deposit for operation required for an individual), financial instruments business operators are excluded from the monitoring in terms of the net assets requirement or capital adequacy requirement. Therefore, it should be noted that there is a likelihood that a financial instruments business operator will file a petition for commencement of bankruptcy proceedings, rehabilitation proceedings or reorganization proceedings (hereinafter referred to as a “petition for commencement of bankruptcy proceedings, etc.”) before the supervisory authorities properly identify the business operator’s financial conditions. Furthermore, in cases where it has been identified that, for example, a Financial Instruments Business Operator is insolvent and it could end up being unable to make payments, supervisors must strive to confirm facts in order to fully examine the need for action from the perspective of protecting investors.

With this in mind, where the supervisory authorities have identified that a Financial Instruments Business Operator could fall into insolvency, or where they have received a notification regarding the filing of a petition for commencement of bankruptcy proceedings, etc. or identified the likelihood of the filing of such petition, they shall take the following measures in addition to those mentioned in III-3-2, so as to ensure the protection of investors.

Local Finance Bureaus shall take actions that are suitable for the circumstances of each case, and shall immediately inform the FSA of the facts regarding the case as well as what actions should be taken, thereby coordinating such actions.

#### (1) Response to Cases where a Financial Instruments Business Operator is Identified as Having Financial Problems

- (i) Supervisors shall confirm facts by conducting hearings on the financial conditions of the subject business operator and on the status of their contracts with customers (in the case of a securities equivalents seller, etc., including the condition of businesses in which the funds it handles are involved; and, in the case of a trust beneficiary rights seller, including the condition of the underlying assets of the trust beneficiary rights it handles), and they shall encourage the business operator to formulate policies to eliminate the risk of it falling into insolvency.
- (ii) In cases where it becomes clear, as a result of a hearing, that a problem has arisen related to the protection of investors, supervisors shall promptly issue an order for the production of a report based on Article 56-2(1) of the FIEA regarding all the facts of the case and measures for resolving the situation.

(iii) After receiving the report, supervisors shall follow up on the progress of the resolution measures, and in cases where no improvements are apparent, they shall examine other actions, including issuing an order for business improvement based on Article 51 of the FIEA.

(2) When Recognizing Information on the Filing of Petition for Commencement of Bankruptcy Proceedings, etc.

(i) Supervisors shall confirm whether the financial instruments business operator has made a notification under Article 50(1)(vii) of the FIEA, and request the business operator to quickly take actions as necessary.

(ii) By issuing an order for production of a report under Article 56-2(1) of the FIEA, supervisors shall quickly identify the facts regarding the case, as well as the financial instruments business operator's financial conditions, the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof), how the business operator responds to customers and the business operator's policy for continuing the business.

(iii) Supervisors shall follow up the status of fulfillment of the actions reported as mentioned in (ii) above, and shall request the financial instruments business operator to brush up its policy for continuing the business. In such case, supervisors shall also consider issuing an order for business improvement under Article 51 of the FIEA.

(3) When Recognizing Information on the Filing of Petition for Commencement of Bankruptcy Proceedings, etc. by Parent Company, etc.

In cases where the party who is likely to have a material impact on the business management of a financial instruments business operator by filing a petition for commencement of bankruptcy proceedings, etc. (hereinafter referred to as the "parent company, etc." in V-2-6) has actually filed a petition for commencement of bankruptcy proceedings, etc. against the financial instruments business operator, supervisors shall, by issuing an order for production of a report under Article 56-2(1) of the FIEA, quickly identify the financial instruments business operator's financial conditions in combination with the most recent conditions of the parent company, etc., the business relationships with the parent company, etc., the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof), and the business operator's policy for continuing the business.

(4) When an Order of Commencement of Bankruptcy Proceedings, etc. Is Made

(i) Supervisors shall confirm whether the financial instruments business operator has made a notification under Article 50-2(1)(iv) of the FIEA, and request the business operator to quickly take actions as necessary.

(ii) Supervisors shall try to ensure cooperation with the bankrupt trustee if it is necessary to do so from the perspective of protecting investors.

(5) When the Financial Instruments Business Operator's Business Place Cannot Be Ascertained

In accordance with Article 52(4) of the FIEA, if the financial instruments business operator fails to make a notification after 30 days have passed since public notice was given regarding the fact that the business operator's

business place cannot be ascertained, the registration of the financial instruments business operator shall be rescinded.

(6) When Acquiring Other Information Implying the Possibility of Raising the Issue of the Continuity of Business of a Financial Instruments Business Operator or Parent Company, etc.

- (i) Supervisors shall, through a voluntary hearing, quickly identify the facts regarding such information, as well as the financial instruments business operator's financial conditions, the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof), and the business operator's policy for continuing the business.
- (ii) In cases where the business instruments business operator does not respond to a hearing mentioned in (i) or it is found as a result of such hearing that there is a concern over the continuity of the business of the financial instruments business operator, supervisors shall quickly identify the facts concerned by issuing an order for production of a report under Article 56-2(1) of the FIEA. Supervisors shall also consider issuing an order for business improvement under Article 51 of the FIEA when it is necessary to do so from the perspective of protecting investors.

#### V-2-7 Points of Attention Regarding Supervision of Non-Affiliated Business Operators

##### (1) Major Supervisory Viewpoints

- (i) In the case of a Financial Instruments Business Operator who does not have membership in any Financial Instruments Firms' Association (excluding individuals; referred to as "Non-Affiliated Business Operators" in V-2-7), whether it has developed internal rules that are in line with Rules Set by Associations, etc.
- (ii) Whether the Financial Instruments Business Operator has developed a control environment that ensures appropriate compliance with internal rules (e.g., information sharing among officers, information sessions for employees and examination of status of compliance).
- (iii) When Rules Set by Associations, etc. have been revised, whether the Financial Instruments Business Operator makes sure to quickly review and revise internal rules accordingly.

##### (2) Supervisory Method and Actions

If a problem is found regarding the creation and revision of internal rules at a Non-Affiliated Business Operator and the status of compliance, supervisors shall conduct an in-depth inquiry and, if necessary, have the operator submit a report based on provisions of Article 56-2(1) of the FIEA to look into the status of spontaneous efforts to improve the situation at the said Financial Instruments Business Operator. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. Further, if, after requesting a report, an operator is not confirmed to have introduced internal rules that are in line with Rules Set by Associations, etc., or that it has failed to introduce a system to ensure compliance with the relevant internal rules, supervisors shall consider necessary responses, including issuance of a Business Improvement Order based on provisions of Article

52(1) of the FIEA.

### V-3 Various Administrative Procedures (Type II Financial Instruments Business Operator)

#### V-3-1 Registration

##### (1) Items Regarding Examination of Staffing Level

When examining whether or not a market derivatives business operator is sufficiently staffed to properly conduct the financial instruments business, as specified under Article 29-4(1)(i)(e) of the FIEA, supervisors shall check the following points based on its application and attachments thereto as well as hearings. Note that the examination as to whether the operator has the structure/system necessary to operate financial instruments business appropriately, thereby falling under Article 29-4(1)(i)(f) of the FIEA, shall also be based on the following points.

- (i) Whether it can be deemed that officers and employees with sufficient knowledge and experience have been secured, and a sufficient organization has been established to conduct the relevant financial instruments business, in light of the following requirements:
  - A. Top-level managers must be sufficiently qualified to conduct financial instruments business in a fair and appropriate manner, in terms of their backgrounds and capabilities.
  - B. Managing directors must understand the viewpoints regarding governance indicated in the FIEA and various other laws and regulations, and have sufficient knowledge and experience to conduct governance, and sufficient knowledge and experience regarding compliance and risk management to conduct financial instruments business in a fair and appropriate manner.
  - C. The market derivatives business operator must be staffed and organized so that personnel necessary for conducting business in an appropriate manner are allocated to individual divisions, and managers in charge of internal control are appropriately allocated.
  - D. The compliance division (staff in charge of compliance) should be independent from the sales division and staffed with personnel with necessary knowledge and experience.
  - E. Staff capable of conducting the following processes should be secured, with regard to the relevant business.
    - a. Compilation and management of account documents, reports and other documents.
    - b. Disclosure
    - c. Risk Management
    - d. Computer system management
    - e. Trading management, customer management
    - f. Advertisement screening
    - g. Customer information management
    - h. Processing of complaints and resolution of disputes

- i. Internal audits
- (ii) When the qualifications of employees and officers are examined in a comprehensive manner in relation to the following criteria regarding organized crime groups, their members and financial crimes, whether there is the risk that public confidence in the financial instruments business could be damaged because of the inclusion of officers and employees with inappropriate qualifications among its staff.
  - A. Officers and employees should not be current or former members of organized crime groups.
  - B. Officers and employees should not have close relationships with organized crime groups.
  - C. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - D. Officers and employees should not have the experience of being sentenced to a fine (including similar punishments imposed under foreign laws and regulations equivalent thereto) for violation of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions of Article 32-2(7) of the same act) or other foreign laws and regulations equivalent thereto, or for committing a crime prescribed under the Penal Code or under the Act on Punishment of Physical Violence and Others.
  - E. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion as well as attempts at these crimes).)

(Note) If the Financial Instruments Business Operator is an individual, the qualifications of the individual shall be examined in light of the items specified in (i) and (ii) above

## (2) Points of Attention Regarding Business Operators That Do Not Have Plans to Join Any Financial Instruments Firms' Association

Supervisors shall notify the following points and request appropriate responses to business operators who do not have plan to join any Financial Instruments Firms' Association at the time of submission of a registration request.

- (i) That supervisory responses in accordance with V-2-7 shall be taken if the operator fails to introduce internal rules that are in line with Rules Set by Associations, etc. or a system to ensure compliance with such rules after registration
- (ii) That failure to revise internal rules in accordance with revisions in Rule Set by Associations, etc., may constitute a situation that corresponds to (i).

## V-3-2 Registration of Sales Representatives

### (1) Scope of Registered Sales Representatives

Of Financial Instruments Business Operators' (limited to market derivatives business operators; the same shall apply in V-3-2) officers and employees engaging in in-branch business operations, (including over-the-counter services), those who are in charge of any of the following operations need to be registered in the Registry of Sales



Representatives specified under Article 64(1) of the FIEA.

- (i) Explanations of the contents of financial instruments transactions for solicitation purposes
- (ii) Solicitation for financial instruments transactions
- (iii) Order-taking
- (iv) Provision of information for solicitation purposes (excluding the provision of information regarding back-office operations and objective information requested by customers)
- (v) Activities specified under Article 64(1)(iii) of the FIEA

(2) Items to be Notified

It should be kept in mind that the case of a sales representative who has ceased to engage in the specified sales representative operations temporarily, due to an intra-company personnel transfer, shall not be deemed to fall under the provision of Article 64-4(iii) of the FIEA.

V-3-3 Points of Attention Regarding Depositing of Deposits for Operation

(1) When supervisors have received the original of a statement of deposit submitted by a Financial Instruments Business Operator after it has deposited a new deposit for operation in order to replace the existing deposit, they shall implement the procedures for the certification of the return of the original of the statement of deposit in their custody, in accordance with the format specified in the Attached List of Formats V-I and return it the Financial Instruments Business Operator.

(2) When supervisors have received the original of a certificate of receipt submitted by a Financial Instruments Business Operator after it has submitted a request for substitute deposit/additional deposit in order to substitute redemption funds for deposited securities, they shall provide a certificate of custody in accordance with (5) below and return the original of the statement of deposit already in their custody to the Financial Instruments Business Operator.

(3) When supervisors have received an application for a revision of the contents of a substitute contract for a deposit for operation or for the cancellation of such a contract, they shall grant approval in the approval form regarding deposit contract revision, as specified in the Attached List of Formats V-2, and in the approval form regarding deposit contract cancellation, as specified in the Attached List of Formats V-3, if it is deemed that the revision/cancellation does not lead to insufficient protection of investors.

(4) The public notification of the retrieval of deposits for operation shall be made in the format specified in the Attached List of Formats V-4.

(5) When supervisors have received the original of a statement of deposit, they shall provide a certificate of custody in the format specified in the Attached List of Formats V-5.

(6) Supervisors shall ensure that all applicants for registration are aware of the possibility that in cases where government bonds are deposited as deposits for operation based on Article 31-2(9) of the FIEA, deposits could become invalid after a certain period of time, due to the statute of limitations under the Act Concerning Government Bonds.

#### V-3-4 Books and Documents Related to Service of Handling Electronic Public Offerings

The "records of information displayed on computer screens as specified in Article 146-2(1)" prescribed in Article 181(1)(v)(b) shall include printouts of web pages showing relevant information, and, when such documents are being created using electromagnetic records, electromagnetic records of the relevant web pages.

## **VI. Supervisory Evaluation Points and Various Administrative Procedures (Investment Management Business)**

### VI-1 Governance (Investment Management Business)

Supervisors shall pay attention to the following points when examining the governance of Financial Instruments Business Operators (limited to business operators engaging in investment management business; the same shall apply in VI).

#### VI-1-1 Officers of Financial Instruments Business Operators

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly takes account of the following eligibility requirements in the decision-making process regarding proposals for the appointment of its officers.

- (i) A person who does not meet any of the ineligibility criteria (Article 29-4(1)(ii)(a) to (i) of the FIEA) and who did not meet any of them at the time of registration.
- (ii) A person who has not violated laws and regulations regarding financial instruments business or related business operations, or a person who has not been subjected to administrative actions taken based on laws and regulations.
- (iii) A person who has not damaged the interests of investors in relation to the conduct of the investment advisory and agency business and the investment management business.
- (iv) A person who has not engaged in an illegal or markedly inappropriate act regarding financial instruments business under particularly grave circumstances.

##### (2) Supervisory Method and Actions

In cases where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 29-4(1)(ii)(a) to (i) of the FIEA or is found to have done so at the time when the business operator obtained registration under Article 29 of the FIEA, or where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 52(1)(vii) and (ix) and (x) of the FIEA, supervisors shall consider taking actions such as ordering the dismissal of the said officer based on Article 52(2) of the FIEA.

In addition, they shall hold an in-depth hearing regarding the decision-making process concerning the proposal for the appointment of the said officer and, when necessary, require the submission of a report based on Article 56-2(1) of the FIEA. Furthermore, supervisors shall consider taking actions such as issuing an order for business improvement, if the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem and the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

## VI-1-2 Adequate Staffing, etc. for Properly Conducting Financial Instruments Business

### (1) Major Supervisory Viewpoints

Supervisors shall examine whether Financial Instruments Business Operators are adequately staffed to properly conduct financial instruments business (limited to investment management business; the same shall apply to VI) in light of IV-3-1, and whether the operators have established structure/system required for operating financial instruments business appropriately.

### (2) Supervisory Method and Actions

The provisions under IV-3-1 are part of a comprehensive set of elements that supervisors should take into consideration when examining whether a Financial Instruments Business Operator is adequately staffed to properly conduct financial instruments business, etc. Even if an officer or an employee is deemed to not meet the requirements, it should not automatically lead to the conclusion that the Financial Instruments Business Operator is not adequately staffed. The important thing is, first and foremost, that Financial Instruments Business Operators strive to ensure on their own responsibility that they are adequately staffed, etc. in light of these requirements and other elements.

However, supervisors shall hold in-depth hearings regarding Financial Instruments Business Operators' view on their staffing, etc. and their decision-making process concerning the proposed appointments of officers and employees, in cases where a Financial Instruments Business Operator is deemed to have failed to take those elements into consideration sufficiently in the said decision-making process and where it is deemed to be necessary and appropriate from the viewpoint of protecting the public interest and investors to hold such hearings. In addition, they shall require the submission of reports based on Article 56-2(1) of the FIEA when necessary.

Supervisors shall consider taking actions such as issuing an order for business improvement under Article 51 of the FIEA, in cases where the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem as a result of the examination of the submitted report, and where the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

Furthermore, when the Financial Instruments Business Operator is deemed to be not adequately staffed to properly conduct financial instruments business, etc. as a result of the examination of the submitted report, supervisors shall consider taking necessary measures, including issuing an order for business suspension based on Article 52(1) of the FIEA.

## VI-2 Appropriateness of Business Operations (Investment Management Business)

### VI-2-1 Control Environment for Legal Compliance

Financial instruments business operators, which play an important role in investors' investment management, have fiduciary duty to the investors who entrust investment to them, and are required to fulfill the duty of loyalty, the duty of due care, and the responsibility for ensuring segregated management under the FIEA. In addition, they are required to conduct their business operations as market players in a sound and appropriate manner.

Their control environments for legal compliance shall basically be examined based on the supervisory viewpoints and method specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules.

### VI-2-2 Appropriateness of Business Operations Related to Discretionary Investment Business

Supervisors shall examine the appropriateness of the business operations of discretionary investment business operators (business operators engaging in the activities specified under Article 2(8)(xii)(b) of the FIEA under discretionary investment contracts (as specified under the same provision; the same shall apply hereinafter); the same shall apply hereinafter) by paying attention to the following points.

#### VI-2-2-1 Control Environment for Business Execution

##### (1) Investment and Administration of Investment Assets

Supervisors shall examine whether a discretionary investment business operator is properly investing and administering investment assets, by paying attention to the following points. It should be noted that the following points should be taken into consideration in a comprehensive manner in light of the nature and size of the business operator's business, and that failure to meet some of the criteria should not automatically be deemed to mean that the investment of investment assets is inappropriate.

- (i) Whether the discretionary investment business operator has properly specified the matters regarding internal organization that decide its investment policy (including a specific decision-making process).
- (ii) Whether the discretionary investment business operator has prescribed a specific investment method for investment of investment assets (as specified under Article 35(1)(xv) of the FIEA; the same shall apply hereinafter) by the investment division.
- (iii) Whether the discretionary investment business operator has developed an appropriate control environment for the management of securities transactions between various investment assets and between investment assets and its own assets or third-party assets.
- (iv) In cases where the discretionary investment business operator entrusts all or part of the authority over the investment made on behalf of rights holders (as specified under Article 42(1) of the FIEA; the same shall apply hereinafter) to another entity under Article 42-3 of the FIEA (including cases where the entrusted entity entrusts part of the authority to yet another entity), whether the discretionary investment business operator has properly established the criteria for selecting the entity to which the authority is entrusted and the method of

communications therewith. Whether the discretionary investment business operator has developed a control environment for continuously examining the entrusted entity's business execution capability and its compliance with contract provisions. Whether it has specified measures to be taken when a problem is found in the entrusted entity's business execution capability (e.g., providing guidance for business improvement and refusing to renew the entrustment contract).

- (v) Regarding the selection of the entities to which orders are placed and business operations are entrusted, whether the discretionary investment business operator has properly specified the matters concerning the entities' transaction execution capability, the control environment for legal compliance, credit risk and trading costs as items that should be taken into consideration.
- (vi) Whether the discretionary investment business operator has arrangements and procedures for a division independent from the investment division to periodically examine whether investment assets are properly managed, including whether the investment decision process is appropriate, in accordance with the discretionary investment contract and the investment guideline (including whether records on the investment status are stored).
- (vii) Whether the discretionary investment business operator has developed internal arrangements and procedures for accurately assessing investment assets. In particular, whether it has developed arrangements and procedures for identifying the fair market values if non-listed shares, securities, etc. are included in the investment assets.
- (viii) In cases where rights holders (excluding specified investors; the same shall apply to (vii) through (x)) entrust investment assets to a trust company, etc., and investment is made in subject securities (as specified under Article 130(3) of the FIB Cabinet Office Ordinance; the same shall apply to (vii) through (x)), whether the discretionary investment business operator has developed an appropriate control environment to ensure that (i) an arrangement to enable the trust company, etc., to directly receive a notice on the value of the subject securities from a person who computes the value, or (ii) an arrangement to enable the trust company, etc., to directly ask a person who computes the value to assess the value of subject securities, is taken as the arrangement necessary for the trust company, etc., to know the true value of the subject securities. Whether the discretionary investment business operator has periodically checked, even after having invested in the subject securities, that the above-mentioned arrangements are in place.
- (ix) In cases where rights holders entrust investment assets to a trust company, etc., and investment is made in subject securities, whether the discretionary investment business operator has developed an appropriate control environment to ensure that a fund audit (as specified under Article 130(4) of the FIB Cabinet Office Ordinance; the same shall apply hereinafter) is conducted for the assets invested or contributed from a person having rights to the subject securities. Whether the discretionary investment business operator has periodically checked, even after having invested in the subject securities, that the above-mentioned fund audit is conducted. In a case where the discretionary investment business operator is involved in the appointment of an external auditor in charge of the fund audit, whether the discretionary investment business operator has made efforts to ensure that the fund audit is independent and effective.
- (x) In cases where rights holders entrust investment assets to a trust company, etc., and investment is made in

subject securities, whether the discretionary investment business operator has developed an appropriate control environment to ensure that necessary arrangements are made to enable the trust company, etc., to receive a true audit report, etc., on the fund audit. Whether the discretionary investment business operator has periodically checked, even after having invested in the subject securities, that the above-mentioned arrangements are in place.

## (2) Execution of Transactions

When discretionary investment business operators execute transactions, they are required to select the transaction form that benefits customers most, by taking into consideration the transaction price and other execution costs in a comprehensive manner. In light of the increasing diversification of the transaction forms due to the advance of financial techniques, supervisors shall examine the status of a discretionary investment business operator's transaction execution by paying attention to the following points, for example:

- (i) At-Average-Price Transaction (transaction made at the average of prices of various orders of the same transaction and delivery dates, aggregated by issue and order category (sell or purchase))

- A. Separation of Divisions

- Whether the discretionary investment business operator has separate divisions for making investment divisions and for taking orders. In cases where organizational separation is difficult, whether, at the minimum, different persons are responsible for these two tasks.

- B. Examination of Transactions

- Whether the discretionary investment business operator has a control environment for ensuring that a relevant management division, for example, examines the whole range of business processes related to at-average-price transactions.

- C. Disclosure to Customers and Consent Thereof

- Whether the discretionary investment business operator makes at-average-price transactions after making prior disclosure to customers and obtaining their consent. In cases where the discretionary investment business operator places orders involving the proportional allocation of executed transactions with regard to two or more investment asset accounts, whether it provides customers with appropriate explanations regarding the criteria for allocation in the case of the total executed transaction volume falling short of the total order volume.

- (ii) Transactions Made via Bulk Orders

- In cases where the discretionary investment business operator places a bulk sell or buy order for the same issue on behalf of two or more investment asset accounts, and allocates executed transactions to each asset account based on the allocation criteria prescribed by the business operator after aggregating the transactions by issue and by buy/sell order, whether it has developed a control environment similar to the one described in (i) above, from the viewpoint of ensuring fairness among customers.

- (iii) Transactions Made between Investment Asset Accounts

- Transactions made between investment asset accounts are in principle prohibited because there is a risk that investors in one of the funds involved in the transactions may receive unfavorable treatment and that

such transactions may be utilized in acts that go against investor protection such as transfers of profits between funds.

On the other hand, of transactions specified under Article 129(1)(i) of the FIB Cabinet Office Ordinance, if a transaction between investment assets accounts falls under a case where the prohibition of transactions between investment assets accounts does not apply, the relevant management division is required to be adequately prepared to verify that the transactions meet the requirements in (a) and (b) of Article 129(1)(i).

The "case where it is deemed to be necessary and rational," as specified by Article 129(1)(i)(a)(4) of the FIB Cabinet Office Ordinance, is a case in which transactions between investment assets accounts executed by fund management companies meet the need to ensure fairness among customers and to fulfill its duties of best execution and loyalty to customers, and this applies to transactions in which relevant "sell" or "buy" decisions by each of the funds are deemed necessary and rational, and that are executed in the best possible manner for the investment decisions made thus (or the each of transactions executed to follow the best execution practice results in transactions between investment assets accounts).

In determining whether there is necessity and rationality, factors such as the investment policy of the funds involved (including in-house investment limits introduced (for the purpose of risk management, etc.) by the investment business operators, inflow or outflow of money associated with cancellation/formation of funds (including whether there is a need to sell or buy assets in order to maintain the portfolios of each funds, etc.), etc. are considered.

On the other hand, from the viewpoint of best execution practice, factors such as transaction costs, mitigation of market impact, etc. are considered in addition to transaction prices.

From the above viewpoints, such transactions as listed below are considered as ones in which fairness among funds and fair price formation are ensured and as constituting a "case where it is deemed to be necessary and rational." (It must be noted, however, that these are shown only as examples and not the only ones that qualify.)

- A. To have traders execute transactions based on investment decisions made by several fund managers (limited to transactions regarding which there is not the risk of the price formation process being distorted in light of liquidity and other factors related to the relevant issue and, in cases where the transactions are executed by the same trader, transactions of which the trader has no discretion over execution).
- B. To place both market buy and sell orders before the market's opening (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- C. To place both buy and sell orders in intraday trading at a reasonable intervals (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- D. To make transactions related to index funds executed through program trading based on contracts and trust contract provisions (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- E. To make VWAP transactions and discretionary transactions, regarding which the decision on the timing



of order placement, price and other execution terms related to individual issues are entrusted by the fund management company to a third-party entity (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).

- F. To make futures transactions, regarding which it is difficult to avoid the placement of orders for the same issue because of the small number of issues available for futures trading (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).

### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a discretionary investment business operator's control environment for business execution, through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the discretionary investment business operator by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the discretionary investment business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the discretionary investment business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

## VI-2-2-2 Control Environment for Customer Solicitation and Explanations

### (1) Prohibition of Advertisements Using Exaggerated Descriptions

- (i) Whether the Financial Instruments Business Operator includes in its advertisements descriptions indicating that the performance, contents and method of its investment are markedly superior to those of other Financial Instruments Business Operators without providing the basis therefor.
- (ii) When including investment performance data in its advertisement, whether the Financial Instruments Business Operator uses descriptions that could cause misunderstanding by investors, by putting excessive emphasis on specific parts of the performance. (When investment performance data is included in an advertisement, appropriate and easy-to-understand descriptions must be made, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the method of investment evaluation and the basis for the use of benchmarks and properly expresses that the investment performance data is an indicator that concerns past results but does not promise future performance.)
- (iii) When including investment simulation in its advertisement, whether the Financial Instruments Business Operator uses descriptions that could cause misunderstanding by investors, by setting arbitrary assumptions, for example. (When investment simulation is included in an advertisement, appropriate and easy-to-understand descriptions must be used, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the basis for the use of assumptions in the simulation and properly indicates that the simulation is based on prescribed assumptions and does not promise future investment performance.)

(2) Points of Attention Regarding Provision of Pre-Contract Documents

- (i) In cases where a discretionary investment business operator concurrently undertakes services unrelated to discretionary investment business and where it receives remuneration related to discretionary investment business and fees related to other services collectively under the same contract, the business operator must separately specify the remuneration related to discretionary investment business and the fees related to other services with regard to the “matters concerning fees, remuneration or any other consideration payable by the customer with regard to said Contract for Financial Instruments Transaction,” as specified under Article 37-3(1)(iv) of the FIEA.
- (ii) The “methods of investment and types of transactions,” as specified under Article 96(1)(i) of the FIB Cabinet Office Ordinance, include specific investment methods (including the individual investment method, the common investment method (under which several customers’ assets are invested in the same way with regard to specific securities and the timing of sales and purchases and are administered on a customer-by-customer basis by the same asset administration organization; the same shall apply hereinafter) and the joint investment method (under which several customers’ assets are jointly invested and jointly administered; the same shall apply hereinafter)) and also include the following items in the case of common investment and joint investment:
  - A. In the case of common investment
    - a. Items regarding the asset administration organization in charge of common investment assets.
    - b. Items regarding the criteria for the allocation of assets acquired through the common investment
  - B. In the case of joint investment
    - a. Customers’ attributes and types of customer assets and items regarding the criteria for joint investment
    - b. Items regarding the asset administration organization in charge of joint investment assets
    - c. Items regarding the criteria for the allocation of assets acquired through the joint investment
    - d. Items regarding the evaluation method of joint investment assets and the calculation method of each customer’s interests in the assets (including cases where assets are withdrawn from the joint investment prematurely).
- (iii) The “items regarding the scope of discretionary investment decisions and the implementation of investment,” as specified under Article 96(1)(iii) of the FIB Cabinet Office Ordinance, include the trade names, addresses, the names of the representative of the business operators specified under each item of Article 16-12 of the FIEA Enforcement Order (hereinafter referred to as “re-entrusted entity”) as well as the scope of re-entrustment.
- (iv) The “external audit of business operations related to financing or discretionary investment contracts” as specified under Article 96(1)(vi) of the FIB Cabinet Office Ordinance includes the following (including the equivalent thereof):
  - Audit certification pursuant to Article 193-2 (1) of the FIEA (“audit of financial statements” in VI-3-2-3 (1) (iv)) and audit certification pursuant to Article 193-2 (2) of the FIEA (“audit of internal control” in VI-3-

2-3 (1) (iv));

- Audit by an accounting auditor under the Companies Act;
- Assurance engagements on internal controls of outsources (assurance engagements on internal controls in VI-3-2-3 (1) (iv)) in accordance with the standards, including the Audit and Assurance Practice Committee Practical Guidelines No.86, the “assurance report on internal control of entrusted business” (JICPA), the Statement on Standards for Attestation Engagements (SSAE) No.16 “Reporting on Controls at a Service Organization” (AICPA), the International Standard on Assurance Engagements (ISAE) No.3402 “Assurance Reports on Controls at a Service Organization” (IAASB); and
- Examination of whether the performance disclosure information of asset management companies conforms to the Global Investment Performance Standards (GIPS).

(v) As for the “capital relationship between the financial instruments business operator, etc., and the fund-related persons” as specified under Article 96(2)(iii) of the FIB Cabinet Office Ordinance, if the fund-related person is the parent corporation, etc., (as specified under Article 1(3)(xiv) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., a subsidiary corporation, etc., (as specified under Article 1(3)(xvi) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., or a related foreign corporation, etc., (as specified under Article 126 (iii) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., such fact must be entered.

(vi) As for the “personal relationship between the financial instruments business operator, etc., and the fund-related persons” as specified under Article 96(2)(iii) of the FIB Cabinet Office Ordinance, the conditions of concurrent holding of positions by officers or employees at a specific time which is deemed to be reasonable must be entered.

(vii) Regarding the matters set forth in Article 96(1)(iii) of the FIB Cabinet Office Ordinance, when the name of the department that makes investment decisions or conducts investments is entered in lieu of the name of the person who makes investment decisions based on a discretionary investment contract or the name of the person who makes such investment decisions and conducts investments based thereon, as “a system which enables prompt responses to the customer’s inquiries,” a discretionary investment business operator may be considered to have developed a system under which records on names of the persons who make investment decisions or conduct investments are appropriately created and stored and prompt responses can be made to customers’ inquiries by checking relevant records.

### (3) Points of Attention Regarding the Provision of Documents at Contract Signing

(i) In the case of joint investment, the “contents and amounts of customers’ assets related to discretionary investment contracts,” as specified under Article 107(1)(vi) of the FIB Cabinet Office Ordinance, include the total amount of joint investment assets at the time of the start of the joint investment and the shares of the relevant customers’ assets in the joint investment assets.

(ii) The “methods of investment and types of transactions,” as specified under Article 107(1)(viii) of the FIB Cabinet Office Ordinance, include specific investment methods (including the individual investment method, the common investment method and the joint investment method) and also include the following items in the

case of common investment and joint investment:

- A. In the case of common investment
    - a. Items regarding the asset administration organization in charge of common investment assets
    - b. Items regarding the criteria for the allocation of assets acquired through the common investment
  - B. In the case of joint investment
    - a. Items regarding the size of joint investment assets
    - b. Customers' attributes and types of customer assets and items regarding the criteria for joint investment
    - c. Items regarding the asset administration organization in charge of joint investment assets
    - d. Items regarding the criteria for the allocation of assets acquired through the joint investment
    - e. Items regarding the evaluation method of joint investment assets and the calculation method of each customer's interests in the assets (including cases where assets are withdrawn from the joint investment prematurely).
- (iii) The "methods of investment and types of transactions," as specified under Article 107(1)(viii) of the FIB Cabinet Office Ordinance, include re-entrusted entities' methods of investment and types of transaction.
- (iv) Regarding the matters set forth in Article 107(1)(vii) of the FIB Cabinet Office Ordinance, when the name of the department that makes investment decisions or conducts investments is entered in lieu of the name of the person who makes investment decisions based on a discretionary investment contract or the name of the person who makes such investment decisions and conducts investments based thereon, as "a system which enables prompt responses to the customer's inquiries," a discretionary investment business operator may be considered to have developed a system under which records on names of the persons who make investment decisions or conduct investments are appropriately created and stored and prompt responses can be made to customers' inquiries by checking relevant records.

#### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a discretionary investment business operator's control environment for customer solicitation and explanations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the discretionary investment business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the discretionary investment business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the discretionary investment business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-2-3 Duty of Loyalty and Measures to Prevent Internal Collusion

#### (1) Points of Attention Regarding Discretionary Investment Business Operators Engaging in Two or More Types of Business

When supervisors examine the appropriateness of measures taken by a discretionary investment business operator engaging in two or more types of business (as specified under Article 29-2(1)(v) of the FIEA) to prevent internal collusion, they shall pay attention to the following points, for example, depending on the nature of its business, from the viewpoint of preventing conflicts of interests and ensuring the appropriateness of business operations in other ways.

- (i) Whether the discretionary investment business operator has taken appropriate measures to prevent collusion between its different types of business, such as establishing an internal control system and procedures for the prevention of such collusion in a manner suited to the nature of its business.
- (ii) Regarding the “non-disclosure information,” as specified under Article 147(ii) of the FIB Cabinet Office Ordinance, whether the discretionary investment business operator has put in place information management measures, such as the appointment of the relevant manager and the establishment of management rules, and ensures the effectiveness of information management by, for example, properly identifying and examining the status of the usage of the non-disclosure information and revising the management method as necessary.

#### (2) Points of Attention Regarding Prevention of Conflicts of Interests in Investment Management Business

Whether appropriate measures have been taken to prevent practices that could promote the interests of specific rights holders at the expense of other rights holders, such as establishing an internal control system and procedures for the prevention of collusion between different types of business in a manner suited to the nature of the business.

#### (3) Duty of Loyalty to Rights Holders

It should be kept in mind that if a discretionary investment business operator causes financial damage to a beneficiary due to a clerical error involved in the investment of investment assets and fails to compensate for the damage, it could constitute a violation of the duty of loyalty. The same shall apply to cases where the clerical error occurs at an entity to which business operations are entrusted and where the discretionary investment business operator which has the obligation of duty to the beneficiary fails to compensate for the damage.

#### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a discretionary investment business operator’s measures to prevent internal collusion between different types of business, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the discretionary investment business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA, since such an issue could directly undermine the interests of rights holders and, in some cases, lead to legal violations, such as a violation of the duty of loyalty and duty of due care. When the discretionary investment business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the discretionary

investment business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-2-4 Measures to Prevent Legal Violations by Agency/Brokerage Service Providers

When discretionary investment business operators entrust business operations to agency/brokerage service providers (business operators engaging in agency/brokerage services (as specified under Article 2(8)(xiii); the same shall apply hereinafter); the same shall apply hereinafter), it is important that they provide the service providers with guidance regarding the establishment of a control environment for customer management, from the viewpoint of ensuring the implementation of appropriate investment solicitation suited to the customers' attributes, and require them to ensure thorough legal compliance based on the examination of the actual status of their investment solicitation. Supervisors shall examine the control environment for the prevention of legal violations by agency/brokerage service providers by paying attention to the following points in particular.

##### VI-2-2-4-1 Selection of Agency/Brokerage Service Providers

###### (1) Points of Attention Regarding Selection of Agency/Brokerage Service Providers

- (i) When signing contracts for entrusting agency/brokerage services, whether the discretionary investment business operator specifies the significance of the entrustment in relation to governance, identifies the various risks involved therein and conducts sufficient deliberations on the method of risk management.
- (ii) Whether the discretionary investment business operator conducts sufficient deliberations on whether the agency/brokerage service providers have sufficient qualifications to conduct the entrusted business operations in a sound and appropriate manner. In cases where the agency/brokerage service providers concurrently engage in other services in particular, whether the discretionary investment business operator not only examines the possibility of the nature of the other services damaging public confidence in the service providers, but also conducts sufficient deliberations in consideration of the primary business operator's reputational risk. (The "primary business operator" refers to discretionary investment business operators which sign discretionary investment contracts through agency/brokerage services provided by agency/brokerage service providers; the same shall apply in VI.)

###### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the primary business operator's selection of agency/brokerage service providers, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the primary business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the primary business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the primary business operator is deemed to have

committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-2-4-2 Measures Taken by Primary Business Operator to Ensure the Appropriateness of Agency/Brokerage Service Providers

##### (1) Development of Internal Control Environment for Supervising Agency/Brokerage Service Providers

- (i) Whether the primary business operator has developed a control environment for ensuring appropriate supervision of agency/brokerage service providers, through actions such as establishing a division responsible for the implementation of measures to ensure the sound and appropriate conduct of business operations related to agency/brokerage services, or appointing a person responsible therefor (including a control environment regarding audits of the business operations of agency/brokerage service providers).
- (ii) Whether the primary business operator has developed an internal control environment for examining whether the said division or person has taken proper measures to ensure the appropriateness of the business operations related to the agency/brokerage services.

##### (2) Points of Attention Regarding Measures to Ensure Necessary and Appropriate Supervision of Agency/Brokerage Service Providers

- (i) Whether the primary business operator has taken the following measures in order to ensure the sound and appropriate conduct of business operations related to agency/brokerage services and monitors the status of the conduct of the business operations:
  - A. To provide guidance regarding business operations related to agency/brokerage services to brokerage service providers and their employees and implement training programs intended to ensure their compliance with laws and regulations regarding the agency/brokerage services.
  - B. To implement measures to ensure the necessary and appropriate supervision of agency/brokerage service providers, such as examining periodically or as necessary whether the service providers properly conduct the services, including investment solicitation and requiring them to make improvement when necessary.
- (ii) Whether the primary business operator has developed a control environment that ensures the results of the above monitoring are examined by the primary business operator's division in charge and reported to the management team when necessary, so that they are reflected in the provision of appropriate guidance by the primary business operator and in the conduct of business operations by agency/brokerage service providers.

##### (3) Measures to Cancel Contracts for Entrusting Agency/Brokerage Services

Whether the primary business operator has developed a control environment for implementing appropriate measures, such as providing guidance to agency/brokerage service providers and canceling contracts for entrusting agency/brokerage services, when a problem has been found as a result of the monitoring of agency/brokerage service providers. In addition, whether it has developed a control environment for properly protecting customers when canceling the entrustment contracts.

#### (4) Measures to Process Complaints

Whether the primary business operator has established arrangements and procedures for responding to complaints, such as specifying the contact point for customer complaints regarding agency/brokerage services, establishing a division in charge of processing complaints and prescribing procedures for processing complaints.

#### (5) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding measures taken by the primary business operator to ensure the appropriateness of agency/brokerage services, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the primary business operator etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the primary business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the primary business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-2-5 Other Points of Attention

##### (1) Accounts for Settlement of Transactions

- (i) It should be kept in mind that regarding transactions made on their own account, discretionary investment business operators must not use an account intended for the settlement of transactions that was made through the activities specified under the proviso of Article 42-5 of the FIEA.
- (ii) It should be kept in mind that discretionary investment business operators' use of the said account for placing orders covering both transactions related to investment based on investment decisions commissioned by customers and transactions made on their own account is equivalent to the "use of the relevant account for purposes other than the settlement of the relevant transaction" specified under Article 130(1)(xi) of the FIB Cabinet Office Ordinance.

##### (2) Points of Attention Regarding Cash Collateral Reinvestment

In cases where a discretionary investment business operator that is a securities lender (and/or its agent) reinvests cash collateral it has received in secured securities lending transactions, only if the investment is found to be leveraged, supervisors shall pay attention to the following points, based on Recommendation 6 in the Financial Stability Board, "Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos" (August 2013):

###### (i) High-Level Principles

- A. In developing its cash collateral reinvestment strategy and investment guidelines, whether the



discretionary investment business operator takes into account the possibility that the cash collateral could be recalled at any time by the party that borrowed securities, considers whether the discretionary investment business operator holds assets that are sufficiently liquid to meet reasonably foreseeable recalls of cash collateral, and takes measures to manage the associated liquidity risk.

- B. Whether the discretionary investment business operator conducts cash collateral reinvestment with one of the primary objectives being capital preservation. In particular, in formulating cash collateral reinvestment guidelines, whether the discretionary investment business operator takes into account whether unexpectedly large requests for returning cash collateral could be met if the market for the assets in which the cash collateral has been reinvested became illiquid and liquidating the assets would result in a loss.
- C. Cash collateral reinvestment should be consistent with the investment policy stated and approved by the discretionary investment business operator that is a securities lender, so as not to add substantial incremental risk to the discretionary investment business operator's risk profile. In developing and approving cash collateral reinvestment guidelines, whether the discretionary investment business operator takes into account the size of this activity relative to the firm overall.
- D. Whether investment guidelines for cash collateral reinvestment are formally documented and communicated to beneficial owners.
- E. Whether the discretionary investment business operator explicitly approves, formally documents and regularly reviews investment guidelines that govern cash collateral reinvestment. Whether the guidelines comply with the high-level principles set forth in (i). Whether a discretionary investment business operator that is a lending agent ensures that all its clients have such investment guidelines for cash collateral reinvestment in place.
- F. Whether assets the discretionary investment business operator holds to meet cash collateral calls are highly liquid with transparent pricing so that they can be valued at least on a daily basis and sold, if needed, at a price close to their pre-sale valuation.

(ii) Liquidity, Credit, and Other Risks

- A. In reinvesting cash collateral, whether the discretionary investment business operator pays attention to the following points:
  - a. Whether it takes measures to limit the potential for maturity mismatch.
  - b. Whether it holds assets that are sufficiently liquid and low risk to meet reasonably foreseeable demands for cash collateral redemption (together with a buffer to guard against stress scenario).
  - c. Whether it has developed an appropriate risk management structure consistent with the cash collateral reinvestment guidelines.
- B. Whether the discretionary investment business operator has set specific requirements including the following for the cash collateral reinvestment portfolio and/or liquidity pool maintained to meet cash collateral recalls, and complies with them on an ongoing basis:
  - a. Whether the discretionary investment business operator invests a minimum portion of the cash collateral in a portfolio such as the following as a reinvestment portfolio that can be readily converted

to cash over short time horizons (such as one day and one week) to meet potential recalls of cash collateral:

- Short-term deposits (with high-quality financial institutions)
  - Highly liquid short-term assets (such as high quality government treasury bills and bonds)
  - Short tenor transactions (such as overnight or open reverse repos backed by highly liquid assets)
- b. Whether the discretionary investment business operator sets specific limits for the weighted average maturity (WAM) and/or weighted average life (WAL) of the portfolio in which the cash collateral is reinvested.
- c. Whether the discretionary investment business operator sets a maximum remaining term to maturity for any single investment in which the cash collateral is reinvested, which could vary by asset class based on the liquidity of the instruments.

(iii) Stress Tests

- A. Whether the discretionary investment business operator stress tests its ability to meet foreseeable and unexpected calls for the return of cash collateral on an ongoing basis.
- B. Whether the stress tests in A. above include an assessment of the discretionary investment business operator's ability to liquidate part or the entire reinvestment portfolio under a range of stressed market scenarios, including the following:
- a. Interest rate changes
  - b. Higher cash collateral recalls
  - c. Higher redemptions by investors in the funds including securities on loan
  - d. Changes in the credit quality of the cash collateral reinvestment portfolio

(iv) Disclosure

- A. Whether a discretionary investment business operator that is a lending agent frequently discloses to its clients (the beneficial owners of securities) the composition and valuation of its portfolio of securities on loan and its cash collateral reinvestment portfolio.
- B. Whether the items disclosed in A. above include the following at the minimum:
- a. The percentage of assets held in cash or cash equivalents over a one day and one week liquidation horizon
  - b. The weighted average maturity (WAM) and/or weighted average life (WAL) of the cash collateral reinvestment portfolio
  - c. The maximum remaining term to maturity of any individual investment
  - d. The percentage of assets that are held in illiquid securities (and how these are defined)
  - e. The maximum exposure of the fund, including securities on loan, to the following items:
    - Individual security
    - Issuer
    - Asset type
  - f. The split between secured and unsecured exposures
  - g. The distribution of collateral received in reverse repo

- h. The average yield of the cash collateral reinvestment portfolio
- i. Results from liquidity stress tests

### (3) Points of Attention Regarding Repo Transactions

In cases where a discretionary investment business operator engages in secured securities lending transactions and purchase and sale of securities on condition of repurchase or resale (hereinafter referred to as “repo transactions”) (including the case where it is an agent of such business operator), whether it formulates internal provisions, etc. concerning collateral valuation and management, based on Recommendation 9 in the Financial Stability Board, “Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos” (August 2013):

#### (i) Type of Collateral

Whether the discretionary investment business operator only takes collateral relating to repo transactions which satisfies the following requirements even at the time of a counterparty failure:

- A. Possible to hold for a period without breaching laws or regulations.
- B. Possible to value.
- C. Possible to appropriately manage risks.

#### (ii) Contingency Plan

- A. Whether the discretionary investment business operator has formulated contingency plans for the failure of its largest market counterparties (including in times of market stress).
- B. Whether the abovementioned contingency plans include the following items:
  - a. How they would manage the collateral following default
  - b. Capabilities to liquidate the collateral in an orderly way

#### (iii) Margin Call

- A. Whether collateral and lent securities are marked to market at least daily
- B. Whether margin calls (meaning the right to demand an excess or shortage of collateral resulting from mark-to-market at any time within the period) are made at least daily.

### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a discretionary investment business operator’s accounts for the settlement of transactions, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the discretionary investment business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the discretionary investment business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the discretionary investment business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

(5) Interpretation of Article 2(8)(xii)(b)

The contracts specified under Article 123(1)(xiii)(b) to (e) of the FIB Cabinet Office Ordinance shall not be deemed to fall under the category of discretionary investment contracts specified under Article 2(8)(xii)(b).

(6) Points of Attention for Discretionary Investment Contracts under the Provisions of the Employees' Pension Insurance Act

- (i) Considering that a surviving employees' pension fund (refers to the surviving employees' pension fund as prescribed in Article 3, item (xi) of the Supplementary Provisions of the Act for Partial Revision of the Employees' Pension Insurance Act to Ensure the Soundness and Reliability of the Public Pension System (Cabinet Order No. 63 of 2013); the same shall apply hereinafter) as a customer is obligated to make an effort to invest reserves for pension benefits, etc., using methods which are not concentrated on a specific means in accordance with the provisions of Article 39-15 (1) of the Cabinet Order for Employees' Pension Fund prior to abolition pursuant to the provisions of Article 1 of the Cabinet Order Concerning the Coordination, etc. of the Relevant Cabinet Orders Related to the Enforcement of the Act for Partial Revision of the Employees' Pension Insurance Act to Ensure the Soundness and Reliability of the Public Pension System (Cabinet Order No. 73 of 2014) that is deemed to be still in effect in accordance with the provisions of Article 3(2) of the Cabinet Order Concerning Transitional Measures due to the Enforcement of the Act for Partial Revision of the Employees' Pension Insurance Act to Ensure the Soundness and Reliability of the Public Pension System (Cabinet Order No. 74 of 2014) (hereinafter the "duty of investment diversification"), if it is recognized that the surviving employees' pension fund could have not fulfilled their duty of investment diversification, whether the discretionary investment business operator has established an appropriate control environment to give a notice to the surviving employees' pension fund. In the case that the notice is given but there is still a risk of violation of the duty of investment diversification, whether the discretionary investment business operator has had a consultation with the surviving employees' pension fund to ask the fund to examine the change of their investment management guideline, for example. Furthermore, if there is still a risk of violation of the duty of investment diversification even after the consultation, whether the discretionary investment business operator has taken measures, including the examination of cancellation of the discretionary investment contract in the worst case, for example, in order to ensure that the surviving employees' pension fund will fulfill their duty of investment diversification.
- (ii) Whether the discretionary investment business operator understands the knowledge, experience, state of assets of the surviving employees' pension fund, and their purpose of concluding a discretionary investment contract. In a case where an investment management guideline is indicated by the surviving employees' pension fund and it is found necessary, whether the discretionary investment business operator has established an appropriate control environment in which the discretionary investment business operator explains to the surviving employees' pension fund about risks which might occur if investment is made according to the investment management guideline.
- (iii) In a case where a surviving employees' pension fund gives instructions about the management of

investment assets (hereinafter the “specific instructions”), such as the acquisition or disposition of specific bonds, stocks, beneficiary securities, etc., in violation of the provision of Article 30(3) of the Cabinet Order for Employees’ Pension Fund prior to abolition, whether the discretionary investment business operator has established an appropriate control environment to ensure compliance with Article 130(1)(xiii) of the FIB Cabinet Office Ordinance and informs the surviving employees’ pension fund of the inability to follow such instructions, for example. Whether the discretionary investment business operator has established an appropriate control environment to avoid such solicitation of products or explanations which encourage a surviving employees’ pension fund to give specific instructions.

The following acts don’t violate Article 130(1)(xiii) of the FIB Cabinet Office Ordinance:

- Accept and follow the following instructions from a surviving employees’ pension fund: (i) instructions on the acquisition, etc., of an affiliated fund of the discretionary investment business operator (a founder or manager of the fund is the discretionary investment business operator, a parent corporation, etc., as specified under Article 1(3)(xiv) of the FIB Cabinet Office Ordinance, subsidiary corporation, etc., as specified under item xvi of the same paragraph, or a related foreign corporation, etc., as specified under Article 126(iii) of the same ordinance) (including the case where instructions are clarified in the investment management guideline, contracts, etc.); (ii) instructions to prohibit the acquisition of securities of certain descriptions; and (iii) instructions on the investment management policy, such as limitations of investment ratios for each description of securities or for each industry.
  - In a case where the discretionary investment business operator intends to invest in securities of certain descriptions (subject securities as specified under Article 96(4) of the FIB Cabinet Office Ordinance) based on a discretionary investment contract after having concluded the contract, make a description and an explanation of the securities in pre-contract documents which are delivered to a surviving employees’ pension fund when conducting solicitation for a discretionary investment contract.
- (iv) In a case where the discretionary investment business operator visits a surviving employees’ pension fund as customer together with a financial instruments business operator for the purpose of explaining about investment performance, whether the discretionary investment business operator has established an appropriate control environment to ensure that such explanations, etc., at the time of visit will not include solicitation of products, etc., which are structured by the financial instruments business operator and will not encourage the surviving employees’ pension fund to give specific instructions.
- (v) With respect to the investment management of reserves for pension benefits, etc., whether the discretionary investment business operator has established an appropriate control environment to ensure that conclusive judgment with respect to an uncertain matter will not be provided to a surviving employees’ pension fund, or information which is likely to have a surviving employees’ pension fund mistakenly believe an uncertain matter as being certain will not be provided to the surviving employees’ pension fund.
- (vi) For the purpose of making persons in charge of important operations concerning fund assets and management thereof comply with requirements for due diligence and continuous monitoring as specified under Article 96(2)(ii) of the FIB Cabinet Office Ordinance, whether the discretionary investment business operator has established, as necessary, an appropriate control environment by which internal rules, operation manuals,

etc., incorporating detailed standards or methods are established, and the status of due diligence and the conditions of monitoring are examined by the compliance division and the risk management division.

(Note) Discretionary investment business operators are required to make an explanation of risks to surviving employees' pension funds as customers. However, it must be noted that discretionary investment business operators cannot be exempted from a good manager's duty of care simply because they have explained about risks involved.

### VI-2-3 Appropriateness of Business Operations Related to Investment Trust Management Business, etc.

Supervisors shall examine the appropriateness of the business operations of investment trust management companies, etc. (Financial Instruments Business Operators engaging in the activities specified under Article 2(8)(xii)(a) of the FIEA and based on contracts specified under the same provision and the activities specified in Article 2(8)(xiv) (excluding acts to establish or instruct foreign investment funds directly from Japan); the same shall apply hereinafter) by paying attention to the following points.

#### VI-2-3-1 Control Environment for Business Execution

##### (1) Investment and Administration of Investment Assets

For the purpose of encouraging medium- to long-term asset building by households in accordance with their stages of life and raising the flow of financial assets from household into growing businesses through financial markets, investment assets, which mediates between them, can play a significant role. As such, it is hoped that investment trust management companies, etc., actively develop and provide products that support stable asset building based on customer needs.

With such hopes in mind, supervisors shall examine whether an investment trust management company, etc., is properly managing and administering investment assets, by paying attention to the following points. It should be noted that the following points should be taken into consideration in a comprehensive manner in light of the nature and size of the company's business and that failure to meet some of the criteria should not automatically be deemed to mean that the investment and administration of investment assets are inappropriate.

- (i) Whether the investment trust management company, etc., has properly specified the matters regarding internal organization that decide its investment policy (including a specific decision-making process).
- (ii) Whether the investment trust management company, etc., has prescribed a specific investment method for investment of investment assets by the investment division. Whether the investment management company is making efforts to clearly present information regarding the status of asset management of the relevant investment trust, such as listed below, to beneficiaries, etc., in a manner appropriate to the characteristics of individual investment trust products. Whether the investment management company is making efforts to clearly present information on investment trust products that use a fund-of-funds strategy to beneficiaries, etc., such as providing an overview of the destination funds (e.g. key invested assets) and the net contribution rate that incorporates the asset-management costs of the destination funds, as well as providing financial instruments business operators that sell the investment trust products with information about asset management costs.

- A. Information about fund managers (e.g. years of experience in managing investment funds, personal history, etc. of the chief fund manager, overview of management team, etc.)
- B. Process of investment decision making in putting the basic investment policy into actual operation
- (iii) Whether the investment trust management company, etc., has developed an appropriate control environment regarding the management of securities transactions between various investment assets and between investment assets and its own assets or third-party assets.
- (iv) In cases where the investment trust management company entrusts all or part of the authority over the investment made on behalf of rights holders to another entity under Article 42-3 of the FIEA (including cases where the entrusted entity entrusts part of the authority to yet another entity), whether the investment trust management company has properly established the criteria for selecting the entity to which the authority is entrusted and the method of communications therewith. Whether the investment trust management company has established arrangements and procedures for continuously examining the entrusted entity's business execution capability and its compliance with contract provisions. Whether it has specified measures to be taken when a problem is found in the entrusted entity's business execution capability (e.g., providing guidance for business improvement and refusing to renew the entrustment contract).
- (v) Regarding the selection of the entities to which orders are placed and business operations are entrusted, whether the investment trust management company, etc., has properly specified the matters concerning the entities' transaction execution capability, control environment for legal compliance, credit risk and trading costs as items that should be taken into consideration.
- (vi) Whether the investment trust management company, etc., has arrangements and procedures for a division independent from the investment division to periodically examine whether investment assets are properly invested (including whether records on the investment status are stored), including whether the investment decision process is appropriate, in accordance with investment trust contracts and asset investment contracts and the investment guideline.
- (vii) With respect to MRFs (referring to bond investment trusts prescribed in Article 25(ii) of the Ordinance for Enforcement of the Investment Trust Act; the same shall apply in (vii) and (viii) below), while compensating part or all of losses incurred on the principal for the purpose of avoiding a sudden and unexpected fall in the value of bond holdings, etc. where the constant value falls below 1 yen per unit and affects individual investors' securities transactions, is exceptionally permitted (as provided in Article 42-2(vi) of the FIEA and Article 129-2 of the FIB Cabinet Office Ordinance), whether the investment trust management company, etc. complies with the "Rules for Operations of MMF, etc.," the Investment Trusts Association's self-regulatory rules, in managing MRFs, in an effort to avoid a situation where stable management of MRF, soundness of investment trust management companies, etc. are impaired. With respect to a contingency plan to be submitted to the FSA based on the Rules, in particular, whether the investment trust management company, etc. sufficiently envisages possible situations where stable management of MRFs would be impaired and puts in place effective countermeasures against such situations, periodically verifies the effectiveness of the contingency plan and reviews it as necessary.
- (viii) With respect to MMFs (referring to bond investment trusts prescribed in Article 59(1)(ii) of the Regulation

on Accounting for Investment Trust Property and bond investment trusts (excluding MRFs) that are managed so that the constant value becomes 1 yen per unit; the same shall apply in (viii)), there is a possibility that the constant value falls or is highly likely to fall below 1 yen per unit due to a sudden and unexpected fall in the value of bond holdings, etc. and this may lead to a deluge of cancellation requests from investors, resulting in a confusion. Whether the investment trust management company, etc. complies with the "Rules for Operations of MMF, etc.," the Investment Trusts Association's self-regulatory rules, in managing MMFs, in an effort to avoid a situation where stable management of MMFs and the soundness of the financial system are impaired. With respect to a contingency plan to be submitted to the FSA based on the Rules, in particular, whether the investment trust management company, etc. sufficiently envisages possible situations where stable management of MMFs would be impaired, in consideration of the characteristics, etc. of MMFs, and puts in place effective countermeasures against such situations. In addition, whether the investment trust management company, etc. periodically verifies the effectiveness of the contingency plan and reviews the plan and the characteristics of the relevant MMFs as necessary.

- (ix) Whether the investment trust management company, etc. has developed internal arrangements and procedures for accurately assessing investment assets. In particular, whether it has developed arrangements and procedures for identifying the fair market values if non-listed shares, securities, etc. are included in the investment assets.
- (x) Whether the investment trust management company, etc. appropriately manages the calculation process in order to ensure accurate calculation of the net asset value. In addition, when there is a notable fluctuation in the net asset value, whether the investment trust management company, etc. identifies the cause of the fluctuation, and if a serious problem is found, reports it to the internal control division or the board of directors.

## (2) Execution of Transactions

When investment trust management companies, etc., execute transactions, they are required to select the transaction form that benefits rights holders most by taking into consideration the transaction price and other execution costs in a comprehensive manner. In light of the increasing diversification of the transaction forms due to the advance of financial techniques, supervisors shall examine the status of the transaction execution of an investment trust management company, etc., by paying attention to the following points, for example:

- (i) At-Average-Price Transaction (transaction made at the average of prices of various orders of the same transaction and delivery dates, aggregated by issue and order category (sell or buy))

### A. Separation of Divisions

Whether the investment trust management company, etc., has separate divisions for making investment divisions and for taking orders. In cases where organizational separation is difficult, whether, at the minimum, different persons are responsible for these two tasks.

### B. Examination of Transactions

Whether the investment trust management company, etc., has a control environment for ensuring that a relevant management division, for example, examines the whole range of business processes related



to at-average-price transactions.

C. Disclosure to Rights Holders and Consent thereof (Limited to Transactions Related to Asset Investment Contracts with Investment Corporations)

Whether the investment trust management company, etc., makes at-average-price transactions after making prior disclosure to rights holders and obtaining their consent. In cases where the investment trust management company, etc., places orders involving proportional allocation of the executed transactions with regard to two or more investment asset accounts, whether it provides rights holders with appropriate explanations regarding the criteria for allocation in the case of the total executed transaction volume falling short of the total order volume.

(ii) Transactions Made via Bulk Orders

In cases where the investment trust management company, etc., places a bulk sell or buy order for the same issue on behalf of two or more investment asset accounts, and allocates the executed transactions to each asset account based on the allocation criteria prescribed by the business operator after aggregating the transactions by issue and by buy/sell order, whether it has developed a control environment similar to the one described in (i) above from the viewpoint of ensuring fairness among various investment assets.

(iii) Transactions Made between Investment Assets Accounts

Transactions made between investment asset accounts are in principle prohibited because there is a risk that investors in one of the funds involved in the transactions may receive unfavorable treatment and that such transactions may be utilized in acts that go against investor protection such as transfers of profits between the funds.

On the other hand, of transactions specified under Article 129(1)(i) of the FIB Cabinet Office Ordinance, if a transaction between investment assets accounts falls under a case where the prohibition of transactions between investment assets accounts does not apply, the relevant management division is required to be adequately prepared to verify that the transactions meet the requirements in (a) and (b) of Article 129(1)(i).

The “case where it is deemed to be necessary and rational,” as specified by Article 129(1)(i)(a)(4) of the FIB Cabinet Office Ordinance, is a case in which transactions between investment assets accounts executed by investment trust management companies meet the need to ensure fairness among customers and fulfill its duties of best execution and loyalty to customers, and this applies to transactions in which relevant "sell" or "buy" decisions by both of the funds executing the transactions between investment assets accounts are deemed necessary and rational, and that such transactions are executed in the best possible manner for the investment decisions made thus (or the transactions executed to follow the best execution practice results in offsetting possible losses involved in such transactions).

In determining whether there is necessity and rationality, factors such as the investment policy and investment plans of the funds involved (including in-house investment limits introduced by the investment trust management companies for the purpose of risk management, etc.), inflow or outflow of money associated with cancellation/formation of funds (including whether there is the need to sell or buy assets in order to maintain portfolios of individual funds, etc.), etc. are considered.

On the other hand, from the viewpoint of best execution practice, factors such as transaction costs,

mitigation of market impact, etc. are considered in addition to transaction prices.

From the above viewpoints, such transactions as listed below are considered as ones in which fairness among funds and fair price formation are ensured and as constituting a "case where it is deemed to be necessary and rational." (It must be noted, however, that these are shown only as examples and not the only ones that qualify.)

- A. To have traders execute transactions based on investment decisions made by several fund managers (limited to transactions regarding which there is not the risk of the price formation process being distorted in light of liquidity and other factors related to the relevant issue and, in cases where the transactions are executed by the same trader, the trader has no discretion over execution).
- B. To place both market buy and sell orders before the market's opening (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- C. To place both buy and sell orders in intraday trading at a reasonable interval (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- D. To make transactions related to index funds executed through program trading based on contracts and trust contract provisions (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- E. To make VWAP transactions and discretionary transactions, regarding which the decision on the timing of order placement, price and other execution terms related to individual issues are entrusted by the investment trust management company, etc., to a third-party entity (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- F. To make futures transactions, regarding which it is difficult to avoid the placement of orders for the same issue because of the small number of issues available for futures trading (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).

### (3) Points of Attention Regarding Origination of Investment Trusts, etc. Whose Investment Targets Include Assets Other Than Specified Assets

Under the Act on Investment Trusts and Investment Corporations, investment trusts and investment corporations are used for the purpose of investing mainly in specified assets, and are given special institutional positions as the people's long-term and stable asset formation means. As it is inappropriate to originate the following products in light of such purpose of the investment trust and investment corporation systems, supervisors shall conduct supervision by paying attention to whether those products are being originated:

- (i) Products whose investment targets include assets other than specified assets (hereinafter referred to as "non-specified assets" in this paragraph (3)) and specified assets that practically have the same nature as non-specified assets, such as equity in investment in a fund for which non-specified assets are

investment targets, (hereinafter referred to as “non-specified assets, etc.” in this paragraph (3)) (however, this shall not apply if the non-specified assets, etc. have a public nature, such as the “public facility, etc.” prescribed in the Act on Promotion of Private Finance Initiative)

- (ii) Products which, when investing in assets other than the fund’s investment targets, invest in non-specified assets, etc. with higher risk of price fluctuation, liquidity, etc. compared to the specified assets that are the original investment targets

Even for products which, when investing in assets other than the fund’s investment targets, invest in non-specified assets, etc. with low risk of price fluctuation, liquidity, etc., particular attention shall be paid to whether the following acts of origination are conducted, in light of the purpose of the investment trust and investment corporation systems:

- A. Act of originating a product that is given a name that evokes non-specified assets

#### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the control environment for business execution of an investment trust management company, etc., through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment trust management company, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the investment trust management company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment trust management company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-3-2 Control Environment for Customer Solicitation and Explanations for Beneficiaries, etc.

##### (1) Prohibition of Advertisements Using Exaggerated Descriptions

- (i) Whether the investment trust management company, etc., includes in its advertisements descriptions indicating that the performance, contents and method of its investment are markedly superior to those of other Financial Instruments Business Operators without providing the basis therefor.
- (ii) When including investment performance data in its advertisement, whether the investment trust management company, etc., uses descriptions that could cause misunderstanding by investors, by putting excessive emphasis on specific parts of the performance. (When investment performance data is included in an advertisement, appropriate and easy-to-understand descriptions must be used, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the method of investment evaluation and the basis for the use of benchmarks and properly expresses that the investment performance data is an indicator that concerns past results but does not promise future performance.)
- (iii) When including investment simulation in its advertisement, whether the investment trust management

company, etc., uses descriptions that could cause misunderstandings by investors by, for example, setting arbitrary assumptions. (When investment simulation is included in an advertisement, appropriate and easy-to-understand descriptions must be made, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the basis for the use of assumptions in the simulation and properly indicates that the simulation is based on prescribed assumptions and does not promise future investment performance.)

## (2) Provision of Documents to Beneficiaries, etc., in Potential Cases of Conflicts of Interests

The following are terminology interpretations regarding the provision of documents as specified under Article 13(1) of the Investment Trust Act, and an appropriate response to inquiries shall be made in accordance therewith.

### (i) Interpretation of “Same Type of Asset”

The “same type of asset,” as specified under Article 13(1)(i) and (ii) of the Investment Trust Act and Article 19(1) of the Order for Enforcement of the Investment Trust Act (hereinafter referred to as the “Enforcement Order of the Investment Trust Act”), does not apply to cases where, because of limits imposed by a relevant investment trust contract or the internal rules of a relevant investment corporation, the contents of a specified asset targeted for investment are different from the contents of a specified asset targeted for investment by another investment trust fund with settlor instructions or by an investment corporation.

### (ii) Interpretation of “entrustment of management”

The “entrustment of management,” as specified under Article 19(3)(i) of the Enforcement Order of the Investment Trust Act, refers to the entrustment of tenant management operations, such as the renewal of real estate-related rental contracts with tenants and receipts of rents, but does not include the entrustment of the building security and maintenance operations to outside specialist business operators.

## (3) Provision of Documents to Investment Corporations, etc., in Potential Cases of Conflicts of Interest

The points of attention described in (2) above shall be applied *mutatis mutandis* to the provision of documents to investment corporations, etc., as specified under Article 203(2) of the Investment Trust Act.

## (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the control environment for customer solicitation and explanations to beneficiaries of an investment trust management company, etc., through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment trust management company, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the investment trust management company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment trust management company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

### VI-2-3-3 Duty of Loyalty and Measures to Prevent Internal Collusion

#### (1) Points of Attention Regarding Investment Trust Management Companies, etc., Engaging in Two or More Types of Business

When supervisors examine the appropriateness of measures taken by an investment trust management company, etc., which is engaging in two or more types of business (as specified under Article 29-2(1)(v) of the FIEA), to prevent internal collusion, they shall pay attention to the following points, for example, depending on the nature of its business, from the viewpoint of preventing conflicts of interests and ensuring the appropriateness of business operations in other ways.

- (i) Whether the investment trust management company, etc., has taken appropriate measures to prevent collusion between its different types of business, such as establishing an internal control system and procedures for the prevention of such collusion in a manner suited to the nature of its business.
- (ii) Regarding the “non-disclosure information,” as specified under Article 147(ii) of the FIB Cabinet Office Ordinance, whether the investment trust management company, etc., has put in place information management measures, such as the appointment of the relevant manager and the establishment of management rules, and ensures the effectiveness of information management by, for example, properly identifying and examining the status of the usage of the non-disclosure information and revising the management method as necessary.

#### (2) Points of Attention Regarding Prevention of Conflicts of Interest in Investment Management Business

Whether appropriate measures have been taken to prevent practices that could promote the interests of specific rights holders at the expense of other rights holders, such as establishing an internal control system and procedures for the prevention of internal collusion between different types of business in a manner suited to the nature of the business.

#### (3) Duty of Loyalty to Rights Holders

It should be kept in mind that if an investment trust investment company, etc., causes financial damage to a rights holder due to a clerical error involved in the investment of investment assets and fails to compensate for the damage, it could constitute a violation of the duty of loyalty. The same shall apply to cases where the clerical error occurs at an entity to which business operations are entrusted and where the investment trust management company, etc., which has the obligation of duty to the rights holder fails to compensate for the damage.

#### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding measures taken by an investment trust investment company, etc., to prevent internal collusion between different types of business, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment trust investment company, etc., by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA, since such an issue could

directly undermine the interests of rights holders and, in some cases, lead to legal violations, such as a violation of the duty of loyalty and duty of due care. When the investment trust investment company, etc., is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment trust investment company, etc., is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-3-4 Business Continuity Management (BCM) of Investment Trust Management Companies

##### (1) Significance and Response

As investment trust management companies play an important role as intermediaries in the financial instruments market, it is extremely important for the people's lives and the economy that they act in an appropriate manner in the event of an emergency, by, for example, taking recovery measures quickly and ensuring that the minimum necessary operations and services are maintained. Therefore, securities companies, etc., need to make appropriate preparations in normal times, such as establishing business continuity management (BCM) systems and creating crisis management manuals. From this viewpoint, supervisors shall examine the appropriateness of the BCMs of investment trust management companies, in light of the characteristics of their business, by paying attention to the following points, for example.

##### (2) Major Supervisory Viewpoints

Whether the business continuity plan (BCP) ensures quick recovery from damage caused by acts of terrorism, large-scale disasters, etc., as well as continuance of the minimum necessary business operations and services for the maintenance of the functions of the financial system. Whether arrangements and procedures are in place for ensuring a response coordinated with Financial Instruments Firms Associations, securities companies, etc., and relevant organizations. Whether the BCP enables international disruptions of business operations to be dealt with in a manner suited to the actual state of business operations.

For example, attention shall be paid to:

- (i) Whether measures to secure the safety of customer data in the event of disasters, etc., have been taken (storing information printed on paper in electronic media, creating back-ups of electronic data files and programs, etc.).
- (ii) Whether measures to secure the safety of computer system centers, etc., have been taken (allocating suitable back-up centers, securing staff and communication lines, etc.).
- (iii) Whether the above back-up measures have been taken in ways to avoid geographic concentration.
- (iv) Whether a specific target period has been set for the recovery of operations vital for the maintenance of the lives of customers, economic activities and the functions of the financial instruments markets (as a consequence of an order cancellation request regarding an investment trust (including MMFs and MRFs): aggregation of the number of cancelled units, communications business (such as the receipt of notification

from a sales company regarding cancellation, aggregation, and notification to the entrusted bank), calculation of the base value, announcements, identification of the existing position, minimum investment instructions, and cancellation operations related to direct customers (point-of-contact services such as receiving cancellations from direct customers); and, for executing these business operations: legal responses (including the preparation and submission of a securities registration statement), organizational management, systems management, and crisis management (including the business of providing explanations to customers) through provisional measures such as manual operations and processing by back-up centers).

- (v) Whether the investment trust management company obtains the approval of the board of directors when it adopts the BCM and makes important revisions. Whether the BCM is subjected to examination by independent entities, such as internal and external audits.

(Reference)

“Development of BCM at Financial Institutions” (BOJ, July 2003)

“Basic Principles on Business Continuity” (Joint Forum, August 2006)

In addition, examination of the BCM and BCP shall basically be conducted with reference given to III-2-9.

#### VI-2-3-5 Points of Attention with respect to consideration of ESG

##### (1)Background

The number of investment products which incorporate Environmental Social and Governance (ESG) factors in their names and investment strategies has been increasing both in Japan and overseas, and at the same time, concerns over “greenwashing” that their actual investments may not be commensurate with their ESG claims are attracting attention globally.

Given this background, regarding publicly offered investment trusts in Japan with ESG factors included in their names and investment strategies, it is necessary to ensure their credibility in the market and to promote ESG investment, which will help build sustainable society.

In order to help retail investors make informed investment decisions, supervisors will check if the disclosures of publicly offered investment trusts and organizational resources and due diligence of investment trust management companies regarding ESG are appropriate by paying attention to the following points.

##### (2)Scope of ESG investment trusts

In this Supervisory Guidelines, an ESG investment trust is defined as a publicly offered investment trust which

- (i) considers ESG as a key factor in the selection of investment assets, and
- (ii) describes the content of (i) in the "Objective and Characteristics of the Fund" section of its delivery prospectus.

Where its investment management is delegated to a third party (including the case of “Funds of Funds”), the classification of the investment trust into ESG investment trusts should be decided appropriately by its entrusting investment trust management company in accordance with the investment strategy and portfolio composition of its

invested funds.

### (3) Disclosure

#### (i) Prevention of customer misunderstanding

Where an investment trust does not fall under the category of ESG investment trust, supervisors will check the following.

- The name or nickname of the investment trust excludes ESG-related terms such as ESG, SDGs (Sustainable Development Goals), green, decarbonization, impact, sustainable, etc. in order to avoid misleading investors.
- Where an ESG factor is considered along with other factors such as financial indicators in the selection of investment assets, ESG-related initiatives described in the "Objective and Characteristics of the Fund" of its delivery prospectus, sales materials, advertisement, etc. would not mislead customers into thinking that ESG is a key factor in its selection of investment assets.
- Where an investment trust which has been set up before the end of March, 2023 includes ESG-related terms in its name or nickname although it is not categorized as ESG investment trusts, that its delivery prospectus clearly states that it is not an ESG investment trust.

Please note that if an investment trust applies to the third case above, it is recommended that its investment management trust company excludes ESG-related terms from its name or nickname as soon as possible.

#### (ii) Investment Strategy

Supervisors will check the following items are described in the "Objective and Characteristics of the Fund" section of the delivery prospectus of an ESG investment trust. It is also accepted for point C below to be described in the "Investment Risk" section.

- A details of key ESG factors (e.g. comprehensive ESG rating or specific environmental or social issues) in the selection of investment assets
- B how key ESG factors are considered in the investment process (e.g. explanation of relevant criteria and indicators, evaluation methods, etc.)
- C risk and limitation in consideration of key ESG factors in the investment process
- D regarding an ESG investment trust that aims to create environmental or/and social impact in order to build a sustainable society, description of its purpose, details of the impact and how to measure and achieve it including target indicators and numbers, and methodologies
- E the content of the stewardship policy, where the investment trust management company has one related to key ESG factors in the selection of investment assets that is company-wide or specifically dedicated to the investment strategy
- F the references, where an ESG investment trust discloses further details of the above items from A through E on the website of the investment trust management company, etc.



(iii) Portfolio Construction

- An ESG investment trust has a target or guideline ratio of its investment asset (on a market value basis) that are selected by the use of key ESG factors out of its net asset value
- An ESG investment trust has other target or guideline indicators for evaluation of achievement of the whole portfolio regarding key ESG factors in the selection of investment asset.

Where either or both of the above is true, supervisors will check the ratio or figures are disclosed in the "Objective and Characteristics of the Fund" section of its delivery prospectus. Where it does not set such target or guideline ratio, supervisors will check the reason behind is explained.

(iv) Reference Index

Where an investment trust seeks to track a specific ESG index, supervisors will check that it explains how ESG factors are incorporated in the index in the "Objective and Characteristics of the Fund" section of its delivery prospectus and the reason why the investment management trust company has chosen the index.

(v) Periodic disclosure

Supervisors will check the following items are disclosed periodically in the delivery investment reports (periodic disclosure documents for Exchange-Traded Funds; the same applies hereinafter) and the "Investment Performance" section of the delivery prospectus of an ESG investment trust.

- A the actual proportion, where it has a target or guideline ratio of investment assets selected with the use of key ESG factors (on a market value basis) out of its net asset value
- B the status of achievement, where it has target or guideline indicators for evaluation of the whole portfolio regarding key ESG factors considered in the selection of investment assets
- C regarding an ESG investment trust that aims to create environmental or/and social impact in order to build a sustainable society, the extent of the impact achieved
- D the actions taken in accordance with the stewardship policy where an investment trust management company has one related to key ESG factors considered in the selection of investment assets that is company-wide or specifically dedicated to the investment strategy
- E the references, where the further details of the above items from A through D are disclosed on a website, etc.

(vi) Outsourcing

Where investment management of an ESG investment trust is outsourced to a third party, supervisors will check the investment management trust company conducts appropriate due diligence on the third party and review the status of investment management, and that it discloses the actual status of (2) to (5) of its invested funds in its delivery prospectus and delivery investment reports. Supervisors will check the reason behind is explained in case of difficulty in the disclosure above.

#### (4) Resources and Due Diligence

##### (i) Organizational Resources

Supervisors will check that an investment management trust company has adequate resources to implement operations in line with an investment strategy considering ESG factors and to monitor its implementation status on an ongoing basis. These resources include development of data, IT infrastructure and human resources regarding ESG factors.

Where investment management of a publicly-offered investment trust is delegated to a third party, supervisors will check that the investment trust management company has appropriate resources in place to conduct due diligence on the organizational resources of the third party and to confirm the status of (3)(ii) to (v) of the invested funds.

Where these disclosure are difficult to be made, supervisors will check the reason behind is stated.

##### (ii) Use of ESG Rating and Data Providers

When an ESG rating provided by a third party is used in the investment process of publicly offered investment trusts, or when data provided by a third party is used in own ESG assessment by an investment trust management company, supervisors will check it conducts appropriate due diligence which could include an understanding of the organizational resources of the third party, what is being rated or assessed by its product, how it is being rated or assessed, and limitations and purposes for which its product is being used.

#### VI-2-3-6 Other Points of Attention

The provisions of VI-2-2-5(2), (3), and (4) shall be applied mutatis mutandis to appropriateness of business operations related to investment trust management business, etc.

#### VI-2-4 Appropriateness of Business Operations Related to Foreign Investment Trust Management Business

Examination of the appropriateness of investment management business for establishing foreign investment trusts and giving direction for investment directly from Japan should be conducted in accordance with VI-2-3 (excluding VI-2-3-2 (2) and (3), VI-2-3-4, and VI-2-3-5).

#### VI-2-5 Appropriateness of Business Operations Related to Fund Management Business

Supervisors shall examine the appropriateness of the business operations of fund management companies (companies engaging in fund management business (financial instruments business involving the activities specified under Article 2(8)(xv) of the FIEA); the same shall apply hereinafter) by paying attention to the following points.

##### VI-2-5-1 Control Environment for Business Execution

###### (1) Investment and Administration of Investment Assets

Supervisors shall examine whether a fund management company is properly managing and administering investment assets by paying attention to the following points. It should be noted that the following points should be

taken into consideration in a comprehensive manner in light of the nature and size of the fund management company's business, and that failure to meet some of the criteria should not automatically be deemed to mean that the investment and administration of investment assets are inappropriate.

- (i) Whether the fund management company has properly specified the matters regarding internal organization that decide its investment policy (including a specific decision-making process).
- (ii) Whether the fund management company has prescribed a specific investment method for investment of investment assets by the investment division.
- (iii) Whether the fund management company has developed an appropriate control environment regarding the management of securities transactions between various investment assets and between investment assets and its own assets or third-party assets.
- (iv) In cases where the fund management company entrusts all or part of the authority over the investment made on behalf of rights holders (as specified under Article 42(1) of the FIEA; the same shall apply hereinafter) to another entity, under Article 42-3 of the FIEA (including cases where the entrusted entity entrusts part of the authority to yet another entity), whether the fund management company has properly established the criteria for selecting the entity to which the authority is entrusted and the method of communications therewith. Whether the investment management company has developed a control environment for continuously examining the entrusted entity's business execution capability and its compliance with contract provisions. Whether it has specified measures to be taken when a problem is found in the entrusted entity's business execution capability (e.g., providing guidance for business improvement and refusing to renew the entrustment contract).
- (v) Regarding the selection of the entities to which orders are placed and business operations are entrusted, whether the fund management company has properly specified the matters concerning the entities' transaction execution capability, control environment for legal compliance, credit risk and trading costs as items that should be taken into consideration.
- (vi) Whether the fund management company has arrangements and procedures for a division independent from the investment division to periodically examine whether investment assets are properly invested (including whether records on the investment status are stored), including whether the investment decision process is appropriate, in accordance with the investment guideline or the investment contract specified under Article 2(2)(v) of the FIEA.

## (2) Execution of Transactions

When fund management companies execute transactions, they are required to select the transaction form that benefits customers most, by taking into consideration the transaction price and other execution costs in a comprehensive manner. In light of the increasing diversification of the transaction forms due to the advance of financial techniques, supervisors shall examine the status of a fund management company's transaction execution by paying attention to the following points, for example:

- (i) At-Average-Price Transaction (transaction made at the average of prices of various orders of the same transaction and delivery dates aggregated by issue and order category (sell or buy))

A. Separation of Divisions

Whether the fund management company has separate divisions for making investment divisions and for taking orders. In cases where organizational separation is difficult, whether, at the minimum, different persons are responsible for these two tasks.

B. Examination of Transactions

Whether the fund management company has a control environment for ensuring that a relevant management division, for example, examines the whole range of business processes related to at-average-price transactions.

C. Disclosure to Customers and Consent Thereof

Whether the fund management company makes at-average-price transactions after making prior disclosure to customers and obtaining their consent. In cases where the fund management company makes orders involving proportional allocation of executed transactions with regard to two or more investment asset accounts, whether it provides customers with appropriate explanations regarding the criteria for allocation, in the case of the total executed transaction volume falling short of the total order volume.

(ii) Transactions Made via Bulk Orders

In cases where the fund management company places a bulk sell or buy order for the same issue on behalf of two or more investment asset accounts, and allocates the executed transactions to each asset account based on the allocation criteria prescribed by the Financial Instruments Business Operator after aggregating the transactions by issue and by buy/sell order, whether it has developed a control environment similar to the one described in (i) above, from the viewpoint of ensuring fairness among customers.

(iii) Transactions Made between Investment Asset Accounts

Transactions made between investment asset accounts are in principle prohibited because there is risk that investors in one of the funds involved in the transactions may receive unfavorable treatment and that such transactions may be utilized in acts that go against investor protection such as transfers of profits between the funds.

On the other hand, of transactions specified under Article 129(1)(i) of the FIB Cabinet Office Ordinance, if a transaction between investment assets accounts falls under a case where the prohibition of transactions between investment assets accounts does not apply, the relevant management division is required to be adequately prepared to verify that the transactions meet the requirements in (a) and (b) of Article 129(1)(i).

The "case where it is deemed to be necessary and rational," as specified by Article 129(1)(i)(a)(4) of the FIB Cabinet Office Ordinance, is a case in which transactions between investment assets accounts executed by fund management companies meet the need to ensure fairness among customers and fulfill their duties of best execution and loyalty to customers, and this applies to transactions in which relevant "sell" or "buy" decisions by both of the funds executing the transactions between investment assets accounts are deemed necessary and rational, and that such transactions are executed in the best possible manner for the investment decisions thus made (or the transactions executed to follow best execution practice result in the offsetting of possible losses involved in such transactions).

In determining whether there is necessity and rationality, factors such as the investment policy of the funds involved (including in-house investment limits introduced by the fund management businesses for the purpose of risk management, etc.), inflow or outflow of money associated with cancellation/formation of funds (including whether there is a need to sell or buy assets in order to maintain the portfolios of individual funds, etc.), etc. are considered.

On the other hand, from the viewpoint of best execution practice, factors such as transaction costs, mitigation of market impact, etc. are considered in addition to transaction prices.

From the above viewpoints, such transactions as listed below are considered as ones in which fairness among funds and fair price formation are ensured and as constituting a "case where it is deemed to be necessary and rational." (It must be noted, however, that these are shown only as examples and not the only ones that qualify.)

- A. To have traders execute transactions based on investment decisions made by several fund managers (limited to transactions regarding which there is not the risk of the price formation process being distorted in light of liquidity and other factors related to the relevant issue and, in cases where the transactions are executed by the same trader, the trader has no discretion over execution).
- B. To place both market buy and sell orders before the market's opening (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- C. To place both buy and sell orders in intraday trading at a reasonable interval (limited to orders which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- D. To conduct transactions related to index funds executed through program trading based on contracts and trust contract provisions (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- E. To make VWAP transactions and discretionary transactions, regarding which the decision on the timing of order placement, price and other execution terms related to individual issues are entrusted by the fund management company to a third-party entity (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).
- F. To make futures transactions, regarding which it is difficult to avoid the placement of orders for the same issue because of the small number of issues available for futures trading (limited to transactions which have no risk of distorting the price formation process in light of liquidity and other factors related to the relevant issue).

### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a fund management company's control environment for business execution, through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the fund management company by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the fund management company is deemed to have a serious problem from the viewpoint of protecting public interests and

investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the fund management company is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-5-2 Control Environment for Customer Solicitation and Explanations

##### (1) Prohibition of Advertisements Using Exaggerated Descriptions

- (i) Whether the fund management company includes in its advertisements descriptions indicating that the performance, contents and method of its investment are markedly superior to those of other Financial Instruments Business Operators without providing the basis therefor.
- (ii) When including investment performance data in its advertisement, whether the fund management company uses descriptions that could cause misunderstanding by investors, by putting excessive emphasis on specific parts of the performance. (When investment performance data is included in an advertisement, appropriate and easy-to-understand descriptions must be used, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the method of investment evaluation and the basis for the use of benchmarks and properly expresses that the investment performance data is an indicator that concerns past results but does not promise future performance.)
- (iii) When including investment simulation in its advertisement, whether the fund management company uses descriptions that could cause misunderstandings by investors by setting arbitrary assumptions, for example. (When investment simulation is included in an advertisement, appropriate and easy-to-understand descriptions must be made, from the viewpoint of protecting investors. For example, it is necessary to examine whether the advertisement specifies the basis for the use of assumptions in the simulation and properly indicates that the simulation is based on prescribed assumptions and does not promise future investment performance.)

##### (2) Points of Attention Regarding Provision of Pre-Contract Documents

In cases where a fund management company concurrently conducts business unrelated to investment management and where it receives remuneration related to investment management business and fees related to other business collectively under the same contract, the fund management company must separately specify the remuneration related to investment management business and the fees related to other business with regard to the “matters concerning fees, remuneration or any other consideration payable by the customer with regard to said Contract for Financial Instruments Transaction,” as specified under Article 37-3(1)(iv) of the FIEA.

##### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a fund management company’s control environment for customer solicitation and explanations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the fund management company by holding in-depth hearings and, when necessary, requiring the submission of

reports based on Article 56-2(1) of the FIEA. When the fund management company is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the fund management company is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-5-3 Duty of Loyalty and Measures to Prevent Internal Collusion

##### (1) Points of Attention Regarding Fund Management Companies Engaging in Two or More Types of Business

When supervisors examine the appropriateness of measures taken by a fund management company, which is engaging in two or more types of business (as specified under Article 29-2(1)(v) of the FIEA), to prevent internal collusion, they shall pay attention to the following points, for example, depending on the nature of its business, from the viewpoint of preventing conflicts of interests and ensuring the appropriateness of business operations in other ways.

- (i) Whether the fund management company has taken appropriate measures to prevent collusion between its different types of business, such as establishing an internal control system and procedures for the prevention of such collusion in a manner suited to the nature of its business.
- (ii) Regarding the “non-disclosure information,” as specified under Article 147(ii) of the FIB Cabinet Office Ordinance, whether the fund management company has put in place information management measures, such as the appointment of the relevant manager and the establishment of management rules, and ensures the effectiveness of information management by, for example, properly identifying and examining the status of the usage of the non-disclosure information and revising the management method as necessary.

##### (2) Points of Attention Regarding Prevention of Conflicts of Interests in Investment Management Business

Whether appropriate measures have been taken to prevent practices that could promote the interests of specific rights holders at the expense of other rights holders, such as establishing an internal control system and procedures for the prevention of collusion between different types of business in a manner suited to the nature of the business.

##### (3) Duty of Loyalty to Rights Holders

It should be kept in mind that if a fund management company causes financial damage to a rights holder due to a clerical error involved in the investment of investment assets and fails to compensate for the damage, it could constitute a violation of the duty of loyalty. The same shall apply to cases where the clerical error occurs at an entity to which business operations are entrusted and where the fund management company that has the obligation of duty to the investor fails to compensate for the damage.

##### (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a fund management company’s measures to prevent collusion between different types of business, through daily supervisory administration or the

reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the fund management company by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA, since such an issue could directly undermine the interests of rights holders and investment assets and, in some cases, lead to legal violations, such as a violation of the duty of loyalty and duty of due care. When the fund management company is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the fund management company is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VI-2-5-4 Other Points of Attention

The provisions of VI-2-2-5(2), (3), and (4) shall be applied *mutatis mutandis* to appropriateness of business operations related to fund management business.

#### VI-2-6 Points of Attention Regarding Real Estate-Related Fund Management Companies

Real estate investment trusts and other real estate-related funds are financial products based on the investment of funds collected from a broad range of investors, including individual investors, mainly in real estate (including financial products backed by real estate as the underlying assets; the same shall apply in VI). Financial instruments business operators which manage these products are required to ensure the appropriateness of the implementation of due processes, information disclosure and measures to prevent conflicts of interest, which are prerequisites for the exercise of an appropriate price formation function of the real estate market, thereby fulfilling the duties of loyalty and due care to investors.

While the viewpoints and supervisory methods and responses specified in VI-2-2 to VI-2-5 shall be applied to the supervision of real estate-related fund management companies, depending on the investment style, attention also needs to be paid to the following items. In this respect, supervisors shall pay particular consideration to whether real estate-related fund management companies sufficiently identify and understand the characteristics unique to real estate, in comparison with other assets, and the risks involved in the investment therein, as they need to conduct their business in a sound and appropriate manner based on sufficient understanding of these matters. It should be noted that the supervision conducted in this manner is not intended to manipulate specific real estate prices.

##### VI-2-6-1 Control Environment for Legal Compliance

Real estate-related fund management companies' control environments for legal compliance shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including measures to prevent conflicts of interest specific to the real estate-related fund business.

##### VI-2-6-2 Internal Control Environment

As real estate-related fund management companies are bound to the duties of due care and loyalty, they are



required to establish a sufficient control environment for legal compliance and risk management. Their management teams need to formulate various rules that ensure thorough legal compliance and risk management rules that ensure appropriate risk management based on the analysis and evaluation of risks involved in real estate investment, and check the status of compliance therewith.

It should be kept in mind that in doing the above, the management teams need to establish an internal control environment, including a control environment for due diligence that pays due consideration to the unique characteristics of real estate.

#### VI-2-6-3 Evaluation Items Concerning Operations of Real Estate-related Fund Management Companies

##### (1) Evaluation Items Concerning Due Diligence Control Environment for Purchase and Sales of Real Estate

Real estate due diligence is an important task for the understanding of the legitimate investment value of real estate, and thus its appropriateness shall be examined with due consideration of the following points.

Meanwhile, the management team must always understand the progress of implementation of measures to ensure the appropriateness of due diligence and the effectiveness of examination functions, while remaining aware of the issues.

- (i) Examinations shall be performed to see whether estimates of various costs of repair/renewal are appropriately investigated and reflected in the appraised value of real estate, considering the significance of an impact on cash flows in the future.
- (ii) The DCF method is an approach for valuation based on cash flows, and is a major and effective method for the appraisal of real estate. However, there are many preconditions, which may blur details. Thus, the point is whether the following items are verified, and the result of verification is recorded when the DCF method is adopted.
  - A. Validity of adopted figures (based on the projected estimates, in particular) and basis for judgment
  - B. Validity of the overall scenario and basis for judgment
  - C. Comparison and balance between the result of adopting the DCF method and the result of adopting other methods/means.
- (iii) The following points shall be considered when entrusting the formulation of engineering reports (ER) and appraisal reports and receiving them:
  - A. Whether it is ensured that ER writers and real estate appraisers make impartial decisions based on objective standards.
  - B. Whether necessary information etc., is provided to ER writers and real estate appraisers, when requesting ERs and real estate appraisal. Also, whether such provision of information, etc. is properly managed.
  - C. Whether the following points are confirmed in addition to necessary examinations on how the information, etc., mentioned in B. above has been reflected in the requested ER:
    - a. Whether necessary investigations are conducted and the investigation results are justified by objective grounds when investigating soil contamination and harmful substances.

- b. Whether it is confirmed what kind of repairs are used as the basis for calculations of cost estimates of repairs and renewals of individual parts of a building.
  - c. Whether necessary verifications of compliance have been conducted regarding the target property, not only compliance with laws but also with ordinances, such as district plans, etc.
- D. When receiving the appraisal report from the appraiser who was requested to perform the evaluation, whether the necessary examination has been conducted to see how the information, etc., listed B. above has been reflected in the report and whether the following points have been verified:
- a. Whether the concept of ER has been considered and reflected. Whether the reasons and grounds for any items not being reflected have been confirmed.
  - b. In the case of adopting the DCF method, whether estimates of future income and utilization rate, etc., are verified as relevant and based on objective data. Also, whether the level of relevance has been verified in the same way for the estimation of discount rates and terminal rates, which serve as preconditions.
  - c. Whether necessary examinations have been performed of items that may possibly influence the liquidity of the real estate itself and the cash flows that would be generated by the real estate.
- E. In the cases where listed details in the ER and appraisal report are not used when calculating the purchase/sales price based on the result of due diligence, whether the relevance of adopted values, etc., is verified and the basis for such values is recorded and stored.

## (2) Control Environment for Preventing Conflict of Interest Transactions

The management team needs to be aware of the potential for risks of conflict of interest transactions to occur, and identify not only interested persons specified in laws, but also possible business partners with which conflicts of interest may arise, and then to establish an adequate management system concerning the transactions with these persons. Examination shall be made, focusing on the following points.

- (i) In cases where the management team adopts a policy to the effect that a fair transaction price for acquiring property can be calculated on the basis of the appraised value of the real estate, with a certain range of adjustment, whether the real estate-related fund management company has developed a control environment for periodically examining the appropriateness of such range of adjustment in view of the market conditions; whether the real estate-related fund management company has developed a control environment for appropriately announcing such policy (if the policy is revised, the reasons for the revision shall be included) (in the case of a private placement fund, such announcement shall be made by making notifications to subscribers).
- (ii) Whether the real estate-related fund management company has developed a centralized management system for property information (including the state of negotiations concerning purchase and sales, etc.), and authorized compliance personnel to manage negotiations concerning sales and purchases from the perspective of preventing conflict of interest transactions.
- (iii) Whether the real estate-related fund management company is aware of a high risk of conflict of interest occurring in cases where it uses the warehousing function when it is unable to acquire real estate held by a

third party at the time said party wishes to sell the same, and with this in mind, carries out negotiations, clarifies the sharing of roles, and conducts due diligence procedures appropriately.

(3) Points to Consider in the Cases Where Management of Real Estate-related Assets of Several Funds are Entrusted to One Real Estate-related Fund Management Company

In the cases where a real estate-related fund management company is entrusted with the management of real estate from several funds, it shall be considered, at the time when property information is obtained, to see whether measures have been taken to avoid competition over the acquisition among management funds and whether a framework has been established to enable each fund to make decisions independently.

(4) Points of Attention When Acquiring Shares in Overseas Companies That Holds Real Estate Assets

When an investment corporation wants to acquire a real estate asset located overseas but the corporation itself is unable to do so because of inevitable reasons including local laws and local practices, such a corporation can acquire a majority of shares with voting rights in the company that holds the said real estate asset (hereinafter referred to as "overseas real estate holder"). In such a case, all of the following requirements must be met.

- (i) The overseas real estate holder's sole purpose of business is acquisition, assignment and other transactions of real estate assets in the country of its location.
- (ii) The investment corporation receives annual payments from the funds available to pay out by the overseas real estate holder as dividends in an amount proportionate to the percentage of the number of shares the investment corporation holds or the amount it invests in the overseas real estate holder (or an amount paid out in accordance with laws or practices in the overseas real estate holder's country of location).
- (iii) The overseas real estate holder has its financial statements audited or verified by a firm engaged in conducting audits or verification at the request of customers.

(5) Others

- (i) Scope of "Acquisition of Real Estate," etc.

"Acquisition of real estate" does not include the development of housing sites or the construction of buildings by an investment corporation itself, but includes cases where the investment corporation concludes a contract for work and orders the development of housing sites or construction of buildings.

However, in cases where an investment corporation is unsuitable to conclude a contract for the development of housing sites or construction of buildings, including the following cases, such practice does not fall within the scope of "acquisition of real estate."

- A. When conducting large-scale repair and renovation work, etc., tenants need to be relocated for a certain period of time, and the fluctuations of cash flows will heavily affect the entire portfolio.
- B. When an investment corporation purchases undeveloped land and constructs new buildings, various risks will be involved in the development of real estate (development risk, authorization risk, construction completion risk, tenant risk, price fluctuation risk, interest fluctuation risk during development, and large natural disaster risk, etc.), and such risks may greatly affect the entire portfolio

because the investment does not generate immediate cash flows.

(ii) Forward Commitment by Investment Corporations

In cases where an investment corporation makes a forward commitment, etc. (referring to a postdated sales contract under which payment and delivery shall be made at least one month after the conclusion of the contract, or any other contract similar thereto; hereinafter the same shall apply in (ii)), attention shall be paid to the following points. Similar treatment shall be applied in cases where an investment corporation manifests the intention to make a postdated purchase, if such manifestation of intention is effectively binding on the transaction.

- A. Whether the investment corporation clearly shows the possible impact on its financial status in the event of its failure to fulfill the forward commitment, etc., by appropriately announcing the terms of cancellation.
- B. Whether the investment corporation has, while taking into consideration the market environment, financing environment and the individual situations of the corporation, drawn up rules regarding the acquisition price of the property under a forward commitment, etc. and the maximum period from the conclusion of the contract until the delivery of the property, as well as the method for procuring funds for payment, and complies with such rules; in particular, in the case of a listed investment corporation, whether the corporation has developed a control environment for carefully considering a forward commitment, etc., under which it might have to pay an excessive penalty compared with the dividend resources, including the delisting requirements.
- C. While the property under a forward commitment, etc. is not included in the balance sheet until payment is made for it, the price volatility risk for the property until that time is attributed to the investment corporation. In light of this, whether the investment corporation conducts continuous appraisal of the properties that it holds, and publicizes the results of the appraisal of such properties (in the case of properties which are yet to be constructed and therefore cannot be appraised, the results of the price research).

(iii) Issuance of Subordinated Investment Corporation Bonds by Investment Corporations

In cases where the investment corporation issues subordinated investment corporation bonds, supervisors shall check whether the corporation has carefully examined the necessity of fund raising through the issuance and the appropriateness of the terms of issuance, while taking into consideration that investors' interest would be harmed depending on the terms of issuance, and has publicized information on these matters appropriately.

(iv) Control Environment for Managing the Outsourcing of Business Operations

Real estate-related fund management companies, while exercising investment discretion, outsource part of their businesses to various corporations (ER corporations, appraisal corporations, trust banks, property management corporations, and building management corporations, etc.). Thus, appropriate supervision over the said outsource is essential if they are to exercise loyalty and fulfill their duties. In order to effectuate supervisions, it is necessary to improve various reporting lines from outsourcees (both direct and indirect via trust banks, etc.) upon formulating various regulations/standards, including selection criteria for outsourcees, thereby implementing effective monitoring periodically. Meanwhile, it should be noted that the appropriate

clarification of role sharing between outsourcers and outsourcees is a prerequisite for a control environment for managing the outsourcing of business operations.

(v) Investment, etc., in Development SPC

Whether analysis and risk management have been appropriately implemented with respect to various risks (development risk, authorization risk, construction completion risk, tenant risk, price fluctuation risk, interest fluctuation risk during development, and large natural disaster risk, etc.). Whether monitoring of project progress has been properly conducted. Meanwhile, attention should be taken to ensure that investment in the development SPC by funds other than those specializing in development-style projects does not impose excessive influence on the entire portfolio, considering that the development does not generate immediate cash flows.

(vi) Control Environment for Managing Information

As for the information management of real estate-related fund management companies, which manage listed real estate investment juridical persons, it is necessary to manage information appropriately, by taking measures to ensure confidentiality of information prior to decision making, such as investment decisions based on asset management outsourcing contracts, etc. (decision making, etc., concerning acquisition and sales), as well as confidentiality of information prior to transaction and prior to disclosure.

(6) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the above evaluation points, through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the real estate-related fund management company by requiring the submission of reports based on Article 56-2(1) of the FIEA. When the real estate-related fund management company is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the real estate-related fund management company is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52 (1) of the FIEA.

VI-2-7 Points of Special Attention Regarding Investment Management Business for Qualified Investors

VI-2-2 to VI-2-6 shall be applied *mutatis mutandis* to the appropriateness of the business operations of investment management business operators for qualified investors (meaning a person engaged in investment management business for qualified investors prescribed in Article 29-5(1) of the FIEA; the same shall apply hereinafter). In addition, supervisors shall examine the appropriateness by paying attention to the following points in particular.

VI-2-7-1 Points of Attention Regarding the Control Environment for Business Execution

### (1) Points of Attention Regarding the Control Environment for Execution of Transactions

In the case of an investment management business operator for qualified investors which does not have separate divisions (personnel) for making investment decisions and for taking orders, as an alternative, whether measures have been implemented for preventing prohibited acts pertaining to investment management business, in view of the investment policy, the amount of assets managed and other circumstances of the investment management business for qualified investors.

### (2) Points to Consider in Cases Where Compliance Work is Outsourced

In cases where an investment management business operator for qualified investors has outsourced its compliance work, supervisors need to pay attention to the following points, for example.

It should be kept in mind that the following points are general supervisory viewpoints, and that supervisors may need to examine other points too, in view of the business operations of the investment management business for qualified investors.

- (i) Whether the business operator has clearly specified a policy and procedures for selecting the contractors.
- (ii) In cases where compliance work is entrusted to a group corporation in Japan or overseas, whether the business operator can evaluate that a system has been developed for compliance of an investment management business operator for qualified investors, considering the degree to which the said corporation possesses compliance functions and its execution of the outsourced business.
- (iii) In cases where compliance work is entrusted to an attorney, a legal professional corporation or a person equivalent thereto (hereinafter referred to as “attorney, etc.” in this item (iii) and in VI-3-1-2), whether the business operator has considered the following points.
  - A. Whether the attorney, etc. entrusted with the work is a person recognized as being capable of properly carrying out the necessary guidance, etc. for complying with laws and regulations regarding financial instruments business.
  - B. Whether the following items have been stipulated in the outsourcing contract concluded with the said attorney, etc.:
    - a. Identification and examination of actual business conditions from a perspective of legal compliance
    - b. Preparation and management of a compliance manual, and periodic implementation of compliance training
    - c. Periodic preparation of a report on compliance, as well as the storing and provision of reports to the trustor
    - d. System of communication between the trustor and contractor (including responses in the event of a dispute)
    - e. Other matters in addition to those listed in a to d above, which are needed for compliance work pertaining to the investment management business for qualified investors

### VI-2-8 Points of Special Attention Regarding Businesses Specially Permitted for Overseas Investors, etc.

VI-2-5 and VI-2-7 shall also apply regarding the appropriateness of business operations of persons engaging in businesses specially permitted for overseas investors, etc. Supervisors shall examine the appropriateness by paying attention to the following points in particular.

#### VI-2-8-1 Points of Attention Regarding the Control Environment for Business Execution

##### (1) Requirements for Businesses Specially Permitted for Overseas Investors, etc.

- (i) In accordance with the supervisory viewpoints in VI-1-2, whether it is found that adequate staffing for properly performing businesses specially permitted for overseas investors, etc. is secured, and whether it is found that an environment necessary for properly performing businesses specially permitted for overseas investors, etc. has been developed.
- (ii) Whether the investment ratio of non-residents (referring to non-residents prescribed in Article 6(1)(vi) of the Foreign Exchange and Foreign Trade Act; the same shall apply hereinafter) out of overseas investors, etc. to the total investment amount of the fund is over 50% .
- (iii) Whether internal records are properly made and preserved, for example, as a means to properly confirm that the customer, by way of sufficiently confirming, as the customer who is an individual with an address in a foreign country and is going to acquire an invested business equity pertaining to businesses specially permitted for overseas investors, etc., falls under Article 246-10(1)(i) or (ii) of the FIB Cabinet Office Ordinance, by fully utilizing a self-reported document and other materials voluntarily submitted by the customer (a report on outstanding balance of transactions, a copy of a deposit passbook, etc.) or documents, etc. prescribed in Article 246-14(1)(v)(c) of the FIB Cabinet Office Ordinance, thereby managing and preserving documents in which the confirmation results and grounds therefor are stated.
- (iv) Whether efforts are being made to ensure appropriate solicitation by examining as necessary whether staff ever induce customers to make false reports on their assets with the intention of soliciting investments from customers who do not meet requirements for making investments. In particular, in cases where an overseas investor, etc. who does not fall under a professional investor becomes a customer, whether the obligation to deliver documents, such as a document for delivery prior to conclusion of contract, under the FIEA and other conduct control are properly observed.

##### (2) Supervisory Method and Actions

Regarding issues of supervisory concern, which were identified through day-to-day supervisory work and the reporting of problematic conduct, in relation to persons engaging in businesses specially permitted for overseas investors, etc., supervisors shall hold an in-depth hearing and, when necessary, request the submission of a report based on Article 63-14 of the FIEA (including cases where applied mutatis mutandis pursuant to Article 63-11(2) of the same Act). In particular, the other parties to businesses specially permitted for overseas investors, etc. are mainly non-residents, and therefore, supervisors shall endeavor to ascertain and eliminate problems at an early stage by positively utilizing frameworks for cooperation with foreign authorities. When a serious problem from the viewpoint of protecting public interests and investors has been found, supervisors shall take action, such as issuing a business improvement order based on Article 63-13(1) of the FIEA (including cases where applied mutatis mutandis pursuant

to Article 63-11(2) of the same Act; hereinafter the same shall apply in VI-3-3). Furthermore, when a serious and malicious illegal act has been found, supervisors shall consider necessary action, including the issuance of a business suspension order based on Article 63-13(2) of the FIEA (including cases where applied mutatis mutandis pursuant to Article 63-13(2) of the same Act; hereinafter the same shall apply in VI-3-3) or a business abolition order based on Article 63-13(3) of the FIEA (including cases where applied mutatis mutandis pursuant to Article 63-11 (2) of the same Act; hereinafter the same shall apply in VI-3-3).

#### VI-2-9 Points of Special Attention Regarding Businesses Specially Permitted for the Transitional Period, etc.

VI-2-2, VI-2-4, and VI-2-8 shall also apply regarding the appropriateness of business operations of persons engaging in businesses specially permitted for the transitional period, etc. Supervisors shall examine the appropriateness by paying attention to the following points in particular.

##### VI-2-9-1 Points of Attention Regarding the Control Environment for Business Execution

###### (1) Requirements for Businesses Specially Permitted for the Transitional Period, etc.

Persons engaging in businesses specially permitted for the transitional period need to confirm that a customer falls under the category of overseas investors, etc. (referring to overseas investors, etc. prescribed in Article 3-3(6) of the Supplementary Provisions of the FIEA; hereinafter the same shall apply in VI-2-9) or that other requirements for businesses specially permitted for the transitional period, etc. are met and make a record. When ascertaining the actual status through checking submitted documents and business reports, etc., supervisors shall conduct verification while paying attention to the following points, for example.

- (i) Whether the person engaging in businesses specially permitted for the transitional period appropriately confirms that customers are only overseas investors, etc. and prepares and preserves internal records on the confirmation results.
- (ii) In cases where a customer is a Financial Instruments Business Operator or a registered financial institution engaging in investment management business, whether the person engaging in businesses specially permitted for the transitional period confirms the trade name, registration number, address, etc. of the Financial Instruments Business Operator or the registered financial institution and prepares and preserves internal records on the confirmation results.
- (iii) Whether a foreign investment management business operator has obtained registration of the same type as that under the FIEA for conducting investment management business in countries or regions that have a system regarding persons engaging in investment management business that is found to be at the equivalent level as that in Japan.
- (iv) Whether a foreign investment management business operator has continued engaging in investment management business three years or more in a foreign country in compliance with the laws and regulations of that country. Additionally, whether the period of engaging in the relevant business is calculated while excluding a leave period, etc.



(v) Whether the main subjects of investment are not shares, share options, or bonds with share options that contain voting rights against domestic companies, etc., or beneficial interests in which any of these is the trust property.

## (2) Supervisory Method and Actions

Businesses specially permitted for the transitional period, etc. were introduced as a temporary measure to enable commencement of businesses through simple procedures from the perspective of facilitating acceptance of foreign investment management business operators for developing Japan's capital markets' functions as an international financial center. In light of the purpose of this system, supervisors shall conduct supervision while paying attention to the following points, for example.

(i) It is prescribed that businesses specially permitted for the transitional period, etc. may only be conducted until the time when five years have passed from the day of notification, or in cases where a person becomes a Financial Instruments Business Operator, etc. (limited to one engaging in investment management business), a notifier of specially permitted businesses, or a notifier of businesses specially permitted for overseas investors, etc. until the lapse of that five-year period, until the time of becoming said Financial Instruments Business Operator, etc., notifier of specially permitted businesses, or notifier of businesses specially permitted for overseas investors, etc. Therefore, whether the person is scheduled to be a Financial Instruments Business Operator, etc., notifier of specially permitted businesses, or notifier of businesses specially permitted for overseas investors, etc. in Japan within that five-year period of the temporary measure.

(ii) In cases where a Financial Instruments Business Operator, etc., notifier of specially permitted businesses, or notifier of businesses specially permitted for overseas investors, etc. intends to obtain registration or make notification, whether the person considers the need for satisfying the requirements respectively in accordance with a business category.

## VI-2-10 Appropriateness of Investment Corporations' Business Operations

### VI-2-10-1 Items Regarding Investment Corporations' Organizational Management

#### (1) Points of Attention Regarding Management of Executive Committee Meetings

- (i) Whether the investment corporation's executive committee meetings have become a matter of formality. For, example, attention shall be paid to whether decisions are made through the so-called round-robin arrangement, instead of being made at meetings attended by executives in person.
- (ii) Whether the investment corporation has received appropriate data and materials and sufficient explanations from the asset investment company in order to ensure the effectiveness of deliberations by the executive committee
- (iii) Whether the investment corporation's executive committee clearly categorizes the business operations entrusted to the company undertaking general clerical work and the asset investment company and checks whether the fees paid to them are appropriate and suited to the categories of the business operations entrusted to them.

## (2) Role of Executive Officers

Whether executive officers understand the items to be decided by the executive committee and refer all necessary items thereto.

## (3) Supervisory Executives

Whether supervisory executives not only attend executive committee meetings, but also supervise the status of business execution by executive officers based on the recognition of their role as the supervisors of executive officers as specified under Article 111(1) of the Investment Trust Act. Whether they require executive officers, the company undertaking general clerical work, the asset investment company and the asset custody company to report to them and conduct necessary investigations, depending on the circumstances.

## (4) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding an investment corporation's organizational management, through daily supervisory administration and the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment corporation by requiring the submission of reports based on Article 213 of the Investment Trust Act. When the investment corporation is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 214 of the Investment Trust Act. When the investment corporation is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the rescission of registration based on Article 216(1) of the Investment Trust Act.

## VI-2-11 Other Points of Attention

### VI-2-11-1 Points of Attention Regarding Investment Trust Act and Trust Act

The points of attention regarding the laws and regulations applicable to investment trusts, to which assets were entrusted before the new Trust Act entered into force, are as explained below. It should be noted that the definitions of terms used in VI-2-11-1 are as follows:

- (i) "New Trust Act": Trust Act (Act No. 108 of 2006)
- (ii) "Act for Establishment of Laws and Regulations Related to the Trust Act": A law for the establishment of laws and regulations necessitated by the entry into force of the Trust Act (Act No. 109 of 2006).
- (iii) "New Investment Trust Act": Revised Investment Trust Act specified under Article 5 of the revised law
- (iv) "Former Investment Trust Act": Investment Trust Act before the revision as specified under Article 25 of the Act for Establishment of Laws and Regulations Related to the Trust Act
- (v) "New Law-Based Trust": Investment trusts to which assets were entrusted after the entry into force of the New Investment Trust Act and New Trust Act

- (vi) “Former Law-Based Trust”: Investment trusts to which assets were entrusted before the entry into force of the New Investment Trust Act and New Trust Act

The Former Law-Based Trusts may be converted into New Law-Based Trusts under Article 3 or Article 26(1) of the Act for Establishment of Laws and Regulations Related to the Trust Act. Unless the conversion is made, they shall be subject to Article 2 of the Act for Establishment of Laws and Regulations Related to the Trust Act. Therefore, Former Law-Based Trusts are not eligible for the provisions of the New Trust Act nor the Act for Establishment of Laws and Regulations Related to the Trust Act regarding a registry of beneficiary rights, consolidation of trusts and a notice regarding investment trusts by the settlor nor for the provisions of the New Trust Act concerning requests for purchases by beneficiaries who have opposed written resolutions regarding changes in investment trust contract provisions (Articles 4(2)(xvii), 6(7), 16(ii), 17, 18, 20, 25, 49(2)(xviii) and 50(4) of the New Investment Trust Act, Article 16(ii), 17 and 18 of the New Investment Trust Act as applied mutatis mutandis pursuant to Article 54(1) of the same act, Articles 16(ii), 17, 20 and 25 of the New Investment Trust Act as applied mutatis mutandis pursuant to Articles 57 and 59 of the same act, the penalties related to these provisions and relevant FIEA Enforcement Order and cabinet office ordinance). Instead, they are subject to the relevant provisions of the Former Investment Trust Act, the FIEA Enforcement Order and cabinet office ordinance that were effective before the new provisions took effect.

#### VI-2-11-2 Points of Attention Regarding Investment Trusts without Settlor Instructions

The points of attention specified in VI-2-3-2(2) shall be applied mutatis mutandis to the provision of documents to beneficiaries, etc., based on Article 13(1) of the Investment Trust Act as applied mutatis mutandis pursuant to Article 54(1) of the same act.

#### VI-2-11-3 Points of Attention Regarding Merger of Investment Corporations

In the case of an absorption-type merger, if money is to be paid for adjusting the merger ratio upon the calculation of the number of units of investment equity in the corporation surviving the merger to be delivered to the investors of the corporation extinguished upon the merger (e.g. merger ratio adjustment money or substitute money for distribution; hereinafter referred to as “money delivered upon merger”), attention should be paid to the amount of money delivered upon merger or the calculation method thereof and the amount of money delivered upon merger to be allocated according to the number of units of investment equity held by the investors of the extinguished corporation, which can be regarded as the matters listed in Article 147(1)(ii) of the Investment Trust Act.

#### VI-2-11-4 Points of Attention Regarding Segregated Management, etc.

##### (1) Points of Attention Regarding Management, etc. of Crypto-and Other Assets

When a Financial Instruments Business Operator manages crypto-and other assets as investment assets in investment management business, appropriate handling of segregated management of crypto-and other assets needs to be secured based on Article 42-4 of the FIEA and Article 125(ii)(d) of the FIB Cabinet Office Ordinance as applied mutatis mutandis pursuant to Article 132(1) of that Cabinet Office Ordinance. In addition, there is a risk

that investor protection would not be ensured if crypto-and other assets, which are investment assets, are leaked due to unauthorized computer access, etc. Therefore, it is required to take appropriate actions against such risk of leakage through establishment of an internal control environment (including a control environment for internal audits according to the nature of the business), such as segregated management and information technology risk management, etc., in normal times.

Supervisors shall oversee the state of such management by applying mutatis mutandis V-2-1-4.

## (2) Points of Attention Regarding Management, etc. of Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

When a Financial Instruments Business Operator manages electronically recorded transferable rights that must be indicated on securities, etc. as investment assets in investment management business, appropriate handling of segregated management of electronically recorded transferable rights that must be indicated on securities, etc. needs to be secured based on Article 42-4 of the FIEA and Article 132(2)(v) or (vi) of the FIB Cabinet Office Ordinance as well as Article 43-2 of the FIEA and Article 136(1)(v) or (vi) of the FIB Cabinet Office Ordinance. In addition, there is a risk that investor protection would not be ensured if electronically recorded transferable rights that must be indicated on securities, etc., which are investment assets, are leaked due to unauthorized computer access, etc. Therefore, it is required to take appropriate actions against such risk of leakage through establishment of an internal control environment (including a control environment for internal audits according to the nature of the business), such as segregated management and information technology risk management, etc., in normal times.

Supervisors shall oversee the state of such management by applying mutatis mutandis IV-3-6-6 and IV-3-6-7.

## VI-2-12 Points of Attention Regarding Supervision of Non-Affiliated Business Operators

### (1) Major Supervisory Viewpoints

- (i) In the case of a Financial Instruments Business Operator who does not have membership in any Financial Instruments Firms' Association (referred to as "Non-Affiliated Business Operators" in VI-2-12), whether it has developed internal rules that are in line with Rules Set by Associations, etc.
- (ii) Whether the Financial Instruments Business Operator has developed a control environment that ensures appropriate compliance with internal rules (e.g., information sharing among officers, information sessions for employees and examination of status of compliance).
- (iii) When rules set by associations, etc., have been revised, whether the Financial Instruments Business Operator makes sure to quickly review and revise internal rules accordingly.

### (2) Supervisory Method and Actions

If a problem is found regarding creation and revision of internal rules at a Non-Affiliated Business Operator and the status of compliance, supervisors shall conduct in-depth inquiry and, if necessary, have the operator submit a report based on provisions of Article 56-2(1) of the FIEA to look into the status of spontaneous efforts to improve the situation at the said Financial Instruments Business Operator. When the operator is deemed to have a serious

problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. Further, if, after requesting a report, an operator is not confirmed to have introduced internal rules that are in line with Rule Set by Associations, etc., or that it has failed to introduce a system to ensure compliance with the relevant internal rules, supervisors shall consider necessary responses, including issuance of a Business Improvement Order based on provisions of Article 52(1) of the FIEA.

## VI-3 Various Administrative Procedures (Investment Management Business)

### VI-3-1 Registration

#### VI-3-1-1 Investment Management Business

##### (1) Items Regarding Examination of Staffing Level

When supervisors examine whether or not a Financial Instruments Business Operator is sufficiently staffed to properly conduct the financial instruments business, as specified under Article 29-4(1)(i)(e) of the FIEA, they shall check the following points based on its application and attachments thereto as well as hearings. Note that the examination as to whether the operator has the structure/system necessary to operate financial instruments business appropriately, thereby falling under Article 29-4(1)(i)(f) of the FIEA, shall also be based on the following points.

- (i) Whether it can be confirmed that officers and employees with sufficient knowledge and experience have been secured and a sufficient organization has been established to conduct the relevant financial instruments business in light of the following requirements:
  - A. Top managers must be sufficiently qualified to conduct investment management business in a fair and appropriate manner, in terms of their backgrounds and capabilities.
  - B. Managing directors must understand the viewpoints regarding governance indicated in the FIEA and various other laws and regulations, and have sufficient knowledge and experience to conduct governance and sufficient knowledge and experience regarding compliance and risk management to conduct financial instruments business in a fair and appropriate manner.
  - C. Persons with sufficient knowledge and experience regarding investment assets must be secured for the position responsible for making asset investment on behalf of rights holders.
  - D. The compliance division (staff in charge of compliance) must be independent from the asset investment division and staffed with personnel with sufficient knowledge and experience.
  - E. In addition to securing the personnel described in C. and D. above, the Financial Instruments Business Operator must be staffed and organized so that personnel necessary for conducting relevant business in an appropriate manner are allocated to individual divisions and managers in charge of internal control are appropriately allocated.
  - F. Staff capable of conducting the following processes should be secured with regard to the relevant business.
    - a. Compilation and management of account documents (including the account documents as specified in VI-3-2-4), reports and other documents.
    - b. Disclosure
    - c. Segregated management of investment assets
    - d. Risk management
    - e. Computer system management
    - f. Trading management and customer management by relevant management divisions

- g. Management of sensitive corporate information
  - h. Advertisement screening
  - i. Customer information management
  - j. Processing of complaints and disputes
  - k. Execution of asset investment business by the investment division
  - l. Internal audits
  - m. Accounting and screening related to investment trust assets in the case of investment of investment trust assets
- (ii) When the qualifications of employees and officers are examined in a comprehensive manner in relation to the following criteria regarding organized crime groups, their members and financial crimes, whether there is the risk that public confidence in the financial instruments business could be damaged because of the inclusion of officers and employees with inappropriate qualifications among its staff.
- A. Officers and employees should not be current or former members of organized crime groups.
  - B. Officers and employees should not have close relationships with organized crime groups.
  - C. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - D. Officers and employees should not have the experience of being sentenced to a fine (including similar punishments imposed under foreign laws and regulations equivalent thereto) for violation of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions of Article 32-2(7) of the same act) or other foreign laws and regulations equivalent thereto, or for committing a crime prescribed under the Penal Code or under the Act on Punishment of Physical Violence and Others.
  - E. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion, as well as attempts at these crimes).)
- (Note) It should be kept in mind that in cases where it is deemed as a result of comprehensive examination based on the criteria described in (ii) A. to D. that a major shareholder in the Financial Instruments Business Operator could exercise undue influence on it, thereby damaging public confidence in it, the business operator may be deemed to be “not adequately staffed to properly conduct financial instruments business.”

## (2) Documents Specifying Contents and Methods of Business Operations

Supervisors shall check whether documents specifying the contents and methods of an investment management business operator’s business operations properly specify the following items:

- (i) Types of financial instruments transactions which the investment management business operator conducts
- (ii) Items specified under Article 8(ix) of the FIB Cabinet Office Ordinance.
- (iii) Basic principles on business operations

- A. The investment management business operator's basic policy for business operations and principles on the conduct of business operations
- B. Items regarding the basic policy for asset investment
- C. Types of investment assets
- D. Items regarding the entrustment of the authority over investment
- E. Items regarding improvement of the investment management business operator's financial condition
- (iv) Method of Business Execution
  - A. Items regarding the investment method
  - B. Items regarding customer solicitation and contract signing
  - C. Items regarding the administration of investment assets
- (v) Method of the allocation of business operations
  - Items regarding the investment management business operator's organization
- (vi) Arrangements and procedures for dealing with complaints
- (vii) Name of the Financial Instruments Firms' Association to which the investment management business operator belongs and items regarding compliance with voluntary regulatory rules set by the association.

(3) Items to Be Specified in Documents Prescribed under Article 9(i) of the FIB Cabinet Office Ordinance.  
(Documents Specifying Framework for Business Execution Such as Staffing and Organization)

- (i) The lineup of officers and employees at the start of the investment management business (including each officer's experiences and knowledge regarding investment instructions and investment assets), an organization chart and the outline of business operations conducted by individual divisions
- (ii) Framework for Business Operations Related to Asset Investment
  - A. Items regarding the internal organization responsible for deciding the investment policy concerning investment assets
  - B. The asset investment division's arrangements and procedures for asset investment
  - C. Items regarding the selection of an entity to which asset investment is entrusted (including cases of re-entrustment) and arrangements and procedures for communications therewith
- (iii) Knowledge and Experience of Persons in Charge of Asset Investment
  - The knowledge and experience of each person in charge of asset investment, with regard to investment assets, must be specified.
- (iv) Knowledge and Experience of Persons in Charge of Compliance
  - The knowledge and experience of persons in charge of compliance, with regard to processes for ensuring compliance, must be specified.
- (v) Internal Control System and Procedures for Asset Investment and Other Operations
  - Items regarding rules concerning investment instructions (including investment instructions and investment made by an entity entrusted with asset investment in cases where asset investment is entrusted to an outside entity), rules concerning the division in charge of internal inspection of individual divisions, and arrangements and procedures for clerical processes.



- (vi) Arrangements and Procedures for Management of Sensitive Corporate Information
  - A. The person responsible for the management of sensitive corporate information must be specified, and the person's details must be included, in internal rules.
  - B. Management arrangements and procedures must be specified in internal rules and a framework for enabling the rules to be effectively enforced must be in place.
- (vii) In cases where investment trust assets are invested, the knowledge and experience of persons in charge of accounting work related to investment trust assets must be specified.
  - A. The knowledge and experience of each person in charge of accounting work related to investment trust assets, with regard to the relevant work, must be specified.
  - B. In cases where accounting work related to investment trust assets are entrusted to a third-party entity, the knowledge and experience of the said third-party entity, with regard to the relevant work, must be specified.

#### (4) Points of Attention Regarding Business Operators That Do Not Have Plans to Join Any Financial Instruments Firms' Association

Supervisors shall notify the following points and request appropriate responses to business operators who do not have plan to join any Financial Instruments Firms' Association at the time of submission of a registration request.

- (i) That supervisory responses in accordance with VI-2-12 shall be taken if the operator fails to introduce internal rules that are in line with Rules Set by Associations, etc. or a system to ensure compliance with such rules after registration
- (ii) That failure to revise internal rules in accordance with revisions in Rule Set by Associations, etc., may constitute a situation that corresponds to (i)

#### (5) Cases Not Requiring Registration

A corporation is allowed to engage in investment management business irrespective of the provision of Article 29 of the FIEA in cases where it meets the provision of Article 61(2) or (3) of the FIEA (cases where a corporation which is established based on foreign laws and regulations and which engages in investment management business abroad seeks to undertake investment management exclusively on behalf of Financial Instruments Business Operators (business operators engaged in investment management business)).

#### (6) Points of Attention Regarding Applications for New Registrations

Supervisors shall confirm with a business operator who applies for a new registration whether there are grounds for rejecting the application, in principle, by requiring the submission of the following documents.

Of the prima facie evidence, certificates of savings and other deposit balances issued by financial institutions shall be originals.

- (i) Prima facie evidence of documents which show the calculation of net assets (referring to net assets prescribed in Article 29-4(1)(v)(b) of the FIEA)
- (ii) Prima facie evidence of documents which show the calculation of net assets for the most recent month

## VI-3-1-2 Investment Management Business for Qualified Investors

### (1) Basic Points to Consider When Screening Registrations

For the purpose of promoting entry into the investment management business, some requirements for registering an investment management business for qualified investors were relaxed for small investment management business whose only customers are qualified investors. In light of this objective, when examining such registrations, supervisors examine in a way that is suited to the investment policy, the amount of assets managed and other circumstances of the relevant investment management business for qualified investors, while also being mindful of transparency and expeditiousness, and they shall be mindful of not examining all registrations in a uniform fashion.

### (2) Items Regarding Examination of Staffing

VI-3-1-1(1) shall, in principle, be applied mutatis mutandis when examining the organization of an investment management business for qualified investors. In addition the following points shall be taken into account.

- (i) With regard to the position responsible for making asset investment on behalf of rights holders, whether at least one or two persons who fall under either of the following items have been secured as persons with sufficient knowledge and experience regarding investment assets.
  - A. A person who has been engaged in the business of providing advice or managing the relevant assets for no less than one year.
  - B. A person equivalent to A.
- (ii) With regard to establishment of an independent compliance division (staff in charge of compliance), whether at least one or two persons who fall under either of the following items have been secured as persons in charge of compliance (excluding cases where compliance work is outsourced).
  - A. A person who has been engaged in business related to guidance for ensuring compliance with laws and regulations with regard to the financial instruments business for no less than one year.
  - B. A person equivalent to A.
- (iii) With regard to the relevant business, whether at least one or two personnel needed for the processes listed in items a through m in VI-3-1-1(1)(i)F (excluding those not required for the relevant business to be conducted in an appropriate manner, considering the investment policy, the amount of assets managed and other circumstances of the investment management business for qualified investors) have been secured.

(Note) In cases where arrangements and procedures for enabling proper compliance with laws and regulations are deemed to have been established, the business operator may make the personnel secured under item (ii) and the personnel secured under item (iii) the same.

### (3) Examination Items Pertaining to the Relevance of Investment Management Business for Qualified Investors

When examining an investment management business for qualified investors, in addition to the points of attention listed in (2), supervisors shall make the following checks with regard to the management of the total amount of all investment assets and the management of the rights holders (including the investors of a registered

investment corporation that is the other party to a contract set forth in Article 2(8)(xii)(a) of the FIEA and the persons set forth in the items of Article 15-10-4 of the FIEA Enforcement Order; hereinafter the same shall apply in VI-3-1-2) for all investment assets

- (i) Supervisors shall confirm whether an investment management business operator for qualified investors has taken measures to prevent the total amount of all investment assets exceeding the amount prescribed in Article 15-10-5 of the FIEA Enforcement Order.
- (ii) Investment management business operators for qualified investors are required to conduct business in a way such that their business operations do not fall under the category of “situations in which a Financial Instruments Business Operator, which conducts investment management business for qualified investors, is deemed to have not taken necessary and appropriate measures for preventing persons other than qualified investors from becoming rights holders, by such means as checking the attributes of rights holders and persons seeking to become rights holders and identifying the patterns of sale, purchase and other transactions of securities by rights holders” as prescribed in Article 123(xiii-2) of the FIB Cabinet Office Ordinance pursuant to Article 40(ii) of the FIEA.

To this end, supervisors shall confirm whether the following measures have been implemented for any investment management business for qualified investors

- A. That internal rules for the following matters be established.
    - a. In cases where the investment management business operator for qualified investors sells the securities of its own accord: that it verifies in advance the attributes of the customers being solicited, and that it explains to customers that the securities have a restriction on resale.
    - b. In cases where a third party sells the securities: that the business operator verifies in advance the attributes of the customers being solicited, and that it verifies that customers are being told that the securities have a restriction on resale.
    - c. That the business operator continuously verifies the attributes of the rights holders and the implementation of the resale restriction (including follow-up in cases where violations of this have been identified).
  - B. That there is ongoing confirmation that the attributes of solicited customers are being verified in advance and that explanations are being given about how the securities have a restriction on resale, in accordance with the abovementioned internal rules.
  - C. That there is ongoing confirmation of the distribution of actual rights holders, in accordance with the abovementioned internal rules.
  - D. That any violations are being appropriately followed up, in accordance with the abovementioned internal rules.
  - E. That internal audits and so forth are used to examine whether the measures listed in A to D above are being implemented appropriately.
- (iii) In cases where a person intending to conduct investment management business for qualified investors is a Financial Instruments Business Operator, a person who has made notification under the FIEA and is engaging in either businesses specially permitted for qualified institutional investors, etc. or specially permitted

investment management business, or a person who has made notification under the FIEA and is engaging in businesses specially permitted for overseas investors, etc., supervisors shall also confirm the following matters.

- A. That the total amount of all investment assets does not exceed the amount prescribed in Article 15-10-5 of the FIEA Enforcement Order.
- B. That the rights holders for all investment assets consist only of qualified investors.

#### (4) Documents Specifying Contents and Methods of Business Operations

VI-3-1-1(2) shall be applied mutatis mutandis to the items to be specified in the documents specifying the contents and methods of business operations.

However, with regard to “(iv) Method of Business Execution,” in addition to confirming that items regarding the management of the total amount of all investment assets have been included in the statements on items regarding the administration of investment assets, supervisors shall also confirm that items regarding the management of rights holders for all investment assets have been specified. In addition, with regard to “(v) Method of the Allocation of Business Operations,” supervisors shall confirm that items regarding the outsourcing of compliance or other business operations (including the name or trade name of contractors) have been specified as items regarding the investment management business operator’s organization.

#### (5) Items to Be Specified in Documents Prescribed under Article 9(i) of the FIB Cabinet Office Ordinance (Documents Specifying Framework for Business Execution Such as Staffing and Organization)

VI-3-1-1(3) shall be applied mutatis mutandis to the items to be specified in documents specifying framework for business execution such as staffing and organization.

However, in cases where compliance work is outsourced to a group corporation in Japan or overseas or to an attorney, etc., supervisors shall confirm that the following items have been specified with regard to “(iv) Knowledge and Experience of Persons in Charge of Compliance.”

- A. Name or trade name of the contractor.
- B. Address or location of the contractor.
- C. Outline of the business operations conducted by the contractor.
- D. Outline of the outsourcing contract.
- E. The contractor’s compliance management system (including the knowledge and experience of the person in charge), in light of the business operations intended to be conducted by the investment management business operator for qualified investors (the trustor).

#### (6) Others

The items listed in VI-3-1-1(4) to (6) shall be applied mutatis mutandis to administrative processes regarding the registration of investment management business for qualified investors.

#### VI-3-1-3 Investment Corporation

(1) Points of Attention when Accepting Notification Concerning the Establishment of Investment Corporations

The following points shall be considered when the director-general of a Local Finance Bureau receives a written notification concerning the establishment of an investment corporation pursuant to the provisions of Article 69(1) of the Investment Trust Act:

(i) Points to Consider in Relation to Examinations of Establishment Notification

- A. Page 2, section 1 of the establishment notification: Trade name of an investment corporation to be established

The trade name should not lead investors to mistakenly believe that the corporation is a public organization

- B. Page 2, section 3 of the establishment notification: (4) Amount of contribution for establishment

Whether the total of issued prices of investment accounts is lower than the total amount of contribution prescribed in Article 57 of the Enforcement Order of the Investment Trust Act

- C. Page 2, section 3 of the establishment notification: (7) Outline of asset management of the said investment corporation

Whether assets are mainly to be managed as an investment in specified assets

(ii) Items Related to Examinations of Documents Attached to the Establishment Notification

A document, submitted by a foreigner living outside Japan, which corresponds to the certificate of residence or a document equivalent thereto shall fall under the category of “documents in lieu of these” prescribed in Article 108(2)(i) of the Ordinance for Enforcement of the Investment Trust Act.

(iii) Receipt Procedures, etc., of Establishment Notification

- A. Receipt procedures

The director-general of a Local Finance Bureau, upon receiving a written notification of establishment of an investment corporation under Article 69(1) of the Investment Trust Act, shall return a copy of the written notification and a set of bylaws to the party making the notification after entering the receipt number, the receipt date, and other necessary information at the bottom right on the first page thereof.

- B. The director-general of a Local Finance Bureau, upon receiving a notification of establishment of an investment corporation, shall record its details in the register book of the notification of establishment of investment corporations, etc. (Attached List of Formats VI-1).

(2) Points to Consider When Receiving Notification of Failure to Establish Investment Corporations

The director-general of a Local Finance Bureau, upon receiving a notification of failure to establish an investment corporation, under Article 110(1) of the Ordinance for Enforcement of Investment Trust Act, shall perform the following procedures:

- (i) Inquire with the project planner about the responses to those who applied for investments and make a record of the merits.

- (ii) Enter the date of receipt of the notification of failure to establish an investment corporation into the registry book for notification of establishment of investment corporations, etc., and briefly describe the reasons for failure to establish an investment corporation in the remarks column.

### (3) Points to Consider When Receiving Application for Registration of Investment Corporations

The following points shall be considered when the director-general of a Local Finance Bureau receives an application for registration (Ordinance for Enforcement of the Investment Trust Act, Attached List of Formats 9 (hereinafter the same shall apply in (iii)) pursuant to the provision of Article 188(1) of the Investment Trust Act.

#### (i) Points to Consider Concerning Examinations on Application for Registration

##### A. Application for Registration Two, page 3, section 2: (5) Minimum net asset to be maintained

Whether the minimum net assets are maintained above the amount prescribed in Article 55 of the Enforcement Order of the Investment Trust Act

##### B. Application for Registration Two, page 3, section 2: (6) Subject and policy of asset management

Whether assets are mainly to be managed as investments in specified assets

##### C. Application for Registration Six, page 9: (1) Total contribution

Whether the total contribution at the time of establishment of an investment corporation is above the amount prescribed in Article 57 of the Enforcement Order of the Investment Trust Act

#### (ii) Points to Consider Concerning the Examinations on Attached Documents to the Application for Registration

A document submitted by a foreigner living outside Japan, which corresponds to the certificate of residence or a document equivalent thereto, shall fall under the category of “documents in lieu of these” prescribed in Article 108(5) of the Ordinance for Enforcement of the Investment Trust Act.

#### (iii) Other Points to Consider Concerning Receipt of Application for Registration

A. The director-general of a Local Finance Bureau, upon receiving an application for registration of an investment corporation, shall record the date of receipt of the application for registration of an investment corporation in the register book of the notification of establishment of investment corporations, etc.

B. After the offer period of investment to be issued at the time of establishment listed in the notification of the establishment of an investment corporation has elapsed, and after the period usually necessary for the submission of an application for registration for an investment corporation has elapsed, if an application for registration for the relevant investment corporation or the notification of failure to establish investment corporations has not been submitted, the director-general of the Local Finance Bureau shall refer to the project planner who submitted the notification of the establishment of an investment corporation to find out about the circumstances.

#### (iv) Registration Procedures, etc.

##### A. Registration number

a. Each registration shall be identified by a serial registration number which is assigned by each local finance bureau (however the following numbers shall not be used: 4, 9, 13, 42, 83, 103, and 893).

- b. When a registration is no longer valid, its registration number shall be retired and no new number shall be issued in its place.
- c. Registration numbers shall be managed by the registration number file of investment corporations using Attached List of Formats VI-2.

B. Notification to applicants for registration

After the examinations on the application for registration of investment corporations, when it is found that the said application form and the attached documents are complete and there are no grounds for rejecting the application, the director-general of the Local Finance Bureau shall promptly notify the applicant to that effect, using the prepared Attached List of Formats 14 of the Ordinance for Enforcement of Investment Trust Act.

(v) Report to the Commissioner of Financial Services Agency

Every month, registration forms for newly registered investment corporations shall be collectively reported to the Commissioner of the Financial Services Agency, using Attached List of Formats VI-3, by the 15<sup>th</sup> of the following month.

(vi) Refusal of Registration (Refer to II-5-6)

The director-general of a Local Finance Bureau shall, when refusing registration, enter the grounds for refusal and the corresponding number among the items listed in Article 190(1) of the Investment Trust Act as grounds for refusal, or shall specifically clarify the part of the application for registration or attached documents that lists false information or is missing important facts, using Attached List of Formats 15 of the Ordinance for Enforcement of the Investment Trust Act.

(vii) Storing of Applications for Registration

Notification of establishment, notification of failure of establishment and their attached documents shall be stored by the director-general of a Local Finance Bureau who has received the said notifications. Application for registration, notification of changes, notification of dissolution and their attached documents shall be stored by the director-general of a Local Finance Bureau who has registered the registered investment corporation.

(viii) Registry of Registered Investment Corporations

- A. Registry of registered investment corporations shall be made available for public inspection and an applicant for inspection shall be required to enter necessary items in the application for inspection of the registry of registered investment corporations, using Attached List of Formats VI-4.
- B. The date of inspection of the registry of registered investment corporations shall be a day other than a holiday as specified in Article 1 of the Act on Holidays of Administrative Organs, and the inspection period shall be within the duration designated by the director-general of the Local Finance Bureau.

However, when it is necessary to organize registry books or for any other reason, the inspection date or time may be changed or the inspection may be suspended or refused.

- C. The registry of registered investment corporations must not be taken out of the place of inspection designated by the director-general of the Local Finance Bureau.

## VI-3-2 Approval and Notification

### VI-3-2-1 Approval

When approving other businesses based on Article 35(4) of the FIEA, supervisors shall pay attention to the following points.

- (i) Whether the relevant business violates relevant laws and regulations.
- (ii) Whether there is the risk of the applicant Financial Instruments Business Operator's net asset value falling below 50 million yen (10 million yen in cases where the application is made by an investment management business operator for qualified investors (excluding those conducting Type I financial instruments business)).
- (iii) In cases where the relevant business involves the signing of contracts with customers, whether the Financial Instruments Business Operator has prescribed specific procedures for the prevention of conflicts of interest, which is necessary for investor protection.
- (iv) Whether the Financial Instruments Business Operator has established internal rules regarding the relevant business.

### VI-3-2-2 Notification

Supervisors shall receive and process notifications specified under the FIEA with due consideration of the following points. When they have received notifications regarding the businesses specified under Article 35(2) of the FIEA in particular, supervisors shall pay attention to whether the procedures legally necessary for regulating the businesses have been implemented. In addition, regarding the businesses listed below, they shall check whether their contents and methods meet the following criteria. In this case, the provision of relevant written documents and the implementation of paper-based procedures may be substituted by electronic means — using computer systems and other information technologies — subject to customers' consent. Regarding businesses that do not meet the following criteria, the applicant business operators shall be required to file an application based on Article 35(4) of the FIEA.

(1) Businesses Related to Signing of Association Contracts as Specified under Article 667 of the Civil Code and the Corresponding Intermediary, Brokerage and Agency Businesses, and Businesses Related to Signing of Anonymous Association Contracts as Specified under Article 535 of Commercial Code and the Corresponding Intermediary, Brokerage and Agency Services (excluding the businesses specified under Article 2(8)(ix) of the FIEA)

When soliciting customers to sign association contracts, whether Financial Instruments Business Operators and their officers and employees provide sufficient explanations regarding the contents of the contracts and make solicitation in an appropriate manner suited to the customers' intentions, knowledge and experience regarding the relevant associations, as well as their financial capacity and the nature of their investment funds. At the time of the signing of the contracts, whether they provide the customers with written explanations regarding the contents of the contracts.



(2) Business Related to Signing of Loan Participation Contracts and the Corresponding Intermediary, Brokerage and Agency Services.

(i) Description of Business

The loan participation contract is a contract envisaged by “Accounting Treatment and Representation of Loan Participation,” a report issued on June 1, 1995 by the Japanese Institute of Certified Public Accountants.

(ii) Conduct of Business

Supervisors shall examine whether the Financial Instruments Business Operator meets the following requirements regarding the conduct of business:

- A. To take due care to protect the original debtors and the transferees when executing business.
- B. To provide the transferees with sufficient explanations regarding the nature and contents of the relevant debts.
- C. To establish adequate arrangements and procedures for evaluating the relevant debts and ensure appropriate price formation
- D. To provide appropriate solicitation in light of the transferees’ intentions, experiences and financial capacity.
- E. At the time of the signing of the contract, to provide the transferee with written explanations regarding the contents of the contract.

VI-3-2-3 Investment Report

(1) Items Concerning Discretionary Investment Management Services to be Entered in an Investment Report

(i) With regard to the items to be entered in an investment report prescribed in Article 42-7(1) of the FIEA and in Article 134(1)(ii) of the FIB Cabinet Office Ordinance, they shall include, in the cases where assets of a number of clients are jointly managed, the total amount of assets to be jointly managed, the financial composition, name, number and price of securities, etc., comprising the said assets, as well the said clients’ shares of the said assets and values corresponding to their shares.

(ii) With regard to repo transactions from among the “purchase and sale or other transactions” prescribed in Article 134(1)(iii)(d)1. of the FIB Cabinet Office Ordinance, only if the investment method pertaining to those transactions is found to leverage the customer’s portfolio upon investment, supervisors shall pay attention to the following points, based on Recommendation 5 in the Financial Stability Board, “Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos” (August 2013):

- A. Global data: the amount of securities on loan as a proportion of total lendable assets and of the fund’s assets under management (AUM); and book values of repo transactions
- B. Concentration data: Top 10 collateral securities received by issuer, top 10 counterparties of repo transactions
- C. Repo transaction data breakdowns:
  - a. By collateral type

- b. By currency
  - c. By maturity tenor (transactions themselves)
  - d. By geography (counterparty)
  - e. Cash versus non-cash collateral,
  - f. Maturity of non-cash collateral
  - g. Settlement/clearing (tri-party, central counterparty, bilateral)
- D. Re-use and re-hypothecation data: share of collateral received that is re-used or re-hypothecated, compared to the maximum authorised amount if any. Information on any restrictions on type of securities
- E. Return data breakdowns:
- a. Sale or purchase of securities on condition of repurchase or resale
  - b. Secured securities lending transactions
  - c. Cash collateral reinvestment
- F. Number of custodians and the amount of assets held by each
- G. The way securities received by the counterparty are held (in segregated accounts or pooled accounts)
- (iii) Items to be entered, as prescribed in Article 134(1)(iv) of the FIB Cabinet Office Ordinance, shall include details of transaction fees and account management fees when such fees are paid separately from rewards for the discretionary investment contract under an integrated contract of discretionary investment management services and security-related services.
- (iv) With respect to details of transactions to be entered, as prescribed in Article 134(1)(vi) of the FIB Cabinet Office Ordinance, it is not necessary to enter the price and quantity of each of the agreed transactions; instead, they can be simplified in light of the purpose and characteristics of transactions. For example, it is sufficient to list the types of mutual transactions of managed assets (requirements, etc., prescribed in each item of Article 129(1) of the FIB Cabinet Office Ordinance).
- (v) The “external audit of business operations related to financing or discretionary investment contracts” as specified in Article 134(1)(xi) of the FIB Cabinet Office Ordinance shall include the following (including the equivalent thereof):
- Audit of financial statements and audit of internal control;
  - Audit by an accounting auditor under the Companies Act;
  - Assurance engagements on internal controls; and
  - Examination of whether the performance disclosure information of asset management companies conforms to the Global Investment Performance Standards (GIPS).
- (vi) In a case where matters specified in Article 134(2) of the FIB Cabinet Office Ordinance are entered pursuant to each subparagraph of Article 96(2) of the FIB Cabinet Office Ordinance, with respect to the “capital relationship between the financial instruments business operator, etc., and the fund-related persons” as specified under Article 96(2)(iii) of the FIB Cabinet Office Ordinance, if the fund-related person is a parent corporation, etc., (as specified under Article 1(3)(xiv) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., subsidiary corporation, etc., (as specified under Article 1(3)(xvi) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., or related foreign corporation,

etc. (as specified under Article 126 (iii) of the FIB Cabinet Office Ordinance) of the financial instruments business operator, etc., such fact must be entered.

With respect to the “personal relationship between the financial instruments business operator, etc., and the fund-related person” as specified under Article 96(2)(iii) of the FIB Cabinet Office Ordinance, the conditions of concurrent holding of positions by officers or employees at a specific time which is deemed to be reasonable must be entered.

(Note) In cases where the term of the investment report to be delivered to right holders which is set by discretionary investment business operators is shorter than the term as specified under Article 134(3) of the FIB Cabinet Office Ordinance (six months (or three months if a right holder is a surviving employees’ pension fund or a national pension fund); hereinafter the “legal term”), it is not necessary to make all legal entries in every investment report delivered to right holders. Instead, it shall be enough if legal entries are made in investment reports as a whole which are delivered within the legal term.

## (2) Details of Items to be Entered in a Report on Investment Trust Asset Management (complete version)

A management report concerning investment trust assets (complete version), in accordance with the provisions of Article 14-1 of the Investment Trust Act, shall be prepared so as to be easily understood by investors, and the following items, which are pursuant to Article 58(1) of the Rules for Calculation of Investment Trust Assets (hereinafter referred to as “Investment Assets Calculation Rules”) shall be included. Furthermore, appropriate responses shall be given when referrals are made.

### (i) Structure of the investment trust (including investment policy)

The purpose and characteristics of the investment trust are presented in ways that make them easily understood by investors, including such items as the scheme, investment method, investment limits and dividend policy.

### (ii) Process of Asset Management During the Calculation of the Said Investment Trust Assets

- A. The state of net asset value at the beginning, during and at the end of the period shall be included. In addition, the relationship between the management policy of the investment trust assets of the said investment trust and the “future management policy” described in the investment report of the previous term (examination results on whether investment activities have been in compliance with the management policy) shall be included.
- B. The future management policy shall be described specifically, and shall be based on the management policy for investment trust assets of the said investment trust.
- C. With respect to dividend from the current period’s profits, the grounds for the determination of the dividend and future management policy for retained earnings shall be included.

### (iii) Transition of Management Status

- A. In accordance with the categories below, management performance during the corresponding period below shall be included (referring to the performance that allows accurate understanding of the status of investment trust assets, such as net asset value, dividends, rate of fluctuation during the current period beneficiaries yield, stock price indices, composite ratio of major investment target assets or percentage

- of outstanding principal, etc.).
- a. Unit-type investment trust: from the start of the trust of investment trust assets to the end of the calculation period for the investment trust assets (referred to as the “end of the current period” in (2) below).
  - b. Open investment trust (excluding those applicable to c. or d. below): At least five periods prior to the current period (however, at least five formulation periods prior to the current formulation period in the cases where the provision of Article 59(1) of the rules for investment asset calculation applies).
  - c. Open bond investment trust (excluding those applicable to d. below): At least three periods prior to the current period (however, at least three formulation periods prior to the current formulation period in the cases where the provision of Article 59(1) of the rules for investment asset calculation applies).
  - d. Open bond investment trust whose calculation period is one day: at least one formulation period.
- B. As a tool for the comparison between net asset value and market conditions during the current period, when the management policy for investment trust assets of the said investment trust adopts the management method that is linked with specific indices, in addition to the ratio of fluctuation of the calculation period of trust, the movement of the said indices shall be included.
- (iv) Rewards etc. paid to the investment trust management company and entrusted company during the accounting period, and other costs the beneficiary bears in relation to the trust property, as well as details of the services provided in exchange for such costs shall be shown.
- Trust fees and other costs that the investor bears during the accounting period, as well as details of the services provided in exchange for such costs, shall be presented in ways that make them easily understood by the investor.
- (v) The number of stocks both at the end of the calculation period immediately preceding the calculation period for the investment trust assets (referred to as the “end of the previous period” in (2) below) and at the end of the current period, the aggregate market value by stock at the end of the current period and total transaction volume and total transaction value of stocks during the calculation period of the said investment trust asset.
- A. Stocks include warrant. In this case, “the number of stocks” shall be replaced with “number of accounts.”
  - B. List by currency (in the case of Euro, list by country).
  - C. List by stock. In the case of domestic stocks (excluding warrants), list by business sector, together with proportion of business sector to the aggregate domestic market value at the end of the current period.
  - D. With respect to aggregate domestic market value and aggregate domestic market value of warrants at the end of the current period, list each of their proportions to the total value of net investment trust assets.
  - E. With respect to aggregate foreign market value and aggregate foreign market value of warrants at the end of the current period, list each of their proportions to the total value of net investment trust assets.
  - F. Transaction volume and transaction value of stocks in the said calculation period shall be listed by sales transaction and by purchase transaction. Changes (increase or decrease) due to capital increase/reduction, stock split, or change in par value shall be listed in the brackets, and a note shall be provided to that effect.

- G. List the stock transaction ratio and transaction fees per beneficiary right during the relevant calculation period
- (vi) List by type and name of each bond, aggregate market value at the end of the current period and total transaction value of the relevant investment trust asset during the calculation period.
- A. List by type of currency. (In the cases where Article 59(1) of the rule for calculation of investment trust assets applies, the total amount is sufficient, regardless of the type of currency. In the case of Euro, list by country.)
- B. Types shall be classified into national bond certificates, local bond certificates, special bond certificates, warrants, and other bond certificates.
- C. List by stock name.
- D. Total transaction value during the relevant calculation period shall be classified into sales and purchase, and increase/reduction through allocation of bonds with warrants, redemption or exercise of warrants shall be listed in the brackets, and a note is given to that effect.
- E. If purchase and sale of bonds fall under the category of repo transactions, the matters to be stated as referred to in (1)(ii) above shall be applied *mutatis mutandis*.
- (vii) The items shall be listed by name, as specified in Article 58 (1)(vii) of the Rules for Calculation of Investment Trust Assets, with respect to investment trust beneficiary certificates (excluding mother fund beneficiary certificates, hereinafter the same shall apply in (2)), mother fund beneficiary certificates and investment corporation investment certificates
- A. List by currency (in the case of Euro, list by country)
- B. List the transaction commission fees per mother fund beneficiary certificate for the relevant calculation period. In this case, with respect to transaction commission fees for an investment trust that incorporates the said mother fund beneficiary certificates (hereinafter referred to as “baby fund”), list the part corresponding to the said baby fund of the mother fund.
- (viii) In the cases where securities loans are made at the end of the current period, the total number or aggregate face value shall be listed, depending on the type of securities.
- A. Securities shall be classified into stocks and bonds, and the total number of stocks or aggregate face value of bonds shall be listed, respectively.
- B. If the lending of securities falls under the category of repo transactions, the matters to be stated as referred to in (1)(ii) above shall be applied *mutatis mutandis*.
- (ix) With respect to transactions of derivatives (referring to the transactions of derivatives prescribed in Article 2(20) of the FIEA; the same shall apply hereinafter), the outstanding contract balance of the transactions or the transaction balance at the end of the current period and contract transaction value or transaction value during the calculation period of the relevant investment trust asset shall be listed by type.
- With respect to transactions of securities-related derivatives (referring to the transactions of securities-related derivatives prescribed in Article 28(8)(iii) of the FIEA; the same shall apply hereinafter), the outstanding contract balance of the transactions at the end of the current period and contract transaction value or transactions value during the calculation period of the relevant investment trust asset shall be classified

and listed by transaction of stocks or by transaction of bonds, etc. (However, in the cases where Article 59(1) of the Investment Assets Calculation Rules applies, it is acceptable to list the outstanding contract balance of the transactions at the end of the current period and contract transaction value or value of transactions during the calculation period of the relevant investment trust asset, regardless of the above.)

With respect to transactions of derivatives other than transactions of securities-related derivatives, the asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

- (x) The items listed in Article 58(1)(x) of the Investment Assets Calculation Rules shall be listed by real estate, leasehold right or surface right of real estate.

Asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be listed in categories such as real estate, real estate leasehold right or surface right.

- (xi) The amount of claims as of the end of the current period and aggregate transaction value during the calculation period of the relevant investment trust assets shall be listed for notes prescribed in Article 3(vi) of the Enforcement Order of the Investment Trust Act.

Asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

- (xii) With respect to monetary claims prescribed in Article 3(vii) of the Enforcement Order of the Investment Trust Act, the total amount of claims as of the end of the current period shall be listed by type and the aggregate transaction value during the calculation period of the relevant investment trust assets shall be listed by type of claims.

Asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

- (xiii) With respect to equity interest in a silent partnership prescribed in Article 3(viii) of the Enforcement Order of the Investment Trust Act, major details of assets under management as of the end of the current period shall be listed by type.

Asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

- (xiv) With respect to the commodities prescribed in Article 3(ix) of the Enforcement Order of the Investment Trust Act, the volume at the end of the previous period and the end of the current period, the aggregate market value at the end of the current period, and the total transaction value of the commodity during the calculation period of the said investment trust asset shall be listed by type.

- A. List by currency (in the case of Euro, list by country)
- B. Transaction value of the commodity in the said calculation period shall be listed by sales transaction and by purchase transaction
- C. List the stock transaction ratio and transaction fees per beneficiary right during the relevant calculation period

- (xv) With respect to transactions of commodity investment, etc., the outstanding contract balance of the

transactions at the end of the current period and contract transaction value or transactions value during the calculation period of the relevant investment trust asset shall be listed by type.

The asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

(xvi) With respect to assets other than specified assets, major details of the assets as of the end of the current period shall be listed by type.

The asset balance at the end of the current period and management status during the calculation period of the relevant investment trust assets shall be presented in such a way to be easily understood by investors.

(xvii) With respect to specified assets and other assets listed in item (i) or from item (iii) through item (ix) of Article 3 of the Enforcement Order of the Investment Trust Act as of the end of the current period, the percentage of total value of each asset against the total amount of investment trust assets shall be listed.

The percentage shall be the proportion of the total amount of each asset (by name in the case of mother fund beneficiary certificates) to the total amount of investment assets. Also the percentage of aggregate net assets pertaining to assets in foreign currencies as of the end of the current period against the total amount of investment assets shall be provided in the Note.

(xviii) In the cases where assessment on prices of specified assets has been conducted pursuant to the provision of Article 11(1) of the Investment Trust Act, the name of the person who has conducted the said assessment and the outline of the result and method of the said assessment shall be given.

With respect to the outline of the results and method of the said assessment, type and items of specified assets on which the said assessment was conducted and the qualification, etc., of the assessor shall be included in such a way to be easily understood by investors.

(xix) Status of assets, liabilities, principals and net asset values of beneficiary certificates as of the end of the current period and the status of the profit or loss of the relevant investment trust assets during the calculation period shall be given.

In the cases where there are noted items set forth in the calculation rules for investment trust assets, the said items should be presented in the Note.

(xx) The status of transactions with an interested person, etc., during the calculation period of the relevant investment trust assets, and the total amount of commission fees paid to the relevant interested person, etc., shall be listed.

The status of transactions shall be classified into sales amount and purchase amount by type of security, derivative transaction, and other transaction, and the trading value with interested persons and the percentage against the total amount of each item shall also be included.

(xxi) In the cases where an investment trust management company, etc., is engaged in Type I financial instruments business or Type II financial instruments business, the status of transactions with the said investment trust management company, etc., during the calculation period of the relevant investment trust assets and the total amount of commission fees paid to the said investment trust management company, etc., shall be listed.

The trading status shall be grouped into sales amount and purchase amount by type, such as securities and

derivative transactions, and the amount of internal transactions and the percentage against the total amount of each item shall be given.

(xxii) In the cases where an investment trust management company, etc., is engaged in real estate business, the status of transactions with the investment trust management company, etc., which is a real estate transaction business operator, during the calculation period of the relevant investment trust assets and the total amount of commission fees paid to the said investment trust management company, etc., shall be listed.

The status of transactions shall be classified into sales/purchases, leasing, etc., by type of real estate, and the amount of internal transactions and the percentage against the total amount of each item shall be given.

(xxiii) In the cases where an investment trust management company, etc., is engaged in specified real estate cooperative business, the status of transactions with the investment trust management company, etc., which is the specified real estate cooperative business operator, during the calculation period of the relevant investment trust, assets shall be listed.

The status of transactions shall be classified into sales/purchases, leasing, etc., by type of real estate, and the amount of internal transactions and the percentage against the total amount of each item shall be given.

(xxiv) In the case of termination of the trust contract period pertaining to the relevant investment trust asset, a summary of investment trust asset management shall be prepared.

The outline of the process of management from the start of the trust of the relevant trust asset to the end of the previous period shall also be included. Meanwhile, when the outline of the process of the said management is given in (i) above, the outline of the process of the said management may be omitted. The term "the status at the end of every calculation period" in Attached List of Formats No. 2 of the Calculation Rules for Investment Trust Assets under the provision of Article 59 (1) of the said rules may be replaced by "the status at the end of every formulation period."

(xxv) In the cases where an investment trust management company, etc., is engaged in the commodity trading consignment business, the status of transactions with the said investment trust management company, etc., during the calculation period of the relevant investment trust assets and the total amount of commission fees paid to the said investment trust management company, etc., shall be listed.

The trading status shall be grouped into sales amount and purchase amount by type of commodity and of transaction of commodity investment, etc., and the amount of internal transactions and the percentage against the total amount of each item shall be given.

### (3) Items to be Listed in a Summary Investment Report Pertaining to Investment Trust Assets

The summary investment report prepared under the provisions of Article 14(4) of the Investment Trust Act is required to include critically important information regarding the status of investment so as to provide the information necessary for the investor to correctly understand the current status of the assets under management. In light of this, specific presentation of each item in Article 58-2(1) of the Investment Assets Calculation Rules must comply with "Rules on Investment Reports, Etc. Regarding Investment Trusts and Investment Corporations," a set of self-regulatory rules by the Investment Trusts Association, and service providers are required to make creative efforts to facilitate investor understanding by, for example, using ample charts and diagrams and easy-to-understand,



simple explanation in text. Hence, service providers shall pay attention to these considerations and respond properly when referrals are made.

(4) Items to be Listed in an Investment Report of Investment Trust Fund Without Instruction by Trustor

The criteria for specific items to be included pursuant to each item of Article 58(1) and Article 58-2(1) of the Investment Assets Calculation Rules, applied mutatis mutandis pursuant to Article 62 of the said rules, shall be equivalent to (2) and (3) above.

(5) Items to be Listed in an Investment Management Report Pertaining to Investment Corporations

An investment management report to be prepared pursuant to the provision of Article 129(2) of the Investment Trust Act shall be prepared in such a way to be easily understood by investors, and the criteria for specific items to be included pursuant to Article 71 of the Calculation Rules for Investment Corporations (hereinafter referred to as the “Investment Corporation Calculation Rules”) shall be given pursuant to (2) above; provided, however, that this shall not apply when it may cause difficulty in understanding the status of property or profit/loss of investment trust corporations.

In the cases where an investment trust management company, etc., which has entered into an asset management contract, manages the assets of an investment corporation jointly with another investment trust corporation, the aggregate value of assets under joint management of the said investment trust management company, the type of the said assets, the share of the said investment corporation concerning the said assets, and the amount equivalent to its share shall be entered as items required to clarify the status of management of an investment corporation during the relevant business period, as prescribed in Article 73(1)(xxii) of the Investment Corporation Calculation Rules.

VI-3-2-4 Account Documents Regarding Investment Trust Assets

III-3-3(1) (excluding (ii), (iii), (v), (vi) and (viii)) shall be applied mutatis mutandis to the supervision of account documents regarding investment trust assets compiled and stored based on the Investment Trust Act, and attention shall also be paid to following points:

(1) Of account documents compiled and stored based on the Investment Trust Act, those that may be stored by the electromagnetic method are the account documents as specified under Article 26(1), Article 254(1) and Article 255(1) of the Ordinance for Enforcement of the Investment Trust Act.

(i) Points of Attention Regarding Compilation and Storage of Account Documents in Microfilm Form

- A. Microfilm used for storage must have the durability sufficient for the storage periods prescribed for each category of documents as shown below.
  - a. Account documents related to investment trust assets: 10 years from the expiry of the accounting period or the trust contract period of relevant investment trusts assets, as specified under Article 26(2) of the Ordinance for Enforcement of the Investment Trust Act.
  - b. Account books related to investment corporations: 10 years from the approval of the financial results

of relevant investment corporations, as specified under Article 254(2) of the Ordinance for Enforcement of the Investment Trust Act (from the closing of the account book in the case of a commercial account book).

- c. Account documents related to asset custody companies: 10 years from the approval of the financial results of relevant investment corporations as specified under Article 255(2) of the Ordinance for Enforcement of the Investment Trust Act.
  - B. One of the microfilms used for data storage must be selected and specified as the original.
  - C. It must be ensured that a back-up of the original as specified in B. above is made and stored as a copy.
  - D. It must be ensured that account books required for inspection by inspection departments are compiled within a reasonable period of time.
  - E. A person in charge of making and storing microfilms must be appointed and procedures for the management of microfilms must be established.
- (ii) Points of Attention Regarding Compilation and Storage of Account Documents by Electromagnetic Method
- A. The durability of the media used for storage is subject to the requirements specified in (i)A. above.
  - B. It must be ensured that the computer system used for storage prevents data falsification and mishandling by requiring IDs and passwords for data access and input.
  - C. In addition to A. and B. above, III-3-3(6)(i), (iii), (iv) and (vi) to (x) shall be applied mutatis mutandis.

#### VI-3-2-5 Criteria for Items to be Included in Notification of Foreign Investment Fund

The criteria for items to be included in a notification of a foreign investment fund prescribed in each item of Article 58 (1) of the Investment Trust Act and each item of Article 96 (2) of the Ordinance for Enforcement of the Investment Trust Act shall be as follows:

#### (1) Items Related to Trustors (limited to the cases similar to investment trust fund without instruction by trustor), Trustees, and Beneficiaries

##### (i) Items Related to Trustors

The name, amount of capital, details of business and outline of operations of a trustor (name of the company that manages the said foreign investment fund, and the management company in the cases of a management company which is entrusted with the management of investment trust assets by a company that manages a foreign investment fund) shall be entered.

##### (ii) Items Related to Trustees

The name, the amount of capital, details of business and outline of operations of a trustee (custody company) shall be entered.

##### (iii) Items Related to Beneficiaries

Details of the right to dividend, the right to redemption, the repurchase right, and other rights (including the date of emergence and termination of rights) and procedures for the exercise of rights shall be entered.

(2) Items Related to Beneficiary Certificates

- (i) Name of the relevant foreign investment fund
- (ii) Form of foreign investment fund

Items regarding registered or bearer form, par-value or no par-value, open end type or closed end type, exchange of registered form and bearer form, transfer of registered beneficiary certificates, and re-issuance of beneficiary certificates shall be entered.

- (iii) Number issued (offered)
- (iv) Total value of issues (offered)

When submitting notification of a foreign investment fund without entering the “issue price” or “offer price,” the estimated total values as of the date of submission of the said notification shall be entered with a note to that effect.

- (v) Issue (offer) price

When submitting notification of a foreign investment fund without entering the “issue price” or “offer price,” a note specifying the scheduled date and method of determining the price shall be given.

- (vi) Subscription fee

A. In the cases where subscription fees at each subscription handling office are different, the subscription fee of each office shall be listed. When subscription fees cannot be disclosed due to compelling reasons, a note to that effect shall be given.

B. When fees change, subject to the volume and value of subscription, the fees of the said volume and value at each stage shall be listed.

- (vii) Subscription unit
- (viii) Subscription period
- (ix) Others

A. The method of subscription, interest on deposit for subscription, transfer of deposit of subscription to investment trust assets, and items related to other subscriptions, etc., shall be entered.

B. In the cases where the subscription, etc., of the said foreign investment fund is handled in areas other than Japan, the number of issues (offered) and total value of issues (offered) shall be entered.

(3) Items Related to Administration and Management of Trust

- (i) Administration of Trust

A. Items related to administration of a fund entrusted to a trustee until its redemption

Formulation of management report on investment trust assets, method of treatment of profits, and items related to partial cancellation, etc., shall be entered.

B. Others

Procedures concerning change in the conditions and modification of a contract with related companies, items related to the method of disclosure when changes are made, and other important items shall be entered.

- (ii) Management of Trust

A. Basic policy of management

The basic attitude concerning management of investment trust assets shall be described in a detailed manner.

B. Investment target

The type of assets to be invested in, investment criteria, and proportion of planned investment by type or region, if any, etc., shall be given.

C. Investment limit

a. The grounds for all the investment limits prescribed in the laws and regulations or contracts, etc., shall be described.

b. The presence of limits to the underwriting of securities, margin trading, borrowing, concentrated investment, investment in other funds, investment in assets with less liquidity and the grounds and details of such limits, if any, shall be given.

D. Dividend policy

The dividend policy prescribed in the contracts, etc., shall be listed.

E. Loan of assets

Details of loans of assets acquired from investment trust assets

(4) Items Related to Calculation of Trust and Distribution of Profits

(i) Items Concerning Calculation of Trust

A. Appraisal of assets

Method and frequency of calculation and method, frequency, and place of disclosure of net value of assets per unit of beneficial certificates of foreign investment funds (including evaluation of assets to be invested in) shall be entered.

B. Administration rewards, etc.

Items regarding all rewards and commission fees paid from investment trust assets of a foreign investment fund, the method of calculation, amount of payment, method of payment, and time of payment by each receiver shall be listed.

C. Others

Period of existence of foreign investment fund, calculation period of trust, requirements for limited redemption, etc., in relation to addition and partial cancellation shall be entered.

(ii) Items Related to Distribution of Profits

A. Items related to the calculation of the possible amount of dividend shall be listed.

B. Regarding payment of profits and distribution of payments at the time of redemption, delivery from beneficiary to trustor (limited to those similar to an investment trust fund with instruction by trustor), immunity of trustee, and delivery from trustor (limited to those similar to an investment trust fund with instruction by trustor) to beneficiary, time, place and method shall be entered.

(5) Items related to the transfer of all or part of business (limited to those similar to an investment trust fund with

instruction by trustor), procedures for business transfer, method of notification to beneficiaries, and the details of objection if a beneficiary is entitled to oppose the business transfer.

(6) Items Related to Resignation and Removal of Trustee and Appointment of New Trustee

Procedures for resignation and removal of trustee and the appointment of a new trustee shall be described.

(7) When a trustor entrusts another party with power regarding instruction of management (limited to those similar to an investment trust fund with instruction by trustor) or when a trustee entrusts another party with management power (limited to those similar to an investment trust fund without instruction by trustor), details of the entrustment, specific details of entrusted power and the cost of entrustment shall be entered.

(8) Name of Financial Instruments Business Operator Which Handles Subscriptions in Japan

The names of all Financial Instruments Business Operators which handle subscriptions shall be listed.

VI-3-2-6 Investment Report on Foreign Investment Funds

(1) Criteria for Items to be Entered in a Report on Investment Trust Asset Management (complete version)

A report on investment trust asset management (complete version) under the provisions of Article 59 of the Investment Trust Act, applied mutatis mutandis pursuant to Article 59 of the said act, shall be prepared so as to be easily understood by investors, and the following items, which are pursuant to Article 63(1) of the Investment Assets Calculation Rules shall be included. Furthermore, appropriate responses shall be given when referrals are made.

(i) Structure of the foreign investment fund (including investment policy)

The purpose and characteristics of the investment trust are presented in a way that makes them easily understood by investors, including such items as the scheme, investment method, investment limits and dividend policy.

(ii) Process of Asset Management During the Calculation Period of Investment Trust Assets Related to the Relevant Foreign Investment Fund

A. The state of net asset value at the beginning, during, and at the end of the period shall be included. Also, the relationship with the management policy of the investment trust assets of the said foreign investment fund shall be described.

B. The future management policy shall be prepared based on the investment report of the said foreign investment fund.

C. The amount of dividend per unit, the right to which has been fixed during the current period, shall be entered.

D. With regard to an investment report on investment trust assets at the time of termination of trust, the outline of the management process from the acquisition to termination of the said trust shall be given.

(iii) Change in Management Status

A. Management performance (net asset value, dividend, etc.) of the previous ten terms shall be given.

B. As a tool for the comparison between net asset value and market conditions during the current period,

when the management policy for investment trust assets for the said investment trust adopts a form of management that is linked with specific indices, the movement of the said indices shall be included.

(iv) The balance sheet as of the last day of the calculation period of investment trust assets of the relevant foreign investment fund (hereinafter referred to as “end of the current period” in VI-3-2-6) and a statement of income and a statement of retained earnings during the relevant calculation period, and their notes shall be given.

A. The balance sheet and its notes at the end of the current period shall be included.

B. A statement of income and a statement of retained earnings during the relevant calculation period, and their notes shall be included. The amount of loss shall be represented by “△”, “-”, or in the bracket.

(v) Trust and other fees as well as other costs that the beneficiary bears regarding investment trust assets related to the relevant foreign investment fund, as well as details of the services provided in exchange for such costs, shall be shown.

Trust fees and other costs that the investor bears during the accounting period, as well as details of the services provided in exchange for such costs, shall be presented in such a way that make them easily understood by the investor.

(vi) Statement of Net Assets at the End of the Current Period

A. The number of issuance units of the foreign investment fund at the end of the current period shall be specified and the value of net income per unit as of the end of the current period shall be given, which is to be obtained by dividing aggregate net assets by the said number of issuance units.

B. When the relevant items are given in the balance sheet of (iv) above, the statement of net assets may be replaced by the said balance sheet.

(vii) Major Names of Security Certificates to be Invested in

A. Regarding the top 30 valuations among invested stocks at the end of the current period or on the most recent date as of the formulation of the investment report on investment trust assets, the name of the said stocks, quantity, aggregate market value and investment ratio shall be included.

B. In lieu of A. above, monetary value and the investment ratio of securities and the place of issuance of stocks and non-stock securities, at the end of the current period or on the most recent date as of the formulation of the investment report on investment trust assets, shall be given by type of securities, place of issuance or region of listed financial instruments exchange, etc.

(viii) Major Types of Rights Pertaining to Transactions of Derivatives to be Invested in

Asset balance at the end of the current period and the management status during the calculation period of the relevant investment trust assets shall be listed by type of transaction of derivatives.

(ix) Major Types of Real Estate to be Invested in and Real Estate Leasehold Rights or Surface Rights

Asset balance at the end of the current period and the management status during the calculation period of the relevant investment trust assets shall be listed by categories, such as real estate, and real estate leasehold rights or surface rights.

(x) Major Types of Money Claims to be Invested in

Assets outstanding at the end of the current period and the management status during the calculation period of the said investment trust assets shall be presented in such a way to be easily understood by

investors.

(xi) Major Types of Drafts to be Invested in

Assets outstanding at the end of the current period and the management status during the calculation period of the said investment trust assets shall be presented in such a way to be easily understood by investors.

(xii) Major Types of Specified Assets to be Invested in as prescribed in Article 3 (viii) of the Enforcement Order of the Investment Trust Act and Equivalent Thereto

Assets outstanding at the end of the current period and the management status during the calculation period of the said investment trust assets shall be presented in such a way to be easily understood by investors.

(xiii) Major Types of Commodities to be Invested in

Regarding the top 30 valuations among invested commodities at the end of the current period or on the most recent date as of the formulation of the investment report on investment trust assets, the name of the said commodities, quantity, aggregate market value and investment ratio shall be included.

(xiv) Major Types of Rights Pertaining to Transactions of Commodity Investment, etc. to be Invested in

Asset balance at the end of the current period and the management status during the calculation period of the relevant investment trust assets shall be listed by type of transaction of commodity investment, etc.

(xv) Besides those listed in each of the previous items, items to be included in an investment report formulated pursuant to the Japanese laws and regulations under which the relevant foreign investment fund is established (items equivalent to those to be included pursuant to each item of Article 58(1) of the calculation rules for investment assets, in the cases where no specific statute applies to investment reports formulated pursuant to the laws and regulations of the country concerned under which the relevant foreign investment fund is established).

In the cases under Article 58(1) of the Investment Assets Calculation Rules, items in accordance with VI-3-2-3-(2) shall be entered.

(2) Criteria for Items to be Entered in a Summary Investment Report

The summary investment report prepared under the provisions of Article 14(4) of the Investment Trust Act, applied mutatis mutandis pursuant to Article 59 of the said act, is required to include critically important information regarding the status of investment so as to provide the information necessary for the investor to correctly understand the current status of the assets under management. In view of this, it shall include critically important information about the status of the investment and, as such, provide an amount of information similar to that provided in the summary investment report for investment trusts (refer to VI-3-2-3(3)) to an extent possible.

In view of such considerations, presentation of each item in the Article 63(3) shall be made in line with the realities of laws in the countries and funds overseas, taking into consideration the provisions of the "Rules on Investment Reports, Etc. Regarding Investment Trusts and Investment Corporations," a set of self-regulatory rules by the Investment Trusts Association (flexible measures are required in this regard if items prescribed in these rules cannot be included for inevitable reasons due to the realities of laws in the countries and funds overseas), paying

attention to the requirement that service providers are required to make creative efforts to facilitate investor understanding by, for example, using ample charts and diagrams and easy-to-understand, simple explanation in text. Furthermore, an appropriate response to inquiries shall be made in accordance therewith.

#### VI-3-2-7 Items to be Included in Notification on Foreign Investment Corporations

The following are the items to be included in a notification of foreign investment funds prescribed in Article 220(1) of the Investment Trust Act and each item of Article 261(2) of the Ordinance for Enforcement of the Investment Trust Act.

##### (1) Objectives, Trade Name, Address

###### (i) Objectives

- A. The objectives listed in the bylaws of foreign investment corporation or equivalent thereto shall be included.
- B. The number of issuances (offer), total value of issue (offer), issue price (offer price), subscription fees, subscription unit, subscription period, etc., shall be listed pursuant to VI-3-2-5 (2).

###### (ii) Trade Name and Address

The trade name and address (name in the original language shall be attached) shall be listed in the registry of foreign investment corporations or equivalent thereto.

##### (2) Items Related to Organization and Officers

###### (i) Items Related to Organization

- A. The name and details of the organization of the relevant foreign investment corporation
- B. The names and outlines of relevant businesses of corporations concerned (a juridical person equivalent to an asset management company, asset deposit company or equivalent thereto, or a juridical person entrusted with administrative work or equivalent thereto) involved in the management of the said foreign investment corporation shall be included, in addition to those of companies issuing foreign investment certificates for the relevant foreign investment corporation.

###### (ii) Items Related to Officers

The names, addresses and duties of officers of the foreign investment corporation (details of duties of personnel equivalent to executive officers or supervisory officers of investment corporations) shall be listed.

##### (3) Items Related to Administration and Management of Assets

###### (i) Items Related to Administration of Assets

- A. Items related to the administration of assets conducted until the dissolution of the relevant foreign investment corporation shall be listed.
- B. With regard to an asset custody company or an enterprise equivalent thereto, the name, amount of capital, details of business and outline of operations shall be entered.
- C. Others



Changes in the bylaws or the equivalent documents and procedures concerning changes in the contract with concerned companies, items related to the disclosure method of such changes, and other important items shall be included.

(ii) Items Related to Asset Management

A. Basic policy of management

Specific details about the basic attitude toward the management of assets shall be included.

B. Investment target

The type of assets to be invested in, investment criteria, and the proportion of planned investment by type or region, if any, etc., shall be given.

C. Investment limit

a. Grounds for all investment limits prescribed in laws, regulations and bylaws, etc., or other documents equivalent thereto, etc., shall be described.

b. The presence of limits to the underwriting of securities, margin trading, borrowing, concentrated investment, investment in other funds, and investment in assets with less liquidity and grounds for and details of such limits, if any, shall be mentioned.

D. Dividend policy

The dividend policy prescribed in bylaws or other documents equivalent thereto shall be included.

E. With regard to an asset management company or an enterprise equivalent thereto, the name, amount of capital, details of business and outline of operations shall be entered.

(4) Items Related to Calculation and Distribution of Profits

(i) Items Related to Calculation

A. Asset

The method and frequency of calculation and the method, frequency and place of disclosure of net value of assets per unit of foreign investment certificates (including evaluation of assets to be invested in) shall be entered.

B. Administration rewards, etc.

Regarding all rewards and commission fees paid from the assets of the foreign investment corporation, the method of calculation, amount of payment, method of payment and time of payment classified by each receiver shall be listed.

C. Others

The period of existence of the foreign investment corporation, fiscal year, limits on additional contribution and return of contribution, and conditions for dissolution, etc., shall be entered.

(ii) Items Related to Profit Distribution

Items related to the payment of profits at the time of dissolution or the distribution of profits at the time of each settlement shall include the time, place, method of delivery from an asset custody company to a foreign investment company, immunities of an asset custody company, and delivery from trustor to investor or party equivalent thereto.

(5) Items Related to the Rights Indicated on Foreign Investment Certificates

Details of voting rights, the rights of investors or other persons equivalent thereto, the right to receive dividend, the right to receive settlement (including the date of emergence of termination of rights) and procedures for exercise of rights shall be included.

(6) Items Related to Distribution or Redemption

Details of the claim for distribution or redemption of the relevant foreign investment corporation (including the date of emergence and termination of rights) and the procedures for exercise of rights shall be included.

(7) Items Related to Transfer of All or Part of Business of a Party Equivalent to an Asset Management Company

The procedures of business transfer, the method of notification to investors or parties equivalent thereto, and details of objections if investors or parties equivalent thereto are entitled to oppose the business transfer.

(8) Items Related to Resignation of a Party Equivalent to Asset Custody Company and Appointment of New Asset Deposit Company or a Party Equivalent Thereto

The procedures for resignation of a party equivalent to an asset custody company, and the appointment of a new asset depository company or a party equivalent thereto shall be described.

(9) Details of Entrustment When a Party Equivalent to Asset Custody Company Entrusts the Power to Manage Assets of Another Party

Specific details of entrusted power and the cost of such entrustment shall be listed.

VI-3-3 Points of Attention Regarding Administrative Processes Related to Businesses Specially Permitted for Overseas Investors, etc.

VI-3-3-1 Confirmation of Matters to be Notified

(1) Major Supervisory Viewpoints

- (i) Whether there are any omissions, etc. with regard to matters required to be notified. Whether the requirements for notification are satisfied.
- (ii) Whether there are any omissions, etc. with regard to documents required to be attached. Furthermore, whether there are any discrepancies, etc. between the notified matters and the contents of the attached documents.
- (iii) In cases where the person making the notification is a juridical person, whether it is possible to make contact with said juridical person's representative. In cases where the person making the notification is a foreign juridical person, whether it is possible to make contact with said foreign juridical person's representative in Japan.

- (iv) Whether the principal business office or office (for a foreign juridical person, its principal business office or office in Japan) and the business office or office where businesses specially permitted for overseas investors, etc. are conducted is a so-called virtual office. (In cases where, such as where the notified business office, etc. is a rental office based on a short-term contract, businesses specially permitted for overseas investors, etc. are likely to be conducted at a place other than said business office, supervisors shall strive to grasp the actual conditions through hearings and requesting the submission of relevant materials.)
- (v) When a notification of abolition of businesses specially permitted for overseas investors, etc. based on Article 63-10(3)(ii) of the FIEA has been filed by a person engaging in businesses specially permitted for overseas investors, etc., supervisors shall check whether customer transactions by said person engaging in businesses specially permitted for overseas investors, etc. have been completed and properties that were deposited by customers as well as properties occupied in its calculation have been returned.

## (2) Supervisory Method and Actions

Upon receiving a written notification regarding businesses specially permitted for overseas investors, etc., supervisors shall check the matters to be notified as to whether there are any deficiencies in relation to the requirements for the relevant businesses. When any deficiencies or doubts, etc. are found in the content regarding the matters to be notified as a result, supervisors shall request corrections before accepting the written notification.

In cases where any deficiencies or doubts, etc. are found in the content after receiving a written notification, supervisors shall request the submission of a report based on Article 63-14 of the FIEA as necessary to ascertain the status of corrections and shall consider necessary action, including the issuance of a business improvement order or a business suspension order, depending on circumstances.

If no specific corrective measures are presented or it is deemed that any of the reasons for disqualification specified in the items of Article 63-9(6) of the FIEA applies, supervisors shall issue a business abolition order based on Article 63-13(3) of the FIEA, in principle.

## VI-3-3-2 Preparation and Publication, etc. of the List of Notifiers, etc.

### (1) Preparation and Publication, etc. of the List of Notifiers, etc.

In order to enable investors to acquire information on persons engaging in businesses specially permitted for overseas investors, etc., the FSA shall prepare and publish on its website a list indicating matters concerning those persons that are subject to public inspection based on Article 63-9(4) of the FIEA (including cases where applied *mutatis mutandis* pursuant to Article 63-11(2) of the FIEA) (the matters shall be those prescribed in (4) and shall be hereinafter referred to as the "matters to be indicated in a list of notifiers for businesses specially permitted for overseas investors, etc." and the list shall be hereinafter referred to as the "list of notifiers for businesses specially permitted for overseas investors, etc.>").

To this end, the FSA shall, for each month, after confirming the status of receiving notifications at Local Finance Bureaus, prepare, update and publish on its website the list of notifiers for businesses specially permitted for overseas investors, etc.

(2) Preparation and Publication, etc. of the List of Notifiers Subject to Business Abolition Orders

To provide investors information on persons engaging in businesses specially permitted for overseas investors, etc. to whom a business abolition order was issued based on Article 63-13(3) of the FIEA, the FSA shall prepare and publish on its website a list of notifiers for businesses specially permitted for overseas investors, etc. to whom a business abolition order was issued (hereinafter referred to as the "list of notifiers for businesses specially permitted for overseas investors, etc. subject to business abolition orders")

As such, when a business abolition order has been issued based on Article 63-13(3) of the FIEA to a person engaging in businesses specially permitted for overseas investors, etc., the FSA shall remove such person from the list of notifiers for businesses specially permitted for overseas investors, etc. or the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc. (as defined in (3) below), enter that person in the list of notifiers for businesses specially permitted for overseas investors, etc. subject to business abolition orders, and publish it on its website.

(3) Preparation and Publication, etc. of the List of Uncontactable Notifiers for Businesses Specially Permitted for Overseas Investors, etc.

In order to enable investors to acquire information on persons engaging in businesses specially permitted for overseas investors, etc. with whom supervisory authorities cannot make contact or locate their business places or offices, the FSA shall prepare and publish on its website a list of notifiers for businesses specially permitted for overseas investors, etc. who are not in contact (hereinafter referred to as the "list of uncontactable notifiers for businesses specially permitted for overseas investors, etc.>").

As such, if the FSA finds, through day-to-day supervisory work, any person engaging in businesses specially permitted for overseas investors, etc. with whom supervisory authorities cannot make contact or locate their business places or offices, the FSA shall remove the matters to be indicated in a list of notifiers for businesses specially permitted for overseas investors, etc. regarding such person from the list of notifiers for businesses specially permitted for overseas investors, etc., enter those matters in the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc. and publish it on its website. In making the entry and in publication, the following shall be clearly indicated: the notified business office or office cannot be identified; a notice shall be made to the Commissioner of the Financial Services Agency or other competent official having jurisdiction over notifications for businesses specially permitted for overseas investors, etc. (referring to the Commissioner of the Financial Services Agency or other competent official having

jurisdiction over notifications for businesses specially permitted for overseas investors, etc. prescribed in Article 246-20(1) of the FIB Cabinet Office Ordinance; hereinafter the same shall apply in (4) below) within 30 days from the day when the failure of ascertainment was published on the FSA website; a business abolition order may be issued if supervisors receive no notice during said period, after conducting separate administrative procedures such as a hearing, etc.

With regard to persons engaging in businesses specially permitted for overseas investors, etc. whose business offices or offices have been identified, the FSA shall remove them from the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc. and enter them in the list of notifiers for businesses specially permitted for overseas investors, etc. With regard to persons engaging in businesses specially permitted for overseas investors, etc. to whom a business abolition order has been issued based on Article 63-13(3) of the FIEA, the FSA shall remove them from the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc. and enter them in the list of notifiers for businesses specially permitted for overseas investors, etc. subject to business abolition orders

(4) Matters to be Indicated in a List of Notifiers for Businesses Specially Permitted for Overseas Investors, etc.

(i) Matters to be indicated in a list of notifiers for businesses specially permitted for overseas investors, etc. shall be as follows (however, M. below shall be excluded from the matters to be indicated in the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc., and Q. below shall only be entered in the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc.).

A. Trade name or name and corporate number

B. The Commissioner of the Financial Services Agency or other competent official having jurisdiction over notifications for businesses specially permitted for overseas investors, etc.

C. Names and positions of the representative, other officers and employees specified by Cabinet Order

D. Types of employees specified by Cabinet Order

E. Types of businesses

F. Name, address and phone number of the principal business office or office (for a foreign juridical person, including the principal business office or office in Japan);

G. Name, address and phone number of the business office or office where businesses specially permitted for overseas investors, etc. are conducted

H. URL of the website

I. Types of other businesses conducted

J. Amount of capital or total contribution

K. Whether having been registered as a financial instruments business operator

L. Date of notification under Article 63-9(1) of the FIEA or the most recent date of notification

pursuant to Article 63-9(7) of the FIEA

M. Status of administrative dispositions, etc.

N. Name of the invested business equity

O. Type of the invested business equity

P. Details of the invested business

Q. Date of publication of the failure of ascertainment of the business office or office

(ii) Entry regarding the status of administrative dispositions, etc. as prescribed in M. above

A. With regard to persons engaging in businesses specially permitted for overseas investors, etc. to whom a business improvement order based on Article 63-13(1) of the FIEA or a business suspension order based on Article 63-13(2) of the FIEA has been issued, the status of the relevant administrative disposition shall be entered.

B. With regard to persons engaging in businesses specially permitted for overseas investors, etc. to whom a warning based on the Supervisory Guidelines has been issued or for whom any problem such as the failure to respond to a report order under Article 63-14 of the FIEA has been found, the details of the problem shall be entered.

#### VI-3-3-3 Points of Attention Regarding Business Operators Which Fail to Make Necessary Notifications

When supervisors have found that any person is engaging in businesses specially permitted for overseas investors, etc. without fulfilling the obligation to make a notification under Article 63-9(1) of the FIEA, as a result of receiving a complaint from a customer, an inquiry from an investigative authority, or the provision of information from a Financial Instruments Business Operator or a Financial Instruments Firm's Association, etc., or based on a newspaper advertisement, etc., they shall warn that person in writing to immediately suspend such act or immediately make the necessary notification.

#### VI-3-3-4 Points of Attention Concerning Supervisory Actions for Persons Engaging in Businesses Specially Permitted for Overseas Investors, etc.

(1) Points of Attention in Cases Where Businesses are Suspected of Not Falling under Businesses Specially Permitted for Overseas Investors, etc.

Supervisors shall strive to publicize the need to obtain registration based on Article 29 of the FIEA when businesses of a person engaging in businesses specially permitted for overseas investors, etc. do not satisfy the requirements for the relevant businesses.

If supervisors suspect, through day-to-day supervisory work, that any person engaging in businesses specially permitted for overseas investors, etc. fails to meet the requirements mentioned above, they shall require such person to make a report based on Article 63-14 of the FIEA, and shall take necessary action, including the issuance of a business abolition order based on Article 63-13(3) of the FIEA, when they find it necessary to do so based on such

report. In addition, the same action shall be taken when it is deemed, through on-the-spot inspections, etc., that the requirements mentioned above are not met.

(2) Points of Attention in Cases Where Businesses No Longer Fall under Businesses Specially Permitted for Overseas Investors, etc.

In cases where businesses conducted by a person engaging in businesses specially permitted for overseas investors, etc. no longer fall under the relevant businesses due to such reasons as an increase in overseas investors, etc. other than non-residents, supervisors shall take the following action from the perspective of investor protection.

(i) Order based on Article 63-9(9) of the FIEA

As prescribed in Article 63-9(9) of the FIEA (including cases where applied mutatis mutandis pursuant to Article 61-11(2) of the same Act), "when the right set forth in Article 2(2)(v) or (vi) pertaining to the act set forth in paragraph (1), item (i) of the preceding Article that a notifier for businesses specially permitted for overseas investors, etc. commenced as the relevant businesses has come to no longer fall under the right prescribed in paragraph (1), item (i) of the preceding Article, or when the money invested or contributed by overseas investors, etc. (referring to the overseas investors, etc. prescribed in paragraph (2) of the preceding Article) who hold that right has come to no longer fall under the money invested or contributed mainly by non-residents" is considered to refer to cases where the relevant businesses were businesses specifically permitted for overseas investors, etc. at the time of commencement thereof but have come to no longer fall under businesses specifically permitted for overseas investors, etc. for a reason not attributable to the responsibility of the relevant person engaging in businesses specifically permitted for overseas investors, etc., and in such cases, supervisors shall order that person to take measures such as transferring the relevant businesses to another Financial Instruments Business Operator.

(ii) Cases other than (i) above

In cases other than (i) above, a special clause specified in Article 63-8 of the FIEA shall not apply, and therefore, a person engaging in businesses specially permitted for overseas business investors, etc. will engage in investment management business without being registered under the FIEA. Accordingly, against such person, supervisors shall take necessary action, including the issuance of a business abolition order based on Article 63-13(3) of the FIEA.

(3) Points of Attention Concerning Actions for Persons Engaging in Businesses Specially Permitted for Overseas Investors, etc. Whose Business Office or Office Cannot be Identified

In cases where supervisors find, through day-to-day supervisory work, any person engaging in businesses specially permitted for overseas investors, etc. with whom supervisory authorities cannot make contact and whose business office or office cannot be identified, the FSA shall, in accordance with VI-3-3-2(3), include such person in the list of uncontactable notifiers for businesses specially permitted for overseas investors, etc., while clearly indicating that the notified business office or office cannot be ascertained and other facts, and shall publish it on its website. If supervisors receive no notice from that person after 30 days have passed since the day of the publication, supervisors shall issue a business abolition order to that person based on Article 63-13(3) of the FIEA.

#### (4) Points of Attention in Issuing a Business Abolition Order

With regard to problems concerning the appropriateness of business operations of a person engaging in businesses specially permitted for overseas investors, etc., if the impact on investors, etc. and maliciousness of the conducted act are significant or serious, but it is unlikely that the issuance of a business improvement order based on Article 63-13(1) of the FIEA or a business suspension order based on Article 63-13(2) of the FIEA will lead to an improvement in the situation in relation to that person, supervisors shall issue a business abolition order based on Article 63-13(3) of FIEA.

In addition, "a case where the purpose of supervision cannot be achieved by any other method" as prescribed in Article 63-13(3) of the FIEA does not necessarily mean to require the issuance of a business improvement order or a business suspension order prior to the issuance of a business abolition order based on the provisions of the same paragraph. For example, when a person engaging in businesses specially permitted for overseas investors, etc. is deemed to have committed a serious violation of the law that may lead to cancellation of registration if that person is a Financial Instruments Business Operator, etc., supervisors shall immediately issue a business abolition order since the case falls under "a case where the purpose of supervision cannot be achieved by any other method."

In the event that a business abolition order has been issued against a person engaging in businesses specially permitted for overseas investors, etc., supervisors shall check whether customer transactions by that person have been completed and whether properties deposited by customers as well as properties occupied in its calculation have been returned, before requiring that person to make a notification of the abolition of businesses specially permitted for overseas investors, etc. as prescribed in Article 63-10(3)(ii) of the FIEA.

#### VI-3-4 Points of Attention Regarding Administrative Processes Related to Businesses Specially Permitted for the Transitional Period, etc.

VI-3-3 shall also apply for points of attention regarding administrative processes related to businesses specially permitted for the transitional period, etc.

#### VI-3-5 Points of Attention Regarding Administrative Processes Related to Investment Corporations

##### VI-3-5-1 Notification of Changes Related to and Dissolution of Registered Investment Corporations

###### (1) Notification of Changes Related to Registered Investment Corporations

- (i) VI-3-1-3(3)(i) and (ii) shall be applied mutatis mutandis to the notification of changes related to registered investment corporations.
- (ii) Notifications of changes related to registered investment corporations, based on Article 191(1) of the Investment Trust Act, that are received by the director-general of a Local Finance Bureau (excluding notifications of a relocation of the head office from a region under the jurisdiction of one Local Finance Bureau to a region under the jurisdiction of another) shall be collectively reported each month to the FSA



Commissioner by the 15th day of the following month, in the format specified in the Attached List of Formats VI-5.

(iii) In cases where an investment corporation's notification of a change has revealed that a new executive officer meets the provision of any of Article 98(ii) to (v) of the Investment Trust Act, that a new supervisory officer meets the provision of any of the items of Article 100 of the Investment Trust Act, or that a new accounting auditor meets the provision of any of the items of Article 102(3) of the Investment Trust Act, the director-general of the relevant Local Finance Bureau shall immediately instruct the investment corporation to take corrective action. If corrective action is not taken immediately, the registration shall be rescinded based on Article 216(1) of the Investment Trust Act.

## (2) Notification of Cross-Jurisdictional Relocation of Head Office

(i) When the director general of a Local Finance Bureau has received notification of a relocation of the head office from a region under the jurisdiction of his/her bureau to a region under the jurisdiction of another bureau, he/she shall send the notification document with an opinion of his/her bureau and the results of the most recent inspection attached thereto, in the format specified in the Attached List of Formats VI-6, to the director-general of the Local Finance Bureau to which the authority over the relevant registered investment corporation will be transferred, in addition to implementing the procedures specified under Article 275(1) of the Ordinance for Enforcement of the Investment Trust Act.

(ii) When the director-general taking over the authority over the registered business operator has completed registration change procedures based on Article 275(2) of the Ordinance for Enforcement of the Investment Trust Act, he/she shall immediately notify the director-general who previously had the authority via e-mail, etc or through other means.

(iii) The director-general who previously had the authority shall cancel the registration of the relevant investment corporation after being notified, by the director-general who has taken over the authority, of the completion of the registration of the relocation based on Article 275(2) of the Ordinance for Enforcement of the Investment Trust Act.

(iv) Relocations of the head offices registered each month shall be collectively reported to the FSA Commissioner by the directors-general of Local Finance Bureaus who have taken over the authority, by the 15th day of the following month in the format specified in the Attached List of Formats VI-7.

## (3) Notifications of Dissolution of Investment Corporations

Notifications of dissolution of investment corporations (the format is as specified in the Attached List of Formats XVII of the Ordinance for Enforcement of the Investment Trust Act) received by the directors-general of Local Finance Bureaus shall be collectively reported each month to the FSA Commissioner by the 15th day of the following month, in the format specified in the Attached List of Formats VI-8.

### VI-3-5-2 Extraordinary Reports

Procedures to be implemented by the directors-general of Local Finance Bureaus are as follows.

(1) The director-general of a Local Finance Bureaus, upon receiving an extraordinary report, based on Article 215(1) of the Investment Trust Act, shall immediately send a copy thereof to the FSA Commissioner.

(2) Notice to Investment Corporations

Directors-general of Local Finance Bureaus shall hold consultations with the FSA before giving notice, based on Article 215(2) of the Investment Trust Act, to an investment corporation.

It should be noted that the directors-general shall report the results of the deliberations made by their bureaus and express the opinions thereof in the consultations.

VI-3-5-3 Consultations, etc., with the FSA about Permissions and Administrative Actions Regarding Investment Corporations, etc

(1) Consultations with FSA about Permissions for Investment Corporations, etc.

(i) The directors-general of Local Finance Bureaus shall hold prior consultations with the FSA with regard to the following permissions and approvals, the authority over which is delegated to them as a matter of supervisory process.

- A. Permission based on Article 81(4) of the Companies Act as applied mutatis mutandis pursuant to Article 73(4) of the Investment Trust Act
- B. Permission based on Article 82(4) of the Companies Act as applied mutatis mutandis pursuant to Article 73(4) of the Investment Trust Act
- C. Permission based on Article 297(4) of the Companies Act as applied mutatis mutandis pursuant to Article 90(3) of the Investment Trust Act
- D. Permission based on Article 318(5) of the Companies Act as applied mutatis mutandis pursuant to Article 94(1) of the Investment Trust Act
- E. Permission based on Article 371(2) or (4) of the Companies Act as applied mutatis mutandis pursuant to Article 115(1) of the Investment Trust Act (including cases where Article 371(4) of the Companies Act is applied mutatis mutandis pursuant to Article 115(5) of the Investment Trust Act)
- F. Permission based on Article 433(3) of the Companies Act as applied mutatis mutandis pursuant to Article 128-3(2) of the Investment Trust Act
- G. Permission based on Article 442(4) of the Companies Act as applied mutatis mutandis pursuant to Article 132(2) of the Investment Trust Act
- H. Permission based on Article 371(2) or (4) of the Companies Act as applied mutatis mutandis pursuant to Article 154-3(2) of the Investment Trust Act (including cases where Article 371(4) of the Companies Act is applied mutatis mutandis pursuant to Article 154-3(5) of the Investment Trust Act)
- I. Permission based on Article 500(2) of the Companies Act as applied mutatis mutandis pursuant to Article 157(3) of the Investment Trust Act

(ii) The directors-general of Local Finance Bureaus shall hold prior consultations with the FSA with regard

to the exercise of the authority regarding the following matters, the authority over which is delegated to matters of supervisory process concerning investment corporations:

- A. Order based on Article 307(1) of the Companies Act as applied mutatis mutandis pursuant to Article 94(1) of the Investment Trust Act
  - B. Appointment of a person responsible for performing the duties of a temporary officer based on Article 108(2) of Investment Trust Act
  - C. Order based on Article 359(1) of the Companies Act as applied mutatis mutandis pursuant to Article 110(2) of the Investment Trust Act
  - D. Order based on Article 162 of the Investment Trust Act
  - E. Application for a court order of the dissolution of an investment corporation based on Article 824(1) of the Companies Act as applied mutatis mutandis pursuant to Article 144 of the Investment Trust Act
  - F. Application with a court appointment of an administrator based on Article 825(1) of the Companies Act as applied mutatis mutandis pursuant to Article 144 of the Investment Trust Act
  - G. Appointment of a liquidator or a liquidation supervisor based on Article 151(3) of the Investment Trust Act
  - H. Appointment of a liquidator or a liquidation supervisor based on Article 151(4) of the Investment Trust Act
  - I. Appointment of a liquidator or a liquidation supervisor based on Article 151(5) of the Investment Trust Act
  - J. Dismissal of a liquidator or a liquidation supervisor based on Article 153(1) of the Investment Trust Act
  - K. Appointment of a liquidator or a liquidation supervisor based on Article 153(1) of the Investment Trust Act
  - L. Determination of the amount of remuneration for the liquidator based on Article 154(2) of the Investment Trust Act or determination of remuneration for the liquidation supervisor based on Article 154(2) of the Investment Trust Act as applied mutatis mutandis pursuant to Article 154-2(2) of the same act.
  - M. Appointment of an appraiser of a debt with an undetermined value based on Article 501(1) of the Companies Act as applied mutatis mutandis pursuant to Article 157(3) of the Investment Trust Act
  - N. Appointment of a person in charge of the storage of account documents based on Article 508(2) of the Companies Act as applied mutatis mutandis pursuant to Article 161 of the Investment Trust Act
  - O. Appointment of a person responsible for performing the duties of a temporary liquidator or a temporary liquidation supervisor based on Article 108(2) of the Investment Trust Act as applied mutatis mutandis pursuant to Article 153(2) of the same act
  - P. Immediate appeal based on Article 872 of the Companies Act as applied mutatis mutandis pursuant to Articles 84(2), 139-9(8), 139-10(2), 141(3), 144, 149-3(4), 149-8(4), 149-13(4), 150 and 163
- (iii) When the directors-general of Local Finance Bureaus have decided to grant permissions and approvals regarding the above matters, they shall notify the applicants in the format specified in the Attached List of Formats VI-9. When they have decided not to grant permissions or approvals, the notice shall be made in the format specified in the Attached List of Formats VI-10.

## (2) Consultations with FSA about Administrative Actions

- (i) The directors-general of Local Finance Bureaus shall hold prior consultations with the FSA with regard to the following matters, the authority over which is delegated to them as a matter of supervisory process concerning investment corporations.

It should be noted that the directors-general shall report the results of the deliberations made by their bureaus and express the opinions thereof in the consultations.

A. Order for business improvement based on Article 214(1) of the Investment Trust Act

B. Rescission of registration based on Article 216 of the Investment Trust Act

- (ii) In cases where the director-general of a Local Finance Bureau intends to take an administrative action against a person planning to establish an investment corporation or against an investment corporation, and where the said person or investment corporation, an investment management company to which the investment corporation or said person entrusts asset investment, an entity to which the asset investment is re-entrusted under Article 202(1) of the Investment Trust Act, an asset administration company in charge of the relevant assets, or the company undertaking the relevant general clerical work is located in a region under the jurisdiction of another Local Finance Bureau, the said director-general shall, in principle, solicit the opinion of the director-general of the other Local Finance Bureau before taking said administrative action and later communicate the action taken thereto.

## (3) Notice to Heads of Relevant Administrative Organizations

When giving notice to relevant administrative organizations based on Article 132(6) and Article 135(1) of the Enforcement Order of the Investment Trust Act, the directors-general of Local Finance Bureaus shall pay attention to the following points:

- (i) Notice regarding a registration application based on Article 187 of the Investment Trust Act must be given to the section in charge of the relevant department of the administrative organization concerned immediately after the receipt of the registration application.
- (ii) Regarding a report based on the items of Article 132(3) of the Enforcement Order of the Investment Trust Act, the contents of the report must be quickly notified to the section in charge of the relevant department of the administrative organization concerned, by the end of the month following the month of the receipt of the report at the latest.

## (4) Re-delegation to Directors-General of Local Finance Offices

Of the administrative processes delegated to the directors-general of Local Finance Bureaus based on Article 135 of the Enforcement Order of the Investment Trust Act, the directors-general may re-delegate the following processes to the directors-general of local Finance Offices that have jurisdiction over the regions where the applicants and the investment corporations are located, as well as to the heads of the Oar and Kitami Branch Offices.

- (i) Administrative processes regarding the receipt of notification related to the establishment of an investment corporation as specified under Article 69(1) of the Investment Trust Act

- (ii) Administrative processes regarding the receipt of a notification based on Article 152(1) of the Investment Trust Act
- (iii) Administrative processes regarding the receipt of a registration application as specified under Article 188(1) of the Investment Trust Act
- (iv) Administrative processes regarding the receipt of a notification of change as specified under Article 191(1) of the Investment Trust Act
- (v) Administrative processes regarding the receipt of a notification based on Article 192(1) of the Investment Trust Act

#### VI-3-5-4 Issuance of Certificates

##### (1) Issuance of Certificates to Trust Companies, etc.

- (i) Issuance of Certificates Necessary for Reduction of License Registration Tax Regarding Ownership Transfer

The following procedures should be taken with regard to the issuance of the certificate, as specified under Article 31-5(2) of the enforcement rules for the Act for Special Tax Measures, necessary for the reduction of the license registration tax for trust companies, etc., based on Article 83-2-3(2) of the said act.

It should be kept in mind that a trust company, etc., seeking to become eligible for the provision of Article 83-2-3(2) of the Act for Special Tax Measures needs to do so within one year from the acquisition of the relevant real estate.

- A. An application from a trust company, etc., for a certificate necessary for the reduction of the license registration tax regarding the transfer of ownership and the certificate to be issued by the FSA Commissioner shall be in accordance with the format specified in the Attached List of Formats VI-11.
- B. The applicant shall be required to fill out the necessary items of the application form and attach to it a copy of the relevant real estate transaction contract, in order to confirm the dates of the signing of the contract and the real estate acquisition.
- C. After the application for a certificate has been submitted, the certificate shall be issued upon the confirmation, made in reference to the attached documents and other materials, of the following points regarding the items specified in the submitted application.
  - a. Whether it is specified as an investment policy for the relevant investment trust, under the investment trust contract provisions, that the ratio of the total value of specified real estate assets (as specified under Article 83-2-3(2)(i) of the act for special tax measures) to the total value of specified assets included in the trust assets of the said investment trust (hereinafter referred to as the specified real estate asset ratio in this paragraph (1)) should be 75% or higher.
  - b. In cases where funds are borrowed, whether the borrowed funds have been provided by qualified institutional investors as specified under Article 2(3)(i) of the FIEA.
  - c. Whether the specified assets invested by the investment trust meet either of the following criteria:
    - i) The specified real estate asset ratio is 75% or higher.

(When the submitted asset investment report confirms a specified real estate asset ratio of 75% or higher, this criterion shall be deemed to be met.)

- ii) The specified real estate asset ratio is expected to rise to 75% or higher when the applicant trust company, etc., acquires the real estate for which it is filing the application.

(In cases where this criterion is to be met, materials showing the status of the specified assets as of the application date shall be required to be attached to the submitted application in the format specified in the Attached List of Formats VI-12 in order for the status to be confirmed.)

D. If the type of building section on the application for a certificate is specified as warehouse and the date of acquisition of the ownership of the said building precedes April 1, 2015, which is the date specified in the main clause of Article 1 of the Supplementary Provisions Law No. 9 to Partially Revise the Income Tax and Other Laws (2015), the following actions shall be taken.

- a. It shall be ensured that the application includes the ratio of the floor area used for purposes other than warehouse use.
- b. The applicant shall be requested to attach a certificate by the Minister of Land, Infrastructure and Transport that verifies the ratio of the floor area used for purposes other than warehouse use.

(Note) It should be noted that such a certificate is not issued if the entire building is used for warehouse use only, as the provisions in Article 83-2-3(2) of the Act for Special Tax Measures do not apply.

(ii) Issuance of Certificate Necessary for Reduction of Real Estate Acquisition Tax

The following procedures shall be followed with regard to the issuance of the certificate, as specified under Article 7(5) of the Order for Enforcement of the Local Tax Act, necessary for the reduction of the real estate acquisition tax for trust companies, etc., based on Article 11(4) of the supplementary provisions of the local tax act.

- A. An application from a trust company, etc., for a certificate for the reduction of the real estate acquisition tax and the certificate to be issued by the FSA Commissioner shall be in accordance with the format specified in the Attached List of Formats VI-13.
- B. After the application for a certificate has been submitted, the certificate shall be issued upon the confirmation, made in reference to the attached documents and other materials, of the following points with regard to the items specified in the submitted application.
  - a. Whether it is specified as an investment policy for the relevant investment trust, under the investment trust contract provisions, that the specified real estate asset ratio should be 75% or higher.
  - b. In cases where funds are borrowed, whether the borrowed funds have been provided by qualified institutional investors as specified under Article 2(3)(i) of the FIEA and designated under a relevant ordinance of the Ministry of Internal Affairs and Communications.
  - c. Whether the specified assets invested by the investment trust meet either of the following criteria:
    - i) The specified real estate asset ratio is at least 75%.

(When the submitted asset investment report confirms a specified real estate asset ratio of 75% or higher, this criterion shall be deemed to be met.)

- ii) The specified real estate asset ratio is expected to rise to 75% or higher when the applicant trust company, etc., acquires the real estate for which it is filing the application.

(If this criterion is to be met, materials showing the status of the specified assets as of the application date shall be required to be attached to the submitted application in the format specified in the Attached List of Formats VI-12 in order for the status to be confirmed.)

## (2) Issuance of Certificates to Investment Corporations

### (i) Issuance of Certificates Necessary for Reduction of License Registration Tax Regarding Ownership Transfer

The following procedures shall be followed with regard to the issuance of the certificate, as specified under Article 31-5(3) of the enforcement rules for the Act for Special Tax Measures, necessary for the reduction of the license registration tax for investment corporations based on Article 83-2-3(3) of the said act.

An investment corporation seeking to become eligible for the provision of Article 83-2-3(3) of the act for special tax measures needs to do so within one year from the acquisition of the relevant real estate.

- A. An investment corporation's application for a certificate necessary for the reduction of the license registration tax regarding the transfer of ownership and the certificate to be issued by the directors-general of Local Finance Bureaus shall be in accordance with the format specified in the Attached List of Formats VI-14.
- B. The applicant shall be required to fill out the necessary items on the application form and attach to it a copy of the relevant real estate transaction contract, in order for the dates of the signing of the contract and the real estate acquisition to be confirmed.
- C. After the application for a certificate has been submitted, the certificate shall be issued upon the confirmation, made in reference to the attached documents and other materials, of the following points regarding the items specified in the submitted application.
  - a. Whether it is specified as an asset investment policy under the internal rules that the ratio of the total value of specified real estate assets (as specified under Article 83-2-3(3)(i) of the Act on Special Measures Concerning Taxation) to the total value of specified assets owned by the said investment corporation (hereinafter referred to as the specified real estate asset ratio in this paragraph (2)) should be 75% or higher.
  - b. Whether the applicant is registered under Article 187 of the Investment Trust Act
  - c. In cases where funds are borrowed, whether the borrowed funds have been provided by qualified institutional investors as specified under Article 2(3)(i) of the FIEA.
  - d. Whether either of the following criteria is met:
    - i) The specified real estate asset ratio is 75% or higher.

(When the submitted asset investment report confirms a specified real estate asset ratio of 75% or higher, this criterion shall be deemed to be met.)
    - ii) The specified real estate asset ratio is expected to rise to 75% or higher when the applicant investment corporation acquires the real estate for which it is filing the application.

(If this criterion is to be met (including in the initial year), materials showing the status of the specified assets as of the application date shall be required to be attached to the submitted application in the format specified in the Attached List of Formats VI-12 in order for the confirm the status to be confirmed.)

D. If the type of building section on the application for a certificate is specified as warehouse and the date of acquisition of the ownership of the said building precedes April 1, 2015, which is the date specified in the main clause of Article 1 of the Supplementary Provisions Law No. 9 to Partially Revise the Income Tax and Other Laws (2015), the following actions shall be taken.

- a. It shall be ensured that the application includes the ratio of the floor area used for purposes other than warehouse use.
- b. The applicant shall be requested to attach a certificate by the Minister of Land, Infrastructure and Transport that verifies the ratio of the floor area used for purposes other than warehouse use.

(Note) It should be noted that such a certificate is not issued if the entire building is used for warehouse use only, as the provisions in Article 83-2-3(3) of the Act for Special Tax Measures do not apply.

(ii) Issuance of Certificates Necessary for Reduction of Real Estate Acquisition Tax

The following procedures shall be followed with regard to the issuance of the certificate, as specified under Article 7(7) of the Order for Enforcement of the Local Tax Act, necessary for the reduction of the real estate acquisition tax for investment corporations, based on Article 11(5) of the supplementary provisions of the said act.

A. An investment corporation's application for a certificate necessary for the reduction of the real estate acquisition tax and the certificate to be issued by the directors-general of Local Finance Bureaus shall be in accordance with the format specified in the Attached List of Formats VI-15.

B. After the application for a certificate has been submitted, the certificate shall be issued upon the confirmation, made in reference to the attached documents and other materials, of the following points regarding the items specified in the submitted application.

- a. Whether it is specified as an asset investment policy under the internal rules that the specified real estate asset ratio should be 75% or higher.
- b. In cases where funds are borrowed, whether the borrowed funds have been provided by qualified institutional investors as specified under Article 2(3)(i) of the FIEA and designated under a relevant ordinance of the Ministry of Internal Affairs and Communications.
- c. Whether the specified assets invested by the investment corporation meet either of the following criteria:

- i) The specified real estate asset ratio is 75% or higher.

(When the submitted asset investment report confirms a specified real estate asset ratio of 75% or higher, this criterion shall be deemed to be met.)

- ii) The specified real estate asset ratio is expected to rise to 75% or higher when the applicant investment corporation acquires the real estate for which it is filing the application.



(If this criterion is to be met (including in the initial year), materials showing the status of the specified assets as of the application date shall be required to be attached to the submitted application in the format specified in the Attached List of Formats VI-13 in order for the status to be confirmed.)

## **VII. Supervisory Evaluation Points and Various Administrative Procedures (Investment Advisory and Agency Business)**

### VII-1 Governance (Investment Advisory and Agency Business)

Supervisors shall pay attention to the following points when examining the governance of Financial Instruments Business Operators (limited to business operators engaging in investment advisory and agency business; the same shall apply in VII).

#### VII-1-1 Officers of Financial Instruments Business Operators

##### (1) Major Supervisory Viewpoints

Whether the Financial Instruments Business Operator properly takes account of the following eligibility requirements in the decision-making process regarding proposals for the appointment of its officers.

- (i) A person who does not meet any of the ineligibility criteria (Article 29-4(1)(ii)(a) to (i) of the FIEA) and who did not meet any of them at the time of registration.
- (ii) A person who has not violated laws and regulations regarding financial instruments business or related business operations of the FIEA, or a person who has not been subjected to administrative actions taken based on laws and regulations.
- (iii) A person who has not damaged the interests of investors in relation to the conduct of the investment advisory and agency business and the investment management business.
- (iv) A person who has not engaged in an illegal or markedly inappropriate act, under particularly grave circumstances, regarding financial instruments business.

##### (2) Supervisory Method and Actions

In cases where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 29-4(1)(ii)(a) to (i) of the FIEA or is found to have done so at the time when the business operator obtained registration under Article 29 of the FIEA, or where an officer of a Financial Instruments Business Operator is deemed to meet the ineligibility criteria specified under any of Article 52 (1) (vii) and (ix) and (x) of the FIEA, supervisors shall consider taking actions such as ordering the dismissal of the said officer based on Article 52(2) of the FIEA.

In addition, they shall hold an in-depth hearing regarding the decision-making process concerning the proposal for the appointment of the said officer and, when necessary, require the submission of a report based on Article 56-2(1) of the FIEA. Furthermore, supervisors shall consider taking actions such as issuing an order for business improvement if the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem and the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

## VII-1-2 Adequate Staffing, etc. for Properly Conducting Financial Instruments Business

### (1) Major Supervisory Viewpoints

Supervisors shall examine whether Financial Instruments Business Operators are adequately staffed to properly conduct financial instruments business (limited to investment advisory and agency business; the same shall apply to VII), in light of VII-3-1, and whether the operators have established the structure/system required for operating financial instruments business appropriately.

### (2) Supervisory Method and Actions

The provisions under VII-3-1 are part of a comprehensive set of elements that supervisors should take into consideration when examining whether a Financial Instruments Business Operator is adequately staffed to properly conduct financial instruments business, etc. Even if an officer or an employee is deemed to not meet the requirements, it should not automatically lead to the conclusion that the Financial Instruments Business Operator is not adequately staffed, etc. The important thing is, first and foremost, that Financial Instruments Business Operators strive to ensure on their own responsibility that they are adequately staffed, etc. in light of these requirements and other elements.

However, supervisors shall hold in-depth hearings regarding Financial Instruments Business Operators' view on their staffing, etc. and their decision-making process concerning the proposed appointments of officers and employees, in cases where a Financial Instruments Business Operator is deemed to have failed to take those elements into consideration sufficiently in the said decision-making process and where it is deemed to be necessary and appropriate from the viewpoint of protecting the public interest and investors to hold such hearings. In addition, they shall require the submission of reports based on Article 56-2(1) of the FIEA when necessary.

Supervisors shall consider taking actions such as issuing an order for business improvement under Article 51 of the FIEA, in cases where the Financial Instruments Business Operator's control environment for governance is deemed to have a serious problem as a result of the examination of the submitted report, and where the action is deemed to be necessary and appropriate from the viewpoint of protecting public interests and investors.

Furthermore, when the Financial Instruments Business Operator is deemed to be not adequately staffed to properly conduct financial instruments business, etc. as a result of the examination of the submitted report, supervisors shall consider taking necessary measures, including issuing an order for business suspension based on Article 52(1) of the FIEA.

It should be noted that if the Financial Instruments Business Operator is an individual person, supervisors shall examine the qualifications of the person from the above viewpoints, and as with the case of a corporation, they shall judge whether the person is sufficiently qualified, etc. to properly operate financial instruments business and take necessary supervisory actions.

## VII-2 Appropriateness of Business Operations (Investment Advisory and Agency Business)

Supervisors shall examine the appropriateness of Financial Instruments Business Operators' business operations by paying attention to the following points.

### VII-2-1 Appropriateness of Business Operations Related to Investment Advisory Business

#### VII-2-1-1 Control Environment for Legal Compliance

Investment advisory business operators (Financial Instruments Business Operators engaging in investment advisory business (as specified under Article 2(8)(xi) of the FIEA; the same shall apply in VII); the same shall apply in VII) have the function of contributing to the buildup of customers' assets by providing them with information regarding investment decisions based on the analysis of the values of securities, financial products and other items. Therefore, investment advisory business operators are required to conduct their business in a conscientious manner by putting the top priority on customers' interests and maintaining sound and appropriate business operations with a high level of self-discipline.

Investment advisory business operators' control environments for legal compliance shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules.

(Note) When an investment advisory business operator explains details of securities with an intention, purpose, etc. to have customers acquire the securities for the sake of the issuer, it should be noted that the operator is handling a public offering or a private placement of securities and classified as a Type I or II Financial Instruments Business Operator. It should be noted, for example, that if the operator has explained specific product details about the securities, and has received reward, directly or indirectly, whose payment is linked to customers' acquisition of the relevant securities, such an act is deemed Type I or Type II Financial Instruments Business

#### VII-2-1-2 Control Environment for Customer Solicitation and Explanations

##### (1) Prohibition of Advertisements Using Exaggerated Descriptions

- (i) When the investment advisory business operator includes the results of its investment advice regarding specific issues in its advertisements, whether it cites only issues for which results are favorable.
- (ii) Whether the investment advisory business operator includes in its advertisements descriptions indicating that the results, contents and method of its investment advice are markedly superior to those of other investment advisory business operators without providing the basis therefor.
- (iii) Whether the advertisement does not use descriptions that could mislead users to believe that the customer solicitation period and the number of customers to be accepted are limited whereas in reality they are not limited.
- (iv) In cases where the investment advisory business operator has not obtained registration regarding investment management business, whether its advertisements include representations that could lead investors

to erroneously believe that it can engage in investment management business.

## (2) Points of Attention Regarding Provision of Pre-Contract Documents and Provision of Documents at Contract Signing

Regarding the matters set forth in Article 95(1)(ii) and (iv) and Article 106(1)(vi) and (vii) of the FIB Cabinet Office Ordinance, when the name of the department that conducts the analysis of the values, etc. of financial instruments or makes investment decisions based on this analysis or the department that performs the operations is entered in lieu of the name of the analyst, etc. or the name of the person who performs the advisory service based on an investment advisory contract, as “a system which enables prompt responses to the customer’s inquiries,” an investment advisory business operator may be considered to have developed a system under which records on names of the analysts, etc. or the persons who perform the advisory service are appropriately created and stored and prompt responses can be made to customers’ inquiries by checking relevant records.

## (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding an investment advisory business operator’s advertisements, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment advisory business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the investment advisory business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment advisory business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

## VII-2-1-3 Cancellation of Investment Advisory Contracts (Cooling-Off Rule)

### (1) Points of Attention Regarding Cancellation of Investment Advisory Contracts

- (i) The “usual expenses necessary for the signing of an investment advisory contract,” as specified under Article 115(1)(i) of the FIB Cabinet Office Ordinance, include the costs of communications using telephone calls, mail and other means, but do not include travel expenses.
- (ii) The calculation of the “the number of dates between the receipt of the documents provided at the time of the contract signing and the cancellation date,” as specified under Article 115(1)(iii) of the FIB Cabinet Office Ordinance, should include the days on which the documents are received and the “time of cancellation” as specified under Article 115(1)(i) of the FIB Cabinet Office Ordinance.

### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding an investment advisory business operator’s cooling-off rules, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment advisory business

operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the investment advisory business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment advisory business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VII-2-1-4 Duty of Loyalty and Measures to Prevent Internal Collusion

##### (1) Points of Attention Regarding Investment Advisory Business Operators Engaging in Two or More Types of Business

When supervisors examine the appropriateness of measures taken by an investment advisory business operator engaging in two or more types of business (as specified under Article 29-2(1)(v) of the FIEA) to prevent internal collusion, they shall pay attention to the following points, for example, depending on the nature of its business, from the viewpoint of preventing conflicts of interest and ensuring the appropriateness of business operations in other ways.

- (i) Whether the investment advisory business operator has taken appropriate measures to prevent collusion between its different types of business, such as establishing an internal control system and procedures for the prevention of such collusion in a manner suited to the nature of its business.
- (ii) Regarding the “non-disclosure information,” as specified under Article 147(ii) of the FIB Cabinet Office Ordinance, whether the investment advisory business operator has put in place information management measures, such as the appointment of a relevant manager and the establishment of management rules, and ensures the effectiveness of information management by, for example, properly identifying and examining the status of the usage of the non-disclosure information and revising the management method as necessary.

##### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding measures taken by an investment advisory business operator engaging in two or more types of business to prevent internal collusion, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the investment advisory business operator by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the investment advisory business operator is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the investment advisory business operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

## VII-2-1-5 Measures to Prevent Legal Violations by Agency/Brokerage Service Providers

When investment advisory business operators entrust business operations to agency/brokerage service providers, it is important that they provide the service providers with guidance regarding the establishment of arrangements and procedures for customer due diligence that enable precise identification of the attributes of customers and the actual state of transactions, from the viewpoint of ensuring the implementation of appropriate investment solicitation suited to customer attributes. In addition, they should require the agency/brokerage service providers to ensure thorough legal compliance based on the examination of the actual status of their investment solicitation. Supervisors shall examine an investment advisory business operator's control environment for the prevention of legal violations by agency/brokerage service providers by paying attention to the following points in particular:

### (1) Selection of Agency/Brokerage Service Providers

#### (i) Points of Attention Regarding Selection of Agency/Brokerage Service Providers

- A. When signing contracts for entrusting agency/brokerage services, whether the investment advisory business operator specifies the significance of the entrustment in relation to governance, identifies the various risks involved therein and conducts sufficient deliberations on the method of risk management.
- B. Whether the investment advisory business operator conducts sufficient deliberations on whether the agency/brokerage service providers have sufficient qualifications to conduct the entrusted business operations in a sound and appropriate manner. In cases where the agency/brokerage service providers concurrently engage in other services in particular, whether the investment advisory business operator not only examines the possibility of the nature of the other services damaging public confidence in the service providers, but also conducts sufficient deliberations from the viewpoint of reputational risk for the primary business operator. (The "primary business operator" refers to an investment advisory business operator which signs investment advisory contracts through agency/brokerage services provided by agency/brokerage service providers. The same shall apply in VII.)

### (2) Measures Taken by Primary Business Operators to Ensure the Appropriateness of Agency/Brokerage Service Providers

#### (i) Development of Internal Control Environment for Supervising Agency/Brokerage Service Providers

- A. Whether the primary business operator has developed a control environment for ensuring appropriate supervision of agency/brokerage service providers through measures such as establishing a division responsible for the implementation of measures to ensure the sound and appropriate conduct of business operations related to agency/brokerage services or appointing a person responsible therefor (including a control environment regarding audits of the business operations of agency/brokerage service providers).
- B. Whether the primary business operator has developed an internal control environment for examining whether the said division or person has taken proper measures to ensure the appropriateness of the business operations related to the agency/brokerage services.

#### (ii) Points of Attention Regarding Measures to Ensure Necessary and Appropriate Supervision of

#### Agency/Brokerage Service Providers

- A. Whether the primary business operator has taken the following measures in order to ensure a sound and appropriate conduct of business operations related agency/brokerage services and monitors the status of the conduct of the business operations.
    - a. To provide guidance regarding business operations related to agency/brokerage services to brokerage service providers and their employees and implement training programs intended to ensure their compliance with laws and regulations regarding the agency/brokerage services.
    - b. Measures to ensure necessary and appropriate supervision of agency/brokerage service providers, such as examining periodically or as necessary whether the service providers properly conduct the services, including investment solicitation, and requiring them to make improvement when necessary.
  - B. Whether the primary business operator has developed a control environment that ensures the results of the above monitoring are examined by its division in charge and reported to the management team when necessary, so that they are reflected in the provision of appropriate guidance by the primary business operator and in the conduct of business operations by agency/brokerage service providers.
- (iii) Measures to Cancel Contracts for Entrusting Agency/Brokerage Services
- Whether the primary business operator has developed a control environment for implementing appropriate measures, such as providing guidance to agency/brokerage service providers and canceling contracts for entrusting agency/brokerage services, when a problem has been found as a result of the monitoring of agency/brokerage service providers. In addition, whether it has developed a control environment for properly protecting customers when canceling the entrustment contract.
- (iv) Whether the primary business operator has established arrangements and procedures for responding to complaints, such as specifying the contact point for customer complaints regarding agency/brokerage services, establishing a division in charge of processing complaints, and prescribing procedures for processing complaints.

#### (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding a primary business operator's selection of agency/brokerage service providers and its measures to ensure the appropriateness of their business operations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the primary business operator and the service providers by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the primary business operator and the service providers are deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the primary business operator and the service providers are deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.



## VII-2-2 Appropriateness of Business Operations Related to Agency/Brokerage Services

Supervisors shall examine the appropriateness of agency/brokerage service providers with due consideration of the following supervisory viewpoints, for example. It should be noted that the validity of measures to ensure the appropriateness of the business operations of agency/brokerage service providers need to be examined from a comprehensive perspective, in light of the nature and size of their business and their status of concurrent engagement in different types of business, and that failure to meet some of the criteria included in the supervisory evaluation points should not automatically be deemed to mean that their business operations are inappropriate.

### VII-2-2-1 Control Environment for Legal Compliance

The establishment of the framework for agency/brokerage services is expected to contribute to securing and improving investors' access to investment services and facilitate efficient use of various sales channels, including Financial Instruments Business Operators. On the other hand, it is essential to maintain the sound and appropriate management of agency/brokerage services in order to prevent illegal transactions that may be made through the abuse of a position as an ordinary business operator.

Therefore, it is important to supervise agency/brokerage service providers in a timely and appropriate manner so as to ensure that their services are steadily conducted in an appropriate manner. In particular, it is necessary for supervisors to make sure to prevent agency/brokerage services providers concurrently engaging in other businesses from using inappropriate practices, such as abuse of a superior bargaining position and misappropriation of customer information.

Agency/brokerage service providers' control environments for legal compliance shall basically be examined based on the supervisory viewpoints and methods specified in III-2-1. However, they shall also be examined in relation to a broad range of matters, including the status of compliance with voluntary regulatory rules.

### VII-2-2-2 Development of Control Environment by Agency/Brokerage Service Providers

#### (1) Major Supervisory Viewpoints

- (i) Whether agency/brokerage service providers ensure the conduct of appropriate business operations in compliance with laws and regulations by prescribing specific procedures for customer solicitation, the provision of explanations of the contents of contracts and the provision of documents at the signing of contracts under internal rules.
- (ii) Whether agency/brokerage service providers have prescribed specific procedures for properly examining the status of compliance with laws and regulations.
- (iii) Whether agency/brokerage service providers have secured an adequate number of personnel with sufficient knowledge regarding its agency/brokerage services.

#### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the development of control

environments by agency/brokerage services providers, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the agency/brokerage services providers by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the agency/brokerage services providers are deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the agency/brokerage services providers are deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

### VII-2-2-3 Provision of Information to Protect Investors

#### (1) Major Supervisory Viewpoints

(i) Control Environment for Prevention of Explanations That May be Mistaken for Abuse of Superior Bargaining Position

Whether agency/brokerage service providers concurrently engaging in other businesses have developed a control environment that prevents the provision of explanations that could be mistaken as an abuse of a superior bargaining position banned under the Antimonopoly Act in relation to the agency/brokerage services and the businesses in which they concurrently engage.

(ii) Control Environment for Prevention of Misrecognition of Financial Products as Deposits

In cases where banks and other deposit-taking financial institutions engage in agency/brokerage services for the signing of investment advisory and discretionary investment contracts, whether they have developed a control environment that prevents customers from mistakenly believing these investments to be deposits.

(iii) Control Environment for Prevention of Conflicts of Interest

In cases where agency/brokerage service providers are entrusted by discretionary investment business operators to mediate the conclusion of discretionary investment contracts and they solicit customers for the conclusion of an investment advisory contract or provide advice, etc., to customers under an investment advisory contract, whether they have developed a control environment to prevent conflicts of interest in which they make explanations to customers in advance about the fact that they have concluded a contract with discretionary investment business operators.

#### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding agency/brokerage service providers' provision of information intended to protect investors, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the agency/brokerage services providers by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the agency/brokerage services providers are deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors

shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the agency/brokerage services providers are deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VII-2-2-4 Measures to Be Taken by Agency/Brokerage Service Providers When Undertaking Services for Two or More Primary Business Operators

##### (1) Explanations to Customers

When an agency/brokerage service provider undertakes services on behalf of two or more primary business operators, whether it explains the following items to customers in advance. Whether the service provider does its utmost to enable customers to understand the items, by using written explanations, for example.

- (i) In cases where the amount of fees to be paid by the customer is different from the amount of fees to be paid under a similar contract with another primary business operator, the fact that there is a difference must be explained to the customer.
- (ii) In cases where the agency/brokerage service provider acts as an agency/broker for another primary business operator regarding the signing of a contract similar to the one which the customer intends to sign, this fact must be explained to the customer.
- (iii) The contents of the similar contract described in (ii) above and other information that could be useful for the customer must be provided upon his/her request.
- (iv) The trade name of the primary business operator which is the ultimate counterparty to the customer's transaction must be made clear to the customer.

##### (2) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding measures taken by agency/brokerage service providers when undertaking agency/brokerage services on behalf of two or more primary business operators, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the agency/brokerage services providers by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the agency/brokerage services providers are deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51 of the FIEA. When the agency/brokerage services providers are deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52(1) of the FIEA.

#### VII-2-3 Actions to Take When Acquiring Information Regarding Continuity of Business

Not only a juridical person but also an individual may operate a financial instruments business. In addition, since there are no financial requirements for engaging in this business, other than the deposit for operation, financial

instruments business operators are excluded from the monitoring in terms of the net assets requirement or capital adequacy requirement. Therefore, it should be noted that there is the likelihood that a financial instruments business operator will file a petition for commencement of bankruptcy proceedings, etc. before the supervisory authorities properly identify the business operator's financial conditions. Furthermore, in cases where it has been identified that, for example, a Financial Instruments Business Operator is insolvent and it could end up being unable to make payments, supervisors must strive to confirm facts in order to fully examine the need for action from the perspective of protecting investors.

With this in mind, where the supervisory authorities have identified that a Financial Instruments Business Operator could end up being unable to make payments because of insolvency, or where they have received a notification regarding the filing of a petition for commencement of bankruptcy proceedings, etc. or identified the likelihood of the filing of such petition, they shall take the following measures in addition to those mentioned in III-3-2, so as to ensure the protection of investors.

Local Finance Bureaus shall take measures that are suitable for the circumstances of each case, and shall immediately inform the FSA of the facts regarding the case as well as what actions should be taken, thereby coordinating such actions.

(1) Response to Cases where a Financial Instruments Business Operator is Identified as Having Financial Problems

- (i) Supervisors shall confirm facts by conducting hearings on the financial conditions of the subject business operator and on the status of their contracts with customers (including contract periods, compensation, and the preservation status of contract fees that are subject to cooling off), and they shall encourage the business operator to formulate policies to eliminate the risk of it falling into insolvency.
- (ii) In cases where it becomes clear, as a result of a hearing, that a problem has arisen related to the protection of investors, supervisors shall promptly issue an order for the production of a report based on Article 56-2(1) of the FIEA regarding all the facts of the case and measures for resolving the situation.
- (iii) After receiving the report, supervisors shall follow up on the progress of the resolution measures, and in cases where no improvements are apparent, they shall examine other actions, including issuing an order for business improvement based on Article 51 of the FIEA.

(2) When Recognizing Information on the Filing of Petition for Commencement of Bankruptcy Proceedings, etc.

- (i) Supervisors shall confirm whether the financial instruments business operator has made a notification under Article 50(1)(vii) of the FIEA, and request the business operator to quickly take measures as necessary.
- (ii) By issuing an order for production of a report under Article 56-2(1) of the FIEA, supervisors shall quickly identify the facts regarding the case, as well as the financial instruments business operator's financial conditions, the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof), how the business operator responds to customers, and the business operator's policy for continuing the business.
- (iii) Supervisors shall follow up the status of fulfillment of the actions reported as mentioned in (ii) above, and shall request the financial instruments business operator to brush up the policy for continuing the business. In

such case, supervisors shall also consider issuing an order for business improvement under Article 51 of the FIEA.

(3) When Recognizing Information on the Filing of Petition for Commencement of Bankruptcy Proceedings, etc. by Parent Company, etc.

In cases where the party who is likely to have a material impact on the business management of a financial instruments business operator by filing a petition for commencement of bankruptcy proceedings, etc. (hereinafter referred to as the “parent company, etc.” in VII-2-3) has actually filed a petition for commencement of bankruptcy proceedings, etc. against the financial instruments business operator, supervisors shall, by issuing an order for production of a report under Article 56-2(1) of the FIEA, quickly identify the financial instruments business operator’s financial conditions in combination with the most recent conditions of the parent company, etc., the business relationships with the parent company, etc., the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof) and the business operator’s policy for continuing the business.

(4) When an Order of Commencement of Bankruptcy Proceedings, etc. Is Made

- (i) Supervisors shall confirm whether the financial instruments business operator has made a notification under Article 50-2(1)(iv) of the FIEA, and request the business operator to quickly take actions as necessary.
- (ii) Supervisors shall try to ensure cooperation with the bankrupt trustee if it is necessary to do so from the perspective of protecting investors.

(5) When the Financial Instruments Business Operator’s Place of Business Cannot Be Ascertained

In accordance with Article 52(4) of the FIEA, if the financial instruments business operator fails to make a notification after 30 days have passed since public notice was given regarding the fact that the business operator’s place of business cannot be ascertained, the registration of the financial instruments business operator shall be rescinded.

(6) When Acquiring Other Information Implying the Possibility of Raising the Issue of the Continuity of Business of a Financial Instruments Business Operator or Parent Company, etc.

- (i) Supervisors shall, through a voluntary hearing, quickly identify the facts regarding such information, as well as the financial instruments business operator’s financial conditions, the status of contracts with customers (if the business operator has received deposits from customers, the specific content thereof), and the business operator’s policy for continuing the business.
- (ii) In cases where the financial instruments business operator does not respond to a hearing mentioned in (i) or it is found as a result of such hearing that there is a concern over the continuity of the business of the financial instruments business operator, supervisors shall quickly identify the facts concerned by issuing an order for production of a report under Article 56-2(1) of the FIEA. Supervisors shall also consider issuing an order for business improvement under Article 51 of the FIEA when it is necessary to do so from the perspective of

protecting investors.

## VII-3 Various Administrative Procedures (Investment Advisory and Agency Business)

### VII-3-1 Registration

#### (1) Items Regarding Examination of Staffing

When supervisors examine whether or not a Financial Instruments Business Operator is sufficiently staffed to properly conduct the financial instruments business, as specified under Article 29-4(1)(i)(e) of the FIEA, they shall check the following points based on its application and attachments thereto as well as hearings. Note that the examination as to whether the operator has the structure/system necessary to operate financial instruments business appropriately, thereby falling under Article 29-4(1)(i)(f) of the FIEA, shall also be based on the following points.

(Note) When conducting examinations, supervisors shall keep in mind that the required level of staffing, etc. could vary depending on the contents and methods of business operations specified in the documents specifying the contents and methods of business operations.

(i) Whether it can be deemed that officers and employees with sufficient knowledge and experience have been secured and a sufficient organization has been established to conduct the relevant financial instruments business in light of the following requirements:

- A. Top managers must be sufficiently qualified to conduct financial instruments business in a fair and appropriate manner, in terms of their backgrounds and capabilities.
- B. Managing directors must understand the viewpoints regarding governance indicated in the FIEA and various other laws and regulations, and have sufficient knowledge and experience to conduct governance, and sufficient knowledge and experience regarding compliance and risk management to conduct financial instruments business in a fair and appropriate manner.
- C. Persons with sufficient knowledge and experience regarding the values of securities and financial instruments must be secured for the position of providing advice on investment decisions based on the analysis of the values of securities or financial instruments and other items.
- D. The Financial Instruments Business Operator must be staffed and organized so that personnel necessary for conducting the relevant business in an appropriate manner and managers in charge of internal control are appropriately allocated.
- E. Persons with sufficient knowledge and experience to be in charge of compliance must be secured.
- F. Staff capable of conducting the following processes should be secured with regard to the relevant business.
  - a. Compilation and management of account documents, reports and other documents.
  - b. Disclosure
  - c. Risk management
  - d. Computer system management
  - e. Customer management
  - f. Advertisement screening
  - g. Customer information management

- h. Processing of complaints and resolution of disputes
  - i. Internal audits
- (ii) When the qualifications of employees and officers are examined in a comprehensive manner in relation to the following criteria regarding organized crime groups, their members and financial crimes, whether there is the risk that public confidence in the financial instruments business could be damaged because of the inclusion of officers and employees with inappropriate qualifications among its staff.
- A. Officers and employees should not be current or former members of organized crime groups.
  - B. Officers and employees should not have close relationships with organized crime groups.
  - C. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - D. Officers and employees should not have the experience of being sentenced to a fine (including similar punishments imposed under foreign laws and regulations equivalent thereto) for violation of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions of Article 32-2(7) of the same act) or other foreign laws and regulations equivalent thereto, or for committing a crime prescribed under the Penal Code or under the Act on Punishment of Physical Violence and Others.
  - E. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion as well as attempts at these crimes).)
- (Note) If the Financial Instruments Business Operator is an individual, the qualifications of the individual shall be examined in light of the items specified in (i) and (ii) above.
- (iii) When there are any persons who are excluded from the category of a person who makes investment decisions based on the analysis of the values, etc. of financial instruments pursuant to the provisions of Article 6(2) of the FIB Cabinet Office Ordinance, whether or not it is found that the system can properly manage relevant persons in light of the following matters:
- A. A system is developed for enabling prompt responses to customers' inquiries or otherwise names of relevant persons are properly ascertained on a timely basis.
  - B. The status of performance of operations by relevant persons is properly managed to ensure appropriate dispositions in cases where they fall under any of the grounds for disqualification under the FIEA (matters prescribed in Article 64-2(1) of the FIEA), and internal procedures and rules therefor are established.
  - C. A system is developed for examining the status of performance of operations by relevant persons ex post facto.

## (2) Points of Attention in Determining Whether Registration is Necessary

Judgment as to whether registration is necessary should be made from a comprehensive viewpoint, with the significance of a specific activity to be considered in the context of the full range of activities related to investment



advisory and agency businesses. Therefore, it should be kept in mind that it would not be appropriate to conclude that a certain business operator does not need to be registered on the basis of the results of the examination of some parts of the full range of activities.

(i) Cases Not Requiring Registration

A. Cases to which Article 61-1 of the FIEA Is Applicable

Cases where a corporation which has been established based on foreign laws and regulations and which engages in investment advisory business abroad or an individual person whose residence is located in a foreign country and who engages in investment advisory business abroad seeks to provide investment advisory service exclusively to business operators engaging in investment management business and those designated under the FIEA Enforcement Order.

B. Cases to which Article 50-2(3) of the FIEA Is Applicable

Cases where a business operator which is allowed to engage in investment advisory business based on Article 50-2(3) of the FIEA provides investment advisory service for a specified period of time.

(ii) Activities Not Deemed to Fall under Category of Investment Advisory and Agency Services

A. Provision of Investment Decision Information Based on Analysis of Values of Securities and Financial Products (hereinafter referred to as “investment information, etc.”) to Unspecified People through Methods that May Be Used Thereby as Necessary

For example, business operators which provide investment information, etc., through the methods described in a to c below are not required to be registered as investment advisory and agency business operators.

However, it should be kept well in mind that in cases where business operators provide investment information, etc., of a specific nature to unspecified people by taking advantage of the Internet and other advanced information technologies and where they allow access to the information only to registered members (not allow one-off access), registration is required.

a. Sales of Newspapers, Magazines, Books, etc.

(Note) Cases where newspapers, magazines and books containing investment information, etc., are displayed in bookstores and other shops for purchase by any person at any time based on the judgment on their contents shall not be deemed to fall under the category of activities regarding investment advisory service. On the other hand, it should be kept in mind that registration may be necessary in cases where a business operator sells reports containing investment information, etc., on a subscription basis.

b. Sales of Investment Analysis Tools and Other Computer Software Products

(Note) Cases where investment analysis tools and other software products are offered through Internet-based downloading sales services for purchase by any person, based on the judgment on the algorithm and other investment analysis functions of the products, shall not be deemed to fall under the category of investment advisory service. On the other hand, it should be kept in mind that registration may be necessary in cases where the use of the

software products requires continuous support from the seller, such as the provision of investment information, etc.

c. Provision of advice on the value of financial products

(Note) Providing advice on the value of financial products other than securities, the premium of options, and the trend of indexes without providing advice regarding investment decisions based on the analysis thereof or without signing an agreement on the payment of fees shall not be deemed to fall under the category of investment advisory services.

Providing advice on the average temperature in Japan this winter, for example, shall not be deemed to fall under the category of investment advisory service.

B. Activities Not Constituting Brokerage for Signing of Discretionary Investment Contract

In cases where business operators undertake activities which do not constitute a brokerage service, on behalf of investment advisory business operators and discretionary investment business operators, they are not required to be registered as investment advisory/agency business operators.

For example, business operators which undertake only some of the clerical processes related to the activities described in a to c below on behalf of investment advisory business operators and discretionary investment business operators may not be required to be registered as investment advisory/agency business operators.

a. Distribution and Provision of Fliers, Pamphlets, Contract application Forms, etc.

(Note) It should be kept in mind that although merely notifying customers of the trade names of investment advisory business operators and discretionary investment business operators and their contacts does not constitute a brokerage service, explaining how to fill out documents distributed and provided to customers may be deemed to constitute a brokerage service.

b. Receipt and Collection of Contract Applications, Attached Documents, etc. (excluding cases where the business operator checks the contents of the documents)

(Note) It should be kept in mind that in cases where the business operator not only points out technical errors in the application form or failure to attach necessary documents when collecting them from customers but also checks the contents of the application form and other documents, the activity may be deemed to constitute a brokerage service.

c. General explanations provided at seminars for financial instruments with regard to the structures, schemes and the utilization methods of financial instruments

### VII-3-2 Points of Attention Regarding Depositing of Deposits for Operation

(1) When supervisors have received the original of a statement of deposit submitted by investment advisory/agency business operators after they have deposited a new deposit for operation in order to replace the existing deposit, the supervisors shall implement the procedures for the certification of the return of the original of the statement of deposit in their custody, in accordance with the format specified in the Attached List of Formats V-I, and return it to the business operators.

(2) When supervisors have received the original of a certificate of receipt submitted by investment advisor/agency business operators after they have submitted a request for substitute deposit/additional deposit in order to substitute redemption funds for deposited securities, the supervisors shall provide a certificate of custody in accordance with (5) below and return the original of the statement of deposit already in their custody to the business operators.

(3) When supervisors have received an application from investment advisory/agency business operators for a revision of the contents of a substitute contract for a deposit for operation or for the cancellation of such a contract, they shall grant approval in the approval form regarding deposit contract revision as specified in the Attached List of Formats V-2 and in the approval form regarding deposit contract cancellation as specified in the Attached List of Formats V-3, if it is deemed that the revision/cancellation does not lead to insufficient protection of investors.

(4) The public notification of the retrieval of deposits for operation shall be made in the format specified in the Attached List of Formats V-4.

(5) When supervisors have received the original of a statement of deposit, they shall provide a certificate of custody in the format specified in the Attached List of Formats V-5.

(6) Supervisors shall ensure that all applicants for registration are aware of the possibility that in cases where government bonds are deposited as deposits for operation based on Article 31-2(9) of the FIEA, deposits could become invalid after a certain period of time due to the statute of limitations under the Act Concerning Government Bonds.

#### VII-3-3 Account Documents Related to Investment Advisory Business

III-3-3 (excluding III-3-3(4) and (5)) shall be applied mutatis mutandis to the compilation and storage of account documents related to the investment advisory business, and otherwise the following points shall be taken into consideration.

(1) A document stating the content of the advice provided based on an investment advisory contract shall contain the date of providing the advice, the person who provided the advice, the customer to whom the advice was provided, and the issue and order category (sell or purchase), as well as the summary of the advice when it was provided orally. When the advice was provided in writing, a copy of the relevant document shall be stored.

(2) When storing the whole or part of the content of the advice provided based on an investment advisory contract in the form of voice recording, in lieu of the compilation of documents, the following points shall be taken into consideration.

- (i) The electronic media for storage in the form of voice recording should have sufficient durability to last for the storage period prescribed in Article 157(2) and Article 181(3) of the FIB Cabinet Office Ordinance.
- (ii) It must be ensured that the system used for voice recording prevents data falsification and mishandling by such means as managing IDs and passwords, etc.

- (iii) It must be ensured that recordings are integrally stored and a specific one may be searched easily using the date of advice, the adviser, and the counterparty as keywords or otherwise a system is developed for easily examining the appropriateness of business operations ex post facto.
- (iv) Backups of voice recordings are created, and backups are managed safely based on (ii) above.
- (v) In addition to (i) to (iv) above, III-3-3(6)(v), (viii) and (ix) apply mutatis mutandis.

## **VIII. Supervisory Evaluation Points and Various Administrative Procedures (Registered Financial Institutions)**

### VIII-1 Appropriateness of Business Operations (Registered Financial Institutions)

III-2 (excluding III-2-3-4(2), III-2-6(1)(iii)/(v), III-2-8(3) and III-2-15), IV-1-3, IV-3-1 (excluding IV-3-1-2(1), IV-3-1-4(6) and IV-3-1-5), IV-3-2-3(4) and IV-3-3 (excluding IV-3-3-1(1),(2) and (4), IV-3-3-2(4)(iii) to (viii), IV-3-3-4(1) and (2), and IV-3-3-5; however, the exclusion shall not apply to registered financial institutions engaging in foreign exchange margin trading), IV-3-5 (excluding IV-3-5-4), IV-3-6, V-2-4 (excluding V-2-4-4), V-2-5, VI-2 (excluding VI-2-2-1(1)(vii) to (ix) and VI-2-2-5(2) and (3)) and VII-2 shall be applied mutatis mutandis to the examination of the appropriateness of the business operations of registered financial institutions. In addition, attention shall be paid to the following points.

It should be noted that regarding theoretical prices referred to in IV-3-1-2(6)(iii) A. and B. and internal rules referred to in (iii) B. and C. in relation to financial instruments intermediary services, registered financial institutions may use prices calculated by and rules established by Financial Instruments Business Operators to which their business operations are entrusted.

#### VIII-1-1 Appropriateness of Individual Operations

(1) Whether registered financial institutions, which conduct dealing operations of government bond certificates, etc., short-term investment securities or asset finance-type investment securities (in the case of accounts other than specified trading accounts conducted by registered financial institutions which have adopted specified trade accounts (accounts similar to the specified trade accounts for a branch of foreign banks; the same shall apply hereinafter)), conduct trading for the purpose of investment of securities related to the said operations in an integrated manner. Also, whether the list of clients has been shared among the concerned parties.

(2) When a registered financial institution conducts any dealing operations in government bond certificates, etc., futures commission business, trading operations of short-term investment securities, or trading operations of asset finance-type investment securities:

- (i) Whether the operations and the status of assets are made clear by separating the handling of accounting affairs and dealing with securities associated with the said operations from the handling of accounting affairs and dealing with securities associated with other operations
- (ii) Whether the following book transfers between accounts concerning securities handled in the said operations have been conducted:
  - A. In cases where the registered financial institutions has not adopted specified trading accounts, book transfers between the commodity bond account and other securities accounts in the cases.
  - B. In the cases where the registered financial institutions has adopted specified trading accounts, book transfers between a trading securities account from among specified trading accounts and other securities accounts or between the derivatives of trading securities from among specified trading accounts and

derivatives of other trading securities accounts.

(3) In the case of a registered financial institution conducting option trading, except for the cases specified in Article 149-2 of the FIB Cabinet Office Ordinance, whether it makes efforts to disclose market indications concerning options trading in government bond certificates with high liquidity to investors through appropriate means, such as store displays, etc.

(4) Whether the registered financial institution compensates for financial instruments losses or offers clients automatic credit for margins (including remargin) in order to conduct financial instruments trading.

(Note) Overdrafts fall under the category of automatic credit grants.

In such cases, the following measures shall be taken, for example:

- (i) If the registered financial institution conducts futures commission business, it shall open an account for bond futures transactions and prohibit the said account having an overdraft feature, and automatic transfer from an overdraft account to the account for bond futures transactions of the same account holder shall not be conducted.
- (ii) If the registered financial instruments institution conducts financial instruments intermediary services, it shall not conduct financial instruments intermediary activities by providing automatic credit or by promising to do so in order to settle a transaction conducted by a client who failed to settle due to insufficient funds in the securities account opened for the said client in the entrusted Financial Instruments Business Operator.

(5) Regarding registered financial institutions engaged in futures commission business

- (i) In the cases where transactions are conducted by using GLOBEX terminals, it shall be made clear whether it has been stipulated to that effect in the company policy for business conduct
- (ii) In dealing with payment to the account for bond futures transactions, it shall be made clear whether staff in charge of the relevant client has been appointed in advance, the name of the client (or his/her fund manager) has been registered, and the preliminary consent of the said client shall be obtained by phone each time payment is made.

(6) Whether the department in charge of the overall operations (receiving orders, transactions and transfers) of a registered financial institution that conducts transactions of short-term securities is prepared to take all possible measures to block off the inflow/outflow of so-called subtle information between loan business, etc., and business related to the issuance of and transactions involving commercial papers and short-term corporate bonds, etc. (short-term corporate bonds prescribed in the Act on Transfer of Bonds, etc., short-term corporate bonds prescribed in the Insurance Business Act, specified short-term corporate bonds prescribed in the Act on Securitization of Assets, short-term commercial and industrial bonds prescribed in the Shoko Chukin Bank Act, short-term bonds prescribed in the Shinkin Bank Act, and short-term Norin-chukin Bank bonds prescribed in the Norin-chukin Bank Act).

(7) Whether registered financial institutions that sell securities-related products:

- (i) Take necessary measures to avoid misleading clients when soliciting them to sell a set of deposit products and securities-related products
- (ii) Explain fully to clients about risks, such as price fluctuations and differing deposits, when selling securities-related products, such as investment trusts, etc.

(8) Regarding registered financial institutions that conduct financial instruments intermediary services.

- (i) Whether it is provided that officers or employees, etc., who control a division which conducts both financial instruments intermediary services and loan business, financial institution agency service operations, or deposit, etc. intermediary business operations (limited to those handling non-public loan information, etc., of clients, who are the issuers of securities; the same shall apply in (8) and VIII-2-1-(2)-(vi)):
  - A. shall not provide non-public loan information obtained from a person engaged in loan business, financial institution agency service operations, or deposit, etc. intermediary business operations to a person engaged in financial instruments intermediary services;
  - B. shall not use non-public loan information obtained from a person engaged in financial instruments intermediary services for the purpose of loan business, financial institution agency service operations, or deposit, etc. intermediary business operations, or shall not provide such information to a person engaged in loan business, financial institution agency service operations, or deposit, etc. intermediary business operations.
- (ii) Whether internal administrators (referring to internal administrators prescribed in the self-regulatory regulations of the Japan Securities Dealers Association, entitled "Regulations Concerning Internal Administrators, etc., of Association Members") appropriately control exchanges of information pertaining to loan business, financial institution agency service operations, or deposit, etc. intermediary business operations that is to be given to clients for the purpose of legal compliance of those engaged in financial instruments intermediary services, as well as exchanges of customer information with entrusted Financial Instruments Business Operators for the purpose of conducting financial instruments intermediary services and the purpose of legal compliance of entrusted Financial Instruments Business Operators.

(9) Regarding the department supervising private management and implementation of securities, whether the registered financial institution that handles the private management of securities takes all possible organizational measures to block off the flow of so-called subtle information pertaining to loans and securities to and from the investment division and bond management division; provided, however, that this shall not apply when conducting any activities deemed applicable to the handling of private management of securities prescribed in Article 15, paragraph 3 of the FIEA Enforcement Order.

(10) In the cases where an insurance company acting as a registered financial institution has any employee, as prescribed in each item of Article 15-2(2) of the FIEA Enforcement Order (excluding (iii) (hereinafter referred to as the "representative" in (10)), who conducts the specified financial instruments business prescribed in Article 33-8(2) of the FIEA, the insurance company may entrust the representative office to which the said representative

belongs to support for the said specified financial instruments business.

#### (11) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding the appropriateness of a registered financial institution's specific business operations, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the registered financial institution by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the registered financial institution is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51-2 of the FIEA. When the registered financial institution is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52-2(1) of the FIEA.

#### VIII-1-2 Risk Management Framework Related to Non-Cleared Over-The-Counter Derivative Transactions

Whether a registered financial institution (including those for whom the average total notional amount of outstanding non-cleared over-the-counter derivative transactions is less than 300 billion yen that falls under Article 123, paragraph (11), item(iv)B of the FIB Cabinet Office Ordinance) has made efforts to develop a framework for managing counterparty risks in non-cleared over-the-counter derivatives with financial institutions by exchanging variation margin.

In addition, whether a registered financial institution subject to the provisions of Article 123, paragraph (1), item (xxi-ix) (initial margin) of the FIB Cabinet Office Ordinance has made efforts to develop a framework for managing counterparty risks in non-cleared over-the-counter derivative transactions subject to that provision, including by exchanging initial margin.

Refer to IV-2-4 (4), etc. for specific supervisory viewpoints.

#### VIII-1-3 Prevention of Abuse of Superior Bargaining Position

##### (1) Abuse of Superior Bargaining Position by Business Operators Engaging in Two or More Businesses

Supervision of abuse of a superior bargaining position by business operators concurrently engaging in two or more businesses must be conducted with due consideration of "Regarding Unfair Trading Practices Following Loosening of Financial Institutions' Business Categories and Expansion of Business Scope," a document issued on December 1, 2004 by the Fair Trade Commission. For example, the following practices may constitute an abuse of superior bargaining position by business operators concurrently engaging in two or more businesses, so attention shall be paid thereto. In cases where an employee of a registered financial institution concurrently holds office at another financial institution, etc. attention is also paid to whether he/she abuses the superior bargaining position arising from the business of such other financial institution, etc. where he/she holds office.

- (i) Whether the registered financial institution effectively forces customers to sign financial instruments transaction contracts by implying that it will suspend loans or transactions related to other businesses it



concurrently undertakes, or give unfavorable treatment to them unless they sign the contracts.

- (ii) Whether the registered financial institution effectively forces customers to sign financial instruments transaction contracts by requesting them to do so when it makes transactions with them regarding businesses it concurrently undertakes.
- (iii) In cases where customers intend to sign contracts with business competitors of the registered financial institution, whether the financial institution tries to prevent the signing of the said contracts by implying it will suspend transactions with them regarding businesses it concurrently undertakes or give unfavorable treatment to them.
- (iv) Whether the registered financial institution effectively forces customers to refrain from signing contracts with its competitors by requesting them to do so when it makes transactions with them regarding businesses it concurrently undertakes.

## (2) Points of Attention Regarding Abuse of Superior Bargaining Position

Supervisors shall examine a registered financial institution's control environment for the prevention of abuse of a superior bargaining position by paying attention to the following points:

- (i) Whether the registered financial institution has established a division responsible for the implementation of measures to prevent the said abuse or appointed a person responsible therefor and developed an internal control environment for examining whether the said division or person is properly implementing the prevention measures.
- (ii) Whether the registered financial institution provides training periodically and as necessary, with persons with knowledge and practical experiences regarding its businesses as trainers, in order to prevent the said abuse.
- (iii) Whether the registered financial institution has established arrangements and procedures for responding to complaints, such as specifying the contact point for customer complaints regarding the said abuse, establishing a division in charge of processing complaints and prescribing procedures for processing complaints.

## (3) Supervisory Method and Actions

When supervisors have recognized an issue of supervisory concern regarding abuse of a superior position by a registered financial institution concurrently engaging in two or more businesses, through daily supervisory administration or the reporting of problematic conduct, they shall identify and keep track of the status of voluntary improvement made by the registered financial institution by holding in-depth hearings and, when necessary, requiring the submission of reports based on Article 56-2(1) of the FIEA. When the registered financial institution is deemed to have a serious problem from the viewpoint of protecting public interests and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51(2) of the FIEA. When the registered financial institution is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business suspension based on Article 52-2(1) of the FIEA.

#### VIII-1-4 Points of Attention Regarding Supervision of Non-Affiliated But Registered Financial Institutions

##### (1) Major Supervisory Viewpoints

- (i) In the case of a Registered Financial Institution that does not have membership in any Financial Instruments Firms' Association (hereinafter referred to as "Non-Affiliated Registered Financial Institution"), whether it has developed internal rules that are in line with Rules Set by Associations, etc.
- (ii) Whether the Non-Affiliated Registered Financial Institution has developed a control environment that ensures appropriate compliance with internal rules (e.g., information sharing among officers, information sessions for employees and examination of status of compliance).
- (iii) When Rules Set by Associations, etc. have been revised, whether the Non-Affiliated Registered Financial Institution makes sure to quickly review and revise internal rules accordingly.

##### (2) Supervisory Method and Actions

If a problem is found regarding the creation and revision of internal rules at a Non-Affiliated Registered Financial Institution and its status of compliance, supervisors shall conduct in-depth inquiry and, if necessary, have the operator submit a report based on provisions of Article 56-2(1) of FIEA to look into the status of spontaneous efforts to improve the situation at the said financial institution. When the operator is deemed to have a serious problem from the viewpoint of protecting the public interest and investors, the supervisors shall take actions, including issuing an order for business improvement based on Article 51-2 of the FIEA. Further, if, after requesting for a report, an operator is not confirmed to have introduced internal rules that are in line with Rule Set by Associations, etc., or that it has failed to introduce a system to ensure compliance with the relevant internal rules, supervisors shall consider necessary responses, including issuance of a Business Improvement Order based on provisions of Article 52-2(1) of FIEA.

## VIII-2 Various Administrative Procedures (Registered Financial Institutions)

### VIII-2-1 Registration

III-3-1 (excluding (1) and (4)), VI-3-1 (excluding VI-3-1-2) and VII-3-1 shall be applied mutatis mutandis to the treatment of registration applications from financial institutions, and attention shall also be paid to the following points. It should be noted that terms used in the relevant formats specified in the Attached List of Formats shall be replaced as necessary.

#### (1) Registration Numbers

The registration numbers to be recorded in a registry of financial institutions shall be specified as follows:

Example) Director-General of XX Local Finance Bureau (Registered Financial Institution) No. XX

#### (2) Items Regarding Examination of Staffing

When examining whether or not a registered financial institution is sufficiently staffed to properly conduct the business of registered financial institutions as specified under Article 33-5(1)(iii) of the FIEA, supervisors shall check the following points based on the submitted registration application and attachments thereto as well as a hearing. Note that the examination as to whether the operator does not have structure/system necessary to operate financial instruments business appropriately, thereby falling under Article 33-5(1)(v) of the FIEA, shall also be based on the following points.

- (i) Whether the registered financial institution is staffed and organized so that personnel necessary for conducting relevant business in an appropriate manner are allocated to individual divisions and managers in charge of internal control are appropriately allocated.
- (ii) Whether personnel capable of conducting the following processes have been secured with regard to the relevant business.
  - A. Compilation and management of account documents and reports.
  - B. Disclosure
  - C. Segregated management of customer assets
  - D. Risk Management
  - E. Computer system management
  - F. Trading management, customer management
  - G. Processing of complaints and disputes
  - H. Internal audits
- (iii) Whether the financial institution's staff includes two or more permanent officers or employees with more than three years of experiences regarding securities-related businesses. Financial institutions which engage in over-the-counter sales of government bonds without undertaking underwriting and those which engage in brokerage for clearing of government bonds without undertaking underwriting shall be deemed to meet this requirement, if their staff include two or more persons with sufficient knowledge and experience to conduct the relevant business operations properly. It should be noted that in cases where a financial institution, after

obtaining registration, starts securities-related businesses which it did not initially undertake, compliance with this requirement shall be checked again.

- (iv) Whether the financial institution ensures that at sales branches handling any of government bond dealing operations in general, short-term securities trading operations in general, or asset finance-type securities trading operations in general, the organization, responsibilities and authorities regarding the said operations are clearly separated and independent from those regarding trading of these securities for the investment purpose and loan business, and whether it ensures that at such sales branches, employees handling the said operations do not concurrently engage in loan business or securities trading for the purpose of investment.
- (v) Regarding a financial institution engaging in futures brokerage service:
  - A. Whether the financial institution prevents inappropriate use of information concerning trading of securities futures, such as government bond futures, by the proprietary trading division. In this case, whether the financial institution ensures that at sales branches handling futures brokerage operations in general, the organization, responsibilities and authorities regarding the said operations are, in principle, clearly separated and independent from those regarding other businesses (including businesses other than those specified under Article 2(8)(ii) and (iii)).
  - B. Whether the financial institution ensures that sales branches engaging in futures brokerage operations are organized in ways to prevent the solicitation of customers through a promise to provide convenience to them in loans and loan guarantees.
- (vi) In cases where the financial institution offers financial instruments intermediary services, whether it makes sure to prevent exchanges of non-disclosure information regarding loans and other matters concerning securities-issuing customers between employees engaging in financial instruments intermediary services and those engaging in loan operations. For example, whether the financial institution strives to ensure the effectiveness of the prevention of exchanges of non-disclosure information regarding loans and other matters, by establishing internal rules that provide for the separation of the financial instruments intermediary service operations and loan operations, the clarification of persons in charge of those operations, or other similar arrangements.
- (vii) III-3-1(9)(ii) shall be applied mutatis mutandis to the notification of a change in the total capital amount of a shinkin bank.

### (3) Points of Attention Regarding Registered Financial Institutions That Do Not Have Plans to Join Any Financial Instruments Firms' Association

Supervisors shall notify the following points and request appropriate responses to registered financial institutions who do not have plan to join any Financial Instruments Firms' Association at the time of submission of a registration request.

- (i) That supervisory responses in accordance with VIII-1-4 shall be taken if the operator fails to introduce internal rules that are in line with Rules Set by Associations, etc. or a system to ensure compliance with such rules after registration
- (ii) That failure to revise internal rules in accordance with revisions in Rule Set by Associations, etc., may

constitute a situation that corresponds to (i)

#### VIII-2-2 Approval and Notification

III-3-2 (excluding III-3-2(4)), IV-4-2-4, IV-4-3 and VI-3-2 (excluding VI-3-2-3(1)(ii), (2)(vi)E., and (2)(viii)B.) shall be applied *mutatis mutandis*.

#### VIII-2-3 Account Documents Related to Business Operations

III-3-3 shall be applied *mutatis mutandis* to the compilation and storage of account documents related to business operations. Registered financial institutions may compile the account documents on the financial instruments intermediary service, as specified under Article 184(1)(iii) of the FIB Cabinet Office Ordinance, with the use of computer systems and formats adopted by Financial Instruments Business Operators to which they entrust business operations, or they may entrust the establishment of systems and formats necessary for the compilation of the account documents to the entrusted business operators. However, it should be noted that the registered financial institutions bear the responsibility for the compilation and storage of the account documents.

#### VIII-2-4 Registration of Sales Representatives

IV-4-3 and V-3-2 shall be applied *mutatis mutandis*.

#### VIII-2-5 Interpretation of Article 33 of FIEA

##### (1) Interpretation of Article 33(1) of FIEA

- (i) The following business operations undertaken by banks, cooperative structured financial institutions and other financial institutions as specified under Article 1-9 of the FIEA Enforcement Order (referred to as “banks, etc.” in VIII-2-6) shall not be deemed to fall under the category of the prohibited activities as specified under Article 33(1) of the FIEA.
  - A. Providing client companies with advice useful for initial public offerings, and introducing client companies with potential for initial public offerings to underwriting Financial Instruments Business Operators.
  - B. Introducing customers to Financial Instruments Business Operators without conducting soliciting activity
- (ii) The act of “introducing” described in (i) B. applies to the following cases:
  - A. Cases where banks, etc., let Financial Instruments Business Operators display their own advertising media at bank branches.
  - B. Cases where banks, etc., explain their relationships with Financial Instruments Business Operators and the contents of the business operators’ businesses.

##### (2) Interpretation of Article 33(2)

Regarding the brokerage with written orders as specified under Article 33(2), the following points shall be taken

into consideration.

- (i) Banks, etc., are prohibited from soliciting customers to sign contracts for securities trading and other financial instruments transactions when engaging in brokerage with written orders. However, the following activities shall not be deemed to fall under the category of solicitation activities:
  - A. Explaining the specifics of the brokerage with written orders to customers
  - B. Publicizing the specifics of the brokerage with written orders through media such as newspapers, magazines, documents, direct mail, websites, broadcasting and movies
  - C. Placing order forms and documents explaining the specifics of the brokerage with written orders at branches of banks, etc., for distribution to customers, sending them to customers, and displaying the documents at branches for perusal by customers.
- (ii) When banks, etc., receive written orders, they must take instructions concerning the order category (sell or purchase), the ordered issue, the order volume and price with regard to each transaction.

Written orders to be received by banks, etc., for brokerage include continual orders to be executed at predetermined dates.

#### VIII-2-6 Others

##### (1) Points of Attention Regarding Segregated Management

It should be kept in mind that when registered financial institutions (limited to deposit-taking registered financial institutions) treat cash deposits arising from transactions regarding securities-related businesses as deposits in their primary business, the said cash deposits are not subject to segregated management.

##### (2) Points of Attention Regarding Establishment of Internal Rules

Non-affiliated registered financial institutions must establish internal rules that are in line with rules set by Financial Instruments Firms' Associations, according to the types of business they undertake. Such institutions must also introduce a control environment to ensure appropriate compliance with internal rules.

In addition, they must take care to maintain appropriate business operations by revising internal rules periodically or when relevant laws, regulations and rules are revised.

**IX. Supervisory Evaluation Points and Various Administrative Procedures (Specially Permitted Business, etc. for Qualified Institutional Investors, etc.)**

IX-1 Appropriateness of Business Operations Related to Specially Permitted Business, etc. for Qualified Institutional Investors, etc.

The provisions of III-2 (excluding III-2-3-1, III-2-5-2, III-2-5-3, III-2-7 to III-2-10 and III-2-12), III-3-3, III-3-4, V-2-1-1, V-2-6 (excluding (5)) and VI-2-5 to VI-2-7 shall be applied mutatis mutandis to the appropriateness of the business operations of Specially Permitted Business Operators, etc. for Qualified Institutional Investors, etc. (hereinafter "Operators of SPBQII, etc."; meaning Specially Permitted Business Operators for Qualified Institutional Investors, etc. (business operators engaging in SPBQII; hereinafter "Operators of SPBQII") and/or Specially Permitted Investment Management Businesses operators (business operators engaging in SPIMB; hereinafter "Operators of SPIMB)). Supervisors shall examine the appropriateness by also paying attention to the following points.

IX-1-1 Control Environment for Customer Solicitation and Explanations

(1) Major Supervisory Viewpoints

(i) Requirements of SPBQII

Since Operators of SPBQII need to check and record that the customers they solicit meet the requirements of investor according to the attributes of the customer, supervisors shall examine by paying attention to the following points, for example.

- A. Whether the operator appropriately prepares and stores internal records by, for example, adequately confirming that, as a measure to appropriately check that the customer it solicits is a "Qualified Institutional Investor, etc." (a Qualified Institution Investor, etc. defined in Article 63(1)(i) of the FIEA (hereinafter "QII, etc."); the same shall apply hereinafter in IX) that corresponds to attributes such as "possessing assets (by the individual who is the customer) that are expected to amount to 100 million yen or more, reasonably judging from the status of the transactions thereof or any other circumstances" specified in Article 233-2(3)(i)A of the FIB Cabinet Office Ordinance, the amount of investment-type financial assets is estimated to be 100 million yen or more, "reasonably judging" overall by using, for example, a self-declaration document from the customer or materials voluntarily provided by the customer (a copy of a transaction balance report or passbook, etc.), and managing and storing the confirmation result as well as a document that describes the grounds of the results (hereinafter referred to as the "confirmation result record" in (i)).
- B. If a customer that the operator solicits falls under the requirements of a "person who was engaged in the relevant operations by exercising specialized abilities that are essential for the continuity of the relevant operations" specified in Article 233-3(vii) of "Persons with Expertise and Experience in Investment Matters" (referring to persons who fall under any of the items of Article 233-3 of the FIB Cabinet Office Ordinance (excluding persons who fall under any of the items of Article 17-12(1) of the FIEA Enforcement Order); the same shall apply hereinafter in IX), whether the business operator appropriately prepares and

stores internal records by, for example, adequately confirming the facts relating to the requirements such as the particulars of the operations in which the relevant customer was engaged (by requesting the customer to submit an employment certificate that was prepared by the company, etc. the customer belonged to when he/she was engaged in the relevant operations), except for cases where it is apparent that the customer falls under the requirements, and managing and storing the confirmation result records.

C. Whether the business operator appropriately confirms that the number of investors other than QIIs (referring to persons who fall under any of the items of Article 17-12(1) of the FIEA Enforcement Order based on Article 63(1)(i) of the FIEA and persons who have knowledge and experience on matters concerning investment; the same shall apply hereinafter in IX) does not exceed 49, and prepares and stores internal records on the result of the confirmation.

D. Whether the operator makes efforts in conducting solicitation in an appropriate manner by examining, as necessary, whether it does not lead customers to make a false declaration of their asset status, etc. in order to have customers who do not meet the investment requirements invest.

(ii) Principle of Suitability

In accordance with Article 40 of the FIEA, Operator of SPBQII, etc. must ensure that investment solicitation is conducted in an appropriate manner suited to their customer's attributes, etc., by offering transactions with terms and contents that are commensurate with the customer's knowledge, experience, asset status and investment purpose as well as his/her ability to make judgment regarding risk management.

To this end, it is important to establish a control environment for customer management that enables a precise identification of the customer's attributes and the actual status of transactions, and the supervisor should pay attention to the following issues, for example.

A. Efforts for Securing of an Appropriate Identification of Customer Attributes and Appropriate Management of Customer Information

a. Whether, in order to grasp customer attributes such as investment intention and experience in a timely and appropriate manner, the Operator of SPBQII, etc. prepares a system of customer management cards (referring to documents that state customers' knowledge, experience and asset status as well as the purpose of concluding a financial instruments transaction contract; the same shall apply hereinafter in A), for instance, adequately checking the investment purpose and intention of customers, and whether the customer's investment purpose and intention registered on the customer management cards are shared by both the Operator of SPBQII, etc. and the customer (however, the preparation of customer management cards is not automatically required if the customer's asset status and investment judgment capability are apparent). Furthermore, whether the business operator makes sure all directors, officers and employees recognize the need to conduct investment solicitation in an appropriate manner suited to the customer attributes, such as, in cases where, based on the request of a customer, the business operator identifies that the customer's investment purpose and intention has changed, makes changes to the registered details on the customer management cards, and the modified registered details are shared by both the Operator of SPBQII, etc. and the customer.

b. Whether the operator strives to keep track of how customer attributes are identified and how customer



information is managed, and establish an environment that ensures the effectiveness of customer information management by, for example, checking whether solicitation is conducted in an appropriate manner suited to the customer attributes and revising the method of customer information management when necessary.

B. Transfer to a Professional Investor upon Request of an Ordinary Investor

In a case where a customer as an “ordinary investor” requests to transfer to a “Professional Investor” pursuant to the provision of Article 34-3 (1) of the FIEA, whether the Operator of SPBQII, etc. determines the acceptability of such request after having judged whether it is appropriate to treat the customer as a “Professional Investor” in consideration of his/her knowledge, experience, asset status and purpose of investment.

C. Points of Attention Regarding Solicitation Targeting Elderly Customers

Even when they have ample investment experience, elderly customers can be physically weak and their ability to make investment decisions may change quickly. As such, whether the business operator ensures a discreet solicitation and sales structure in soliciting investment targeting elderly customers, based on the Principle of Suitability. In addition, whether the business operator follows up carefully after sale of products.

D. Points of Attention Regarding Solicitation of Electronically Recorded Transferable Rights That Must Be Indicated on Securities, etc.

Whether the Operator of SPBQII, etc. pays attention to the following matters regarding solicitation of electronically recorded transferable rights that must be indicated on securities, etc.

- a. Whether the Operator of SPBQII, etc. continuously conducts appropriate examination regarding the risks involved in the networks, such as the blockchain, used for the electronically recorded transferable rights that must be indicated on securities, etc. by, for example, undergoing an examination by experts as necessary, in light of the importance of the risks.
- b. In conducting purchase and sale or other transactions of electronically recorded transferable rights that must be indicated on securities, etc., whether the Operator of SPBQII, etc. takes into consideration not only customers' investment experience and status of property, but also the degree of understanding of the scheme of holding and transferring electronically recorded transferable rights that must be indicated on securities, etc. and the risks involved therein, and the experience in transactions of products using a similar scheme.

(iii) Control Environment for Providing Explanations to Customers

- A. Whether the business operator explains to customers other than QII in an easy-to-understand manner the basic nature of the products of the businesses eligible for investment, the details, types and fluctuation factors of risks, and that SPBQII is a system originally meant for QIIs (so-called professionals) and that those qualified to invest are limited.
- B. In a case where an Operators of SPBQII “conducts SPBQII that are specified by Cabinet Order as especially requiring the protection of investors” specified in Article 63(9) of the FIEA, whether the Operator of SPBQII issues a document to investors stating matters set forth in Article 17-12(2)(i)A and B

as well as (ii) and (iii) of the FIEA Enforcement Order, such as to the effect that more than 80% of the assets under management will be invested in unlisted stocks, etc. before the conclusion of a contract, and prepares and stores a record relating to that document and the issue date.

- C. Whether the business operator provides false representations and explanations that make their products and services appear free of charge or make fees appear markedly lower than the actual levels.
- D. Whether the business operator provides false representations and explanations to the effect that they guarantee yields or compensate for all or part of losses that may arise.
- E. Whether the business operator provides false representations and explanations such as “principal guaranteed” or “profit guaranteed” to the effect that their products and services do not involve any risks, including the risk of customers incurring losses from transactions.
- F. Whether the business operator provides false representations and explanations regarding the contents of products and transactions (basic product features, the types and characteristics of the risks involved and variable factors).
- G. Whether the Operator of SPBQII, etc. provides representations and explanations that may be misunderstood, due to the fact that the business operator has made a notification of SPBQII, that the Prime Minister, the FSA Commissioner or other public institution guarantees the credibility of the business operator, recommends the financial instrument or guarantees the contents of the advertisement, etc.
- H. If the scheme of the electronically recorded transferable rights that must be indicated on securities, etc. involves risks, etc. that differ from those for ordinary securities in respect to the method of holding or transferring the rights or the like (this includes but is not limited to the reaching of an agreement, settlement, the method of satisfaction of the requirement for perfection, etc. relating to transfer of the rights), whether the business operator explains this appropriately.

## (2) Supervisory Method and Actions

With regard to issues regarding an Operator of SPBQII, etc. that were identified through daily supervisory administration or the reporting of problematic conduct, supervisors shall hold in-depth hearings and, when necessary, require the submission of reports based on Article 63-6 of the FIEA (including cases where it is applied *mutatis mutandis* pursuant to Article 63-3(2) of the FIEA or cases where it is applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply hereinafter in IX). In addition, when it is deemed that there is a serious issue from the perspective of public interest or investor protection, the supervisors shall take necessary actions, including issuing an order for business improvement based on Article 63-5(1) of the FIEA (including cases where it is applied *mutatis mutandis* pursuant to Article 63-3(2) of the FIEA or cases where it is applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply hereinafter in IX). Furthermore, when the Operator of SPBQII, etc. is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 63-5(2) of the FIEA (including cases where it is applied *mutatis mutandis* pursuant to Article 63-3(2) of the FIEA or cases where it is applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply hereinafter in IX) or an order for business

abolition based on Article 63-5(3) of the FIEA (including cases where it is applied mutatis mutandis pursuant to Article 63-3(2) of the FIEA or cases where it is applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply hereinafter in IX).

When the Operator of SPBQII, etc. is suspected to be engaged in false notification or loss compensation to investors prior to the enforcement of the Act for Partial Revision of the Financial Instruments and Exchange Act (Act No. 32 of 2015), supervisors shall require the submission of reports based on Article 63-6 of the FIEA. If it is deemed, as a result, that the relevant business operator is engaged in the relevant act, supervisors shall take necessary actions such as warning the business operator in writing using the Attached List of Formats IX-1. Provisions of II-1-4(4)(iv) will apply to responses made in the case measures such as a warning were taken.

#### IX-1-2 Identification of Actual State of Operator of SPBQII, etc.

##### (1) Points of Attention in Grasping Actual Conditions

The following points shall be taken into consideration when grasping actual conditions through monitoring surveys, subsequent checks of reports, or checks of business reports.

Although SPBQII is basically conducted with QII, the need to grasp actual conditions is especially high when the actual existence of QIIs is in doubt, considering situations where the investment amount and investment percentage of q QIIs are extremely low, etc. in view of the issues and situation of damage that have been identified in inspections, etc. by the authorities.

- (i) Whether QIIs that acquire invested business equity and QIIs that have invested business equity (hereinafter collectively referred to as “QII with Invested Equity” in (1) below) have become an investment limited partnership existing only in name or an investment limited partnership, through which offerings or investments are conducted without going through the procedures required under the FIEA (cases where a person who is not registered as a financial instruments business, etc. or notified as an Operator of SPBQII conducts offerings or investments).
- (ii) Whether a situation has arisen in which a QII with Invested Equity could be judged as not actually having acquired or being in possession of invested business equity as a QII, such as by reason of receiving remuneration as compensation for mostly insubstantial work from, for instance, an Operator of SPBQII, or of being insubstantial such as a subsidiary or affiliate of the Operator of SPBQII.
- (iii) Whether private offerings or investments that do not satisfy the requirements of SPBQII are being conducted, such as the Operator of SPBQII, or other funds managed by the Operator of SPBQII is the only QII with Invested Equity.
- (iv) Whether solicitation of acquisition of fund equity is made to persons other than persons who were appropriately confirmed to be a QII, etc. In addition, in cases where all QIIs with Invested Equity are an investment limited partnership, whether an investment limited partnership that corresponds to “those expected to have 500 million yen or more in cash and other assets that will be managed for the counterparty of the investment limited partnership agreement, minus the amount of borrowings” as stipulated in Article 234-2(1)(i) of the FIB Cabinet Office Ordinance exists.

- (v) Whether the investment ratio of “Closely Related Persons” (referring to persons set forth in Article 233-2(1)(ii) (excluding parent company, etc.) to (vi) (excluding persons who fall under any of the items of Article 17-12(1) (except for (vi)) of the FIB Cabinet Office Ordinance); the same shall apply hereinafter in IX) and “Persons with Expertise and Experience in Investment Matters” to the total investment amount of the fund is 50% or more.
- (vi) Whether the number of investors other than QIIs exceeds 49.
- (vii) Whether false notification, loss compensation, appropriation of customers’ assets or false reports concerning investment details are conducted.

## (2) Supervisory Method and Actions

With regard to issues regarding an Operator of SPBQII, etc. that were identified through daily supervisory administration or the reporting of problematic conduct, supervisors shall hold in-depth hearings and, when necessary, require the submission of reports based on Article 63-6 of the FIEA. In addition, when it is deemed that there is a serious issue from the perspective of public interest or investor protection, the supervisors shall take necessary actions, including issuing an order for business improvement based on Article 63-5(1) of the FIEA. Furthermore, when the Operator of SPBQII, etc. is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business suspension based on Article 63-5(2) of the FIEA or an order for business abolition based on Article 63-5(3) of the same Act.

When the Operator of SPBQII, etc. is suspected to be engaged in false notification or loss compensation to investors or in acts that are problematic from the viewpoint of protecting investors, such as appropriation of customer assets, prior to the enforcement of the Act for Partial Revision of the Financial Instruments and Exchange Act (Act No. 32 of 2015), supervisors shall require the submission of reports based on Article 63-6 of the FIEA. If it is deemed, as a result, that the relevant business operator is engaged in the relevant act, supervisors shall take necessary actions such as warning the business operator in writing using the Attached List of Formats IX-1 or IX-2. Provisions of II-1-4(4)(iv) will apply to responses made in the case measures such as a warning were taken.

## IX-2 Various Administrative Procedure

### IX-2-1 Confirmation Matters to be Notified

#### (1) Major Supervisory Viewpoints

- (i) Whether there are any omissions, etc. with regard to matters required to be notified.
- (ii) Whether there are any omissions, etc. with regard to documents required to be attached. Furthermore, whether there are any discrepancies, etc. between the notified matters and the contents of the attached documents.
- (iii) Whether the applicant falls under any of the items of Article 63(7) of the FIEA (including cases where it is applied pursuant to Article 48(3) or (7) of the Supplementary Provisions of the Amendment Act; the same shall apply hereinafter in IX), such as not having passed five years since the day when registration of a financial instrument business was cancelled.
- (iv) Whether the notified QII falls under the category of a QII prescribed by Article 10(1) of the Cabinet Office Ordinance Regarding Definitions. In addition, in cases where all QIIs with Invested Equity are an investment limited partnership, whether an investment limited partnership that corresponds to “those expected to have 500 million yen or more in cash and other assets that will be managed for the counterparty of the investment limited partnership agreement, minus the amount of borrowings” as stipulated in Article 234-2(1)(i) of the FIB Cabinet Office Ordinance exists.
- (v) Whether the notified QII really exists as a QII prescribed in Article 10(1) of the Cabinet Office Ordinance Regarding Definitions. (In cases where the real existence cannot be confirmed, supervisors shall request presentation of a certificate of registered matters pertaining to said QII or a document in lieu thereof. However, in cases where the reference number obtained through the use of the Registration Information Provision Services is attached, attachment of a certificate of registered matters may be omitted.)
- (vi) Whether the investment ratio of “Closely Related Persons” and “Persons with Expertise and Experience in Investment Matters” to the total investment amount of the fund is 50% or more.
- (vii) In cases where the person making the notification is a juridical person, whether it is possible to make contact with a Representative in Japan of the said juridical person. In cases where the person making the notification is an individual with an address in a foreign country, whether it is possible to make contact with an Agent in Japan of the said individual in Japan.
- (viii) Whether the principal business office or office and business office or office where SPBQII, etc. are conducted is a so-called virtual office. (In cases where, such as where the notified business office, etc. is a rental office based on a short-term contract, it is feasible that the SPBQII, etc. are conducted at a place other than said business office, supervisors shall strive to grasp the actual conditions through hearings and requesting the submission of relevant materials.)
- (ix) When there has been a notification of abolition of SPBQII, etc. based on Article 63-2(3)(ii) of the FIEA by an Operator of SPBQII, etc., supervisors shall check whether customer transactions by said Operator of SPBQII, etc. has been completed and properties that were deposited by customers as well as properties

occupied in its calculation have been returned.

(x) In a case where an Operator of SPBQII “conducts SPBQII that is specified by Cabinet Order as especially requiring the protection of investors” specified in Article 63(9) of the FIEA, supervisors shall check the following matters:

- A. Whether requirements set forth in Article 17-12(2)(i)A and B as well as (ii) and (iii) of the FIEA Enforcement Order, such as that the business will be managed as an investment of more than 80% of assets under management in unlisted stocks, etc. are satisfied.
- B. Whether a document stating that the business meets requirements set forth in Article 17-12(2)(i)A and B as well as (ii) and (iii) of the FIEA Enforcement Order, such as that the business will be managed as an investment of more than 80% of assets under management in unlisted stocks, etc., is issued to investors before the conclusion of a contract, and a record related to said document and the issue date is prepared and stored.
- C. Whether a copy of the contract related to the businesses eligible for investment is submitted within three months from the day when notification based on provisions of Article 63(2) of the FIEA or from the day when there was a change related to the notification pursuant to Article 63(8) of the FIEA (within six months if notification stipulated in Article 239-2(4) of the FIB Cabinet Office Ordinance has been made).
- D. Whether all matters set forth in all items of Article 239-2(1) of the FIB Cabinet Office Ordinance are stated in the copy of the contract submitted by the Operator of SPBQII.
- E. With regard to the rights that were notified to the effect that a contract stipulated in Article 239-2(6) of the FIB Cabinet Office Ordinance cannot be concluded, whether private offerings or investments are still conducted with “Persons with Expertise and Experience in Investment Matters” as the counterparty even after said notification

## (2) Supervisory Method and Actions

With regard to SPBQII, in cases where notification of SPBQII has been received, supervisors shall confirm the matters to be notified as required. As a result, with respect to the matters to be notified, if deficiencies or doubts about the content of the notification are recognized, where necessary, the supervisors shall require submission of reports based on Article 63-6 of the FIEA, grasp the correction status, and consider necessary actions, in accordance with the status, including business improvement orders and business suspension orders.

If no specific corrective measures are presented or it is deemed that any of the reasons for disqualification specified in the items of Article 63(7) of the FIEA applies, a business abolition order pursuant to Article 63-5(3) of the FIEA shall be issued, in principle.

## IX-2-2 Preparation and Publication, etc. of the List of Notifiers of SPBQII, etc.

### (1) Preparation and Publication, etc. of the List of Notifiers of SPBQII

In order to enable investors to acquire information on respective Operators of SPBQII, etc., supervisors shall prepare and publish on the FSA website a list of information regarding respective Operators of SPBQII, etc. that are

subject to public inspection based on Article 63(5) of the FIEA (including cases where it is applied *mutatis mutandis* pursuant to Article 63-3(2) of the FIEA or cases where it is applied pursuant to Article 48(3), (5) or (7) of the Supplementary Provisions of the Amendment Act) (defined in paragraph (4) of this section, hereinafter referred to as the “List of Notifiers of SPBQII, etc. information items”) (hereinafter referred to as the “List of Notifiers of SPBQII”)

To this end, the FSA shall, for each month, after confirming the status of receiving notifications at Local Finance Bureaus, prepare, update and publish on the FSA website the List of Notifiers of SPBQII.

(2) Preparation and Publication, etc. of the List of Notifiers of SPBQII, etc., whom our Authority issued Order for Abolition of Business Operation

To provide investors information on Operators of SPBQII, etc. who have been issued with an order for abolition of business operation pursuant to Article 63-5(3) of the FIEA, the FSA shall prepare and publish on the FSA website the List of Notifiers of SPBQII, etc., whom our Authority issued Order for Abolition of Business Operation.

As such, when an order for abolition of business operation is issued pursuant to Article 63-5(3) of the FIEA to Operators of SPBQII, etc., the FSA shall remove such operators from the “List of Notifiers of SPBQII, etc.” or the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact nor able to identify the location of business office (defined under paragraph (3) below)” and enter them on the “List of Notifiers of SPBQII, etc., whom our Authority issued Order for Abolition of Business Operation” and publish it on the FSA website.

(3) Preparation and Publication, etc. of the List of Notifiers of SPBQII, etc., whom our Authority cannot make contact nor able to identify the location of business office

To provide investors information on Operators of SPBQII, etc. with whom supervisory authorities cannot make contact or locate the business place or office, such operators shall be recorded on the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact nor able to identify the location of business office” (hereinafter referred to as “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact”) which shall be published on the FSA website.

As such, If the FSA finds, through day-to-day supervisory work, any Operators of SPBQII, etc. with whom our Authority cannot make contact nor able to identify the location of business place or office, they shall remove such operator’s information items from the “List of Notifiers of SPBQII, etc.” and enter them on the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact” and publish it on the FSA website. In making the entry and in publication, supervisors shall clearly indicate that the notified business place or office cannot be identified, that notice shall be made to the Local Finance Bureau having jurisdiction within 30 days from the day when the failure of ascertainment was published on the FSA website, and that an order for abolition of business operation may be issued if supervisors receive no notice during said period, after conducting separate administrative procedures such as a hearing, etc.

Operators of SPBQII, etc. whose business place or office was identified shall be removed from the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact,” and entered on the “List of Notifiers of SPBQII, etc.” Operators of SPBQII, etc. who have been issued with an order for abolition of business operation

based on Article 63-5(3) of the FIEA shall be removed from the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact,” and entered on the “List of Notifiers of SPBQII, etc., whom our Authority issued Order for Abolition of Business Operation.”

(4) List of Notifiers of SPBQII, etc. Information Items

(i) List of Notifiers of SPBQII, etc. information items are provided below. (Note, however, item N shall be excluded from the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact” and item V shall apply to the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact” only.)

A. Name of Notifier and corporate number

B. Jurisdiction of Local Finance Bureau

C. Name and position of representative, other officers and employees specified under a Cabinet Order

D. Type of employees specified under a Cabinet Order

E. Type of business

F. Name, address and phone number of principal business place or office

G. Name, address and phone number of business place or office where SPBQII is conducted

H. URL of website

I. Type of other business conducted

J. Amount of capital or total contribution

K. Existence or nonexistence of registration as a financial instruments business operator, etc.

L. Existence or nonexistence of notification prior to the enforcement date of the Act for Partial Revision of the Financial Instruments and Exchange Act (Act No. 32 of 2015)

M. Date of notification of Article 63(2) of the FIEA or the most recent date of notification based on provisions of Article 63(8) of the FIEA

N. Status of administrative dispositions

O. Name of invested business equity

P. Type of invested business equity

Q. Details of the invested business

R. Type and number of QII

S. Existence or nonexistence of investors other than QII

T. Existence or nonexistence of persons specified under the items of Article 233-3 of the FIB Cabinet Office Ordinance

U. Name of certified public accountant or auditing firm

V. Date that the FSA published the fact that it cannot confirm the related operator’s business place or office

(ii) On the Listing of the Status of Administrative Dispositions Defined in (i)N above

A. With regard to Operators of SPBQII, etc. who have been issued with an order for business improvement based on Article 63-5(1) of the FIEA or a business suspension order based on Article 63-5(2) of the same Act, the status of these administrative dispositions shall be entered on the “List of Notifiers of SPBQII, etc.”



B. With regard to Operators of SPBQII, etc. who have been issued with a warning based on this supervisory guideline and Operators of SPBQII, etc. with recognized problems such as the failure to respond to orders pursuant to Article 63-6 of the FIEA, the details of the problem shall be entered on the “List of Notifiers of SPBQII, etc.”

#### IX-2-3 Points of Attention Regarding Business Operators Which Fail to Make Necessary Notifications

When supervisors have recognized cases where a business operator is engaging in SPBQII, etc. without fulfilling the obligation to make a notification under Article 63(2) of the FIEA, as a result of a complaint from customers, an inquiry from investigative authorities, the provision of information by Financial Instruments Business Operators/Financial Instruments Firms’ Associations, etc. or a newspaper advertisement, etc., they shall warn the business operator in writing to suspend the business or immediately make the necessary notification.

#### IX-2-4 Extension, etc. of Submission Deadline of Copy of Contract Related to Invested Business

##### (1) Notification of Extension of Period

In a case where an Operator of SPBQII “conducts SPBQII that are specified by Cabinet Order as especially requiring the protection of investors” specified in Article 63(9) of the FIEA, the Operator of SPBQII must submit a copy of the contract related to Invested Business within three months from the day when notification based on provisions of Article 63(2) of the FIEA was made or the day when there was a change related to the notification pursuant to Article 63(8) of the FIEA, in principle.

However, attention shall be paid that the submission deadline for the copy of the contract will be extended for three months (up to a maximum of six months) if there was notification that a copy of the contract cannot be submitted within the period above.

##### (2) Notification that a Contract Cannot Be Concluded

If an Operator of SPBQII cannot conclude a contract related to Invested Business during the period stipulated in (1), the operator must notify the fact and reasons without delay after said period has passed.

##### (3) If Neither a Copy of Contract Related to Invested Business nor a Notification to the Effect that a Contract Cannot Be Concluded is Submitted

If neither a copy of the contract related to Invested Business nor a notification to the effect that a contract cannot be concluded is submitted within three months from the day when notification based on provisions of Article 63(2) of the FIEA was made or the day when there was a change related to the notification pursuant to Article 63(8) of the FIEA (within six months if notification of the latter part of (1) above is made), supervisors shall take the necessary actions, including the issuance of a business abolition order based on Article 63-5(3) of the FIEA, in view of the fact that said violation of laws and ordinances cannot be revoked even if a copy of the contract, etc. is submitted after the period has passed.

## IX-2-5 Points of Attention Concerning Supervisory Actions for Operators of SPBQII, etc.

### (1) Points of Attention in Cases Where Business Operation is Suspected of Not Being Qualified as SPBQII, etc.

Supervisors shall strive to publicize that in cases where the business conducted by an Operator of SPBQII, etc. does not meet the requirements for SPBQII or SPIMB (in the case of SPBQII, including instances where, for example, a QII required for the formation of a scheme could be judged as not actually having acquired or being in possession of invested business equity as a QII, such as by reason of receiving remuneration for mostly insubstantial work from an Operator of SPBQII, etc.), such business operator shall be required to obtain registration under Article 29 of the FIEA.

If supervisors suspect, through day-to-day supervisory work, that an Operator of SPBQII, etc. fails to meet the requirements mentioned above, they shall require such business operator to make a report based on Article 63-6 of the FIEA, and shall take necessary actions including the issuance of a business abolition order based on Article 63-5(3) of the FIEA, when they find it necessary to do so based on such report. In addition, the same response shall be taken when it is deemed that the business operator does not meet the requirements mentioned above in on-the-spot inspections, etc.

### (2) Points of Attention in Cases Where Business No Longer Falls Under SPBQII

In cases where the business conducted by an Operator of SPBQII no longer falls under SPBQII (including cases where it has come to no longer satisfy requirements of “cases where conducting SPBQII that are specified by Cabinet Order as especially requiring the protection of investors” specified in Article 63(9) of the FIEA) due to reasons such as withdrawal of QIIs and an increase in investors other than QIIs, supervisors shall take the following actions from the perspective of investor protection:

#### (i) Order Based on Article 63(12) of the FIEA

“When a business commenced as SPBQII under item (ii) of paragraph (1) by an Operator of SPBQII has come to no longer satisfy the requirement to be regarded as SPBQII” as specified under Article 63(12) of the FIEA (including cases where it is applied *mutatis mutandis* pursuant to Article 63-3(2) of the FIEA), refers to cases where although the business satisfied the requirements for SPBQII when the business was commenced, it no longer satisfy those requirements, for a reason not attributable to the responsibility of the Operator of SPBQII. In such cases, supervisors shall order the Operator of SPBQII to transfer the relevant business operations to another Financial Instruments Business Operator.

#### (ii) Cases Other than (i)

In cases other than (i) above, a special clause specified under Article 63 of the FIEA shall not apply, so the Operator of SPBQII will engage in investment management business without being registered under the FIEA. Therefore, against the said business operator, supervisors shall take necessary actions including the issuance of a business abolition order based on Article 63-5(3) of the FIEA.

### (3) Points of Attention Concerning Actions toward Operators of SPBQII, etc. whose Business Place or Office Cannot Be Ascertained

If supervisors find, through day-to-day supervisory work, any Operators of SPBQII, etc. with whom supervisory authorities cannot make contact nor able to identify the location of business place or office, supervisors shall, in accordance with IX-2-2(3), include such operator on the “List of Notifiers of SPBQII, etc., whom our Authority cannot make contact”, clearly indicating the fact that the notified business place or office cannot be ascertained, etc., and publish it on the FSA website. If supervisors do not receive any notice from said business operator after 30 days have passed since the day of the publication, supervisors shall issue an order for abolition of business to said business operator based on Article 63-5(3) of the FIEA.

#### (4) Points of Attention in Issuing a Business Abolition Order

With regard to issues concerning the appropriateness of business operations of an Operator of SPBQII, etc., if the impact on investors, etc. and maliciousness of the conducted act are severe or serious, but improvement of the problem related to said business operator cannot be expected even if a business improvement order based on Article 63-5(1) of the FIEA or a business suspension order based on Article 63-5(2) of the same Act is issued, supervisors shall issue a business abolition order pursuant to Article 63-5(3) of FIEA.

In addition, “cases where the purpose of supervision cannot be achieved by another method,” as specified in Article 63-5(3) of the FIEA, do not necessarily mean to require the issuance of a business improvement order or business suspension order prior to the business abolition order based on provisions of the said Article. For example, when an Operator of SPBQII, etc. is deemed to have committed a serious violation of the law that may lead to cancellation of registration if the business operator was a financial instruments business operator, etc., supervisors shall immediately issue a business abolition order since the case falls under a “case where the purpose of supervision cannot be achieved by another method.”

In the event a business abolition order has been issued against an Operator of SPBQII, etc., supervisors shall check whether customer transactions by said business operator has been completed and properties that were deposited by customers as well as properties occupied in its calculation have been returned, before requiring notification of the abolition of SPBQII, etc. stipulated in Article 63-2(3)(ii) of the FIEA.

## **X. Supervisory Evaluation Points and Various Administrative Procedures (Foreign Securities Companies)**

### X-1 Basic Concept for Foreign Securities Companies

#### X-1-1 Basic Concept on Laws and Regulations Regarding Foreign Securities Companies

Foreign securities companies are not allowed to engage in the activities specified under each item of Article 28(8) of the FIEA (hereinafter referred to as “activities concerning securities-related businesses”) with persons located in Japan as their transaction counterparts, unless their main Japanese sales branches or main business offices engaging in securities-related businesses are registered.

Meanwhile, unregistered foreign securities companies with no business base in Japan are allowed to engage in activities concerning securities-related businesses with persons in Japan as their transaction counterparts, if they take orders from the said persons without conducting solicitation regarding activities concerning securities-related businesses or take orders through agency and brokerage services provided by Financial Instruments Business Operators (limited to Type I Financial Instruments Business Operators).

Furthermore, foreign securities companies may, with the permission of the authorities based on Article 60(1) of the FIEA, engage in trading at financial instruments exchanges in Japan. Supervisors shall perform supervision of the said companies with due consideration of the points of attention indicated in X-2-1.

#### X-1-2 Foreign Securities Companies’ Cross-Border Transactions Using Internet

The posting by foreign securities companies of advertisements regarding activities concerning securities-related businesses on Web sites shall in principle be deemed to constitute a solicitation.

However, it shall not be deemed to constitute a solicitation aimed at investors in Japan as long as reasonable measures are taken to prevent the advertisement from leading to activities concerning securities-related business with investors in Japan as their transaction counterparts.

##### (1) Disclaimer

A disclaimer to the effect that the advertised service is not targeted at investors in Japan must be indicated.

In judging whether an adequate disclaimer is properly indicated, attention shall be paid to the following points:

- (i) Any particular computer operation other than viewing the advertisement should not be necessary for reading and understanding the disclaimer.
- (ii) The disclaimer must be indicated in language reasonably deemed to be readable and understandable for investors in Japan who are accessing the website.

##### (2) Measures to Prevent Transactions

Measures to prevent transactions regarding activities concerning securities-related businesses must be in place.

In judging whether adequate measures are in place, attention shall be paid to the following points:

- (i) When making transactions, the foreign securities company checks the location of the investors by requiring them to provide information regarding their residence location, mail address, e-mail address, payment method and other items.
- (ii) Care must be taken to avoid taking orders from the investors in cases where there is a reasonable reason

for believing that the orders obviously concern activities concerning securities-related businesses involving investors in Japan.

- (iii) Care must be taken to avoid inducing investors in Japan to conduct activities concerning securities-related businesses by, for example, refraining from establishing a call center targeted at customers in Japan and establishing links to web pages targeted at investors in Japan.

The above-mentioned measures are merely examples, so if measures equivalent thereto or more effective measures have been implemented, the posting of advertisements by foreign securities companies shall not be deemed to constitute a solicitation.

(3) It should be noted that in cases where the above-mentioned reasonable measures are not in place, the said posting of advertisements is highly likely to constitute a solicitation aimed at investors in Japan. Therefore, in such cases, the foreign securities companies should bear the burden of proving that they do not engage in activities concerning securities-related businesses involving solicitation aimed at investors in Japan.

## X-2 Appropriateness of Business Operations

### X-2-1 Appropriateness of Business Operations (Authorized Transaction-At-Exchange Operators)

(1) III-2-1 (excluding (1)(v)), III-2-5 (excluding III-2-5-2 and III-2-5-3), III-2-7, III-2-8, III-2-9, IV-3-1-1, IV-3-1-5 and IV-3-2 (excluding IV-3-2-2, IV-3-2-3(2) and (3), IV-3-2-4 and IV-3-2-5) shall be applied mutatis mutandis to the examination of the appropriateness of the business operations of foreign securities companies that conduct transaction-at-exchange operations (referring to the business operations prescribed in Article 60(1) of the FIEA; the same shall apply hereafter) with the permission of the authorities (hereinafter referred to as “authorized transaction-at-exchange operators”). Based on the fact that authorized transaction-at-exchange operators are basically under the supervision of overseas authorities, in cases where the authorized transaction-at-exchange operator is deemed to conduct business operations that are effectively equivalent to those required in Japan, it should be kept in mind that the specific methods of business operations do not matter.

#### (2) Supervisory Response to Problematic Conduct

Supervisory responses to problematic conduct (referring to an act in violation of the law prescribed in Article 223(x) of the FIB Cabinet Office Ordinance; the same shall apply in (2) below) shall be treated as follows.

- (i) In cases where notification pertaining to problematic conduct is submitted by an authorized transaction-at-exchange operator, the supervisor shall check the following points.
  - A. Whether the authorized transaction-at-exchange operator has promptly reported to the internal control and internal audit divisions as well as to the board of directors, etc. in accordance with compliance rules.
  - B. Whether a division independent of the division involved in the conduct (e.g. the internal audit division) has investigated the conduct.
- (ii) The supervisor shall, based on the following viewpoints, examine the relationship between the problematic conduct and the appropriateness of the authorized transaction-at-exchange operator’s business operations.
  - A. Whether an officer has been involved in the conduct and whether there has been any institutional involvement.
  - B. What impacts the conduct is expected to have on Japan’s financial instruments market.
  - C. Whether the internal checking function is properly functioning.
  - D. Whether the authorized transaction-at-exchange operator has formulated improvement measures intended to prevent the recurrence of the conduct, is equipped with a sufficient self-rectification function and has clarified the allocation of responsibilities.
  - E. Whether the authorized transaction-at-exchange operator acted appropriately immediately after the conduct came to light.

#### (3) Supervisory Method and Actions

When supervisors have, through daily supervisory administration or the reporting of problematic conduct,

recognized an issue of operational or financial concern regarding an authorized transaction-at-exchange operator, they shall identify and keep track of the status of voluntary improvement made by the authorized transaction-at-exchange operator by holding in-depth hearings such as through representative persons in Japan, and, when necessary, requiring the submission of reports based on Article 60-11 of the FIEA. Furthermore, supervisors shall always strive to promptly ascertain and resolve any issues regarding an authorized transaction-at-exchange operator, such as by actively exchanging information with financial instruments exchanges with which the authorized transaction-at-exchange operator is a member and with overseas authorities with which agreements for the exchange of information have been concluded. When the authorized transaction-at-exchange operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including issuing an order for business improvement or an order for business suspension based on Article 60-8(1) of the FIEA.

#### X-2-2 Appropriateness of Business Operations (Authorized Service Providers of Electronic Over-the-Counter Derivative Transactions)

(1) III-2-1 (excluding (1)(v) ), III-2-4, III-2-5 (excluding III-2-5-2 and III-2-5-3), III-2-6, III-2-7, III-2-8, III-2-9, III-2-11, IV-3-1-1, IV-3-1-5, IV-3-1-6, IV-3-3-4(4) shall be applied mutatis mutandis to the examination of the appropriateness of business operations by providers of electronic over-the-counter derivative transaction services (referring to the services prescribed in Article 60-14(1) of the FIEA; the same shall apply hereinafter) upon permission from authorities that engage in over-the-counter derivative transactions etc. in foreign countries in compliance with local laws (hereinafter referred to as "authorized provider of electronic over-the-counter derivative transaction service"). It should be noted that authorized providers of electronic over-the-counter derivative transaction service are basically under the supervision of overseas authorities, and they shall not be examined on specific ways they operate as long as their business is operated at levels deemed virtually equal to those required in Japan.

#### (2) Supervisory Response to Problematic Conduct

Supervisory responses to problematic conduct (referring to an act in violation of the law prescribed in Article 232-8(x) of the FIB Cabinet Office Ordinance; the same shall apply in (2) below) shall be treated as follows.

- (i) In cases where notification pertaining to problematic conduct is submitted by an authorized provider of electronic over-the-counter derivative transaction service, the supervisor shall check the following points.
  - A. Whether the authorized provider of electronic over-the-counter derivative transaction service has promptly reported to the internal control and internal audit divisions as well as to the board of directors, etc. in accordance with compliance rules.
  - B. Whether a division independent of the division involved in the conduct (e.g., the internal audit section) investigates the conduct.
- (ii) Relationship between problematic conduct and the appropriateness of business operations by the authorized provider of electronic over-the-counter derivative transaction service shall be examined by paying attention to the points listed below.

- A. Whether an officer has been involved in the conduct and whether there has been any institutional involvement.
- B. What impacts the conduct is expected to have on Japan's financial instruments market.
- C. Whether the internal checking function is properly functioning.
- D. Whether the authorized provider of electronic over-the-counter derivative transaction service has formulated improvement measures intended to prevent the recurrence of the conduct, is equipped with a sufficient self-rectification function and has clarified the allocation of responsibilities.
- E. Whether the authorized provider of electronic over-the-counter derivative transaction service acted appropriately immediately after the conduct came to light.

### (3) Supervisory Method and Actions

When supervisors have recognized issues regarding business operations and finances at authorized providers of electronic over-the-counter derivative transaction service through daily supervisory administration and the reporting of problematic conduct, they shall keep track of the status of their voluntary efforts to improve the situation through in-depth hearing conducted through representatives in Japan or by requiring, if necessary, the submission of reports based on Article 60-11 of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2) of the same act. In addition, supervisors shall actively exchange information on a daily basis with overseas authorities under information exchange agreements to help detect issues faced by authorized providers of electronic over-the-counter derivative transaction service and resolve such issues early. When the provider is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including the issuance of an order for business improvement or suspension based on Article 60-8 (1) of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2) of the same act.



### X-3 Various Administrative Procedures (Authorized Transaction-At-Exchange Operators)

#### X-3-1 Various Administrative Procedures (Authorized Transaction-At-Exchange Operators)

##### X-3-1-1 Permission

III-3-1 shall be applied *mutatis mutandis* to the treatment of applications for permission based on Article 60-2 of the FIEA, and attention shall also be paid to the following points.

##### (1) Permission Procedures

###### (i) Documents to be attached to the application for permission

A. The abstract of residence certification to be submitted shall contain the following items:

- a. address,
- b. name, and
- c. date of birth.

B. A copy of the residence card or a copy of the special permanent resident certificate submitted by a foreign resident living in Japan, and a copy of residence certification of the home country submitted by a foreigner living outside Japan, or any other documents equivalent thereto (a Japanese translation shall be attached to all documents in English, etc.) shall fall under the “documents in lieu thereof” pursuant to the provisions of Article 221(vi) of the FIB Cabinet Office Ordinance.

###### (ii) Points of attention during the period up until permission is granted

A. Applicants shall be reminded to abstain from conducting any transaction-at-exchange operations until they are granted permission.

B. In the case where an applicant for permission is engaged in another business related to laws and regulations under the supervision of the Financial Services Agency and an administrative reprimand concerning the said business has been issued, the details of such a reprimand shall be confirmed and, when necessary, the progress of improvement measures shall be verified through hearings and other means.

In cases where the said disposition is related to legal compliance, attention shall also be paid to III-2-1 as applied *mutatis mutandis* pursuant to X-2-1.

###### (iii) Notification to applicants for permission

When permission under Article 60(1) of the FIEA has been granted, notification of permission shall be issued to the applicant for permission.

###### (iv) Conditions of permission

With regard to foreign securities companies that apply for permission under Article 60(1) of the FIEA to engage only in proprietary trading, supervisors shall examine whether the foreign securities companies can appropriately conduct the business operations for which permission is being sought. However, once the said foreign securities company has been granted the said permission, if it intends to start conducting brokerage services for orders on consignment for overseas customers, supervisors will need to re-examine whether the

foreign securities company can appropriately conduct the said business operations. Therefore, when granting permission to a foreign securities company that will engage only in transaction-at-exchange operations using its own accounts, a condition shall be attached to the said permission to the effect that advance approval needs to be obtained from the authorities in cases where the applicant intends to conduct business operations other than those for which permission was sought at the time of application.

(v) Refusal of permission (Refer to II-5-6)

A. When permission is refused, a notification of refusal of permission shall be issued to the applicant. The notification shall include the grounds for refusal and state that the applicant is entitled to request examination to the Commissioner of the FSA and to file a suit to seek the rescission of disposal, with the government as the counterparty.

B. The notification of refusal of permission shall specifically indicate the grounds for refusal and which of the items set out in Article 60-3(1) of the FIEA correspond to the grounds for refusal, or shall specifically indicate the parts of the application for permission or attached documents which contain misstatements on important matters or which have material facts missing.

(2) Matters for Examination

(i) Items regarding corporate form

When examining whether or not a foreign securities company is a juridical person of the same type as a company with board of directors as specified under Article 60-3(1)(i)(a) of the FIEA, supervisors shall check the following points based on the application for permission and the attached documents, as well as hearings:

A. Whether the foreign securities company has established a consultative body comprised of two or more officers and employees to act as a decision-making body.

B. Whether consideration has been given to the structure of the decision-making body so that the respective checks by each participant are functioning and so that management of the foreign securities company is not being influenced by the wishes of any specific officers.

C. Whether representative persons are determined by counsel or other means comprised of two or more officers and employees.

D. Whether the foreign securities company has arrangements and procedures to ensure that checks by the internal control division on the sales and other divisions function properly.

E. Whether the foreign securities company has arrangements and procedures for audits to be conducted effectively by an independent internal audit division, external auditors or the like.

(ii) Items regarding examination of staffing level

When examining whether or not a foreign securities company is sufficiently staffed to properly conduct transaction-at-exchange operations, as specified under Article 60-3(1)(i)(k) of the FIEA, supervisors shall check the following points based on the application for permission and the attached documents, as well as hearings:

A. Whether it can be confirmed that officers or employees with sufficient knowledge and experience have been secured and a sufficient organization has been established to conduct the relevant business

operations in light of the following requirements:

- a. Top managers and managing directors must be sufficiently qualified to conduct financial instruments business in a fair and appropriate manner, in terms of their backgrounds and capabilities.
  - b. The foreign securities company must secure permanent officers and employees who understand the viewpoints regarding the appropriateness of business operations indicated in the FIEA and other relevant regulations, as well as supervisory guidelines, and who have the knowledge and experience necessary for exercising such viewpoints, and sufficient knowledge and experience regarding compliance and risk management to conduct transaction-at-exchange operations in a fair and appropriate manner.
  - c. The foreign securities company must be staffed and organized so that it can execute business operations appropriately, including having personnel necessary for conducting transaction-at-exchange operations in an appropriate manner allocated to appropriate divisions, and having managers in charge of internal control and other matters appropriately allocated to divisions independent from sales divisions.
  - d. The foreign securities company must have at each transaction-at-exchange office (referring to the business sites or offices conducting transaction-at-exchange operations, prescribed in Article 60-2(1)(iii) of the FIEA; the same shall apply hereafter), two or more permanent officers and employees who have each conducted business operations pertaining to transactions of the same type as transactions at exchange for a period of no less than three years.
  - e. Staff capable of conducting the following processes should be secured with regard to the transaction-at-exchange operations.
    - i) Compilation and management of account documents, reports and other documents.
    - ii) Computer system management
    - iii) Trading management
    - iv) Processing of complaints and resolution of disputes
    - v) Internal audits
    - vi) Training
  - f. In cases where the foreign securities company intends to conduct brokerage transactions, it must have arrangements and procedures for order management and transaction screening to prevent illegal practices such as insider trading and market manipulation.
  - g. From the perspective of preventing activities concerning securities-related businesses with investors in Japan, the foreign securities company must have arrangements and procedures for implementing the measures listed in X-1-2(2).
  - h. Representative persons in Japan must be designated from among persons who are able to coordinate appropriately with transaction-at-exchange offices and the head office and who are able to respond appropriately to requests by supervisory authorities for the submission of reports and so forth.
- B. Whether, as a result of examining the following matters in a comprehensive manner, there is a risk that public confidence in the authorized transaction-at-exchange operator could be damaged because of the

inclusion of persons with inappropriate qualifications for managing transaction-at-exchange operations among its officers or employees who conduct transaction-at-exchange operations.

- a. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - b. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion, as well as attempts at these crimes).)
- (iii) Others
- A. Supervisors shall use “documents describing measures implemented for the purpose of preventing unfair trading” as prescribed in Article 221(x) of the FIB Cabinet Office Ordinance, to check whether the foreign securities company has measures for preventing insider trading, measures for limiting orders, and, in cases where the foreign securities company conducts brokerage transactions, arrangements and procedures for order management and transaction screening to prevent unfair trading.
  - B. When conducting examinations under Article 60-3(1)(i)(b) of the FIEA, supervisors shall confirm that the foreign securities company is registered in all the countries where its head office and transaction-at-exchange office are located, by using such means as attached documents and, as necessary, agreements with overseas authorities on the provision of information.
  - C. When conducting examinations under Article 60-3(1)(ii) of the FIEA, supervisors shall confirm the effectiveness of the assurance given by overseas authorities that they will respond to requests for cooperation in investigations conducted by Japan, such as by liaising with the overseas authorities.
  - D. When conducting examinations under Article 60-3(1)(iii) of the FIEA, supervisors shall request Japan’s financial instruments exchanges to confirm the effectiveness of agreements made with establishers of foreign financial instruments exchange markets on the provision of information.

It should be kept in mind that the “agreements on the provision of information” are not limited to agreements between individual exchanges. As long as the provision of information among the Intermarket Surveillance Group (ISG) and other exchanges is being conducted appropriately, frameworks for the exchange of information between two or more exchanges may also be acknowledged.

#### X-3-1-2 Notification

III-3-2(3) shall be applied *mutatis mutandis* to notifications made by authorized transaction-at-exchange operators, and attention shall also be paid to the following points.

##### (1) Points of Attention Regarding Notifications of Change, etc.

When a notification pursuant to Article 60-5(1) and (2) of the FIEA is received from an authorized transaction-

at-exchange operator, supervisors shall ascertain and confirm the content and appropriateness thereof, by holding in-depth hearings with the said authorized foreign securities company such as through representative persons in Japan, and, when necessary, requiring the submission of reports based on Article 60-11 of the FIEA. Furthermore, when the authorized transaction-at-exchange operator is deemed to have committed a serious and malicious violation of law, the supervisors shall consider necessary actions, including rescinding permission or issuing an order for business suspension based on Article 60-8(1) of the FIEA.

(2) Points of Attention Regarding Notification of Additional Transaction-at-Exchange Offices, etc.

In cases where notification is received from an authorized transaction-at-exchange operator in accordance with Article 60-5(1) of the FIEA regarding an additional transaction-at-exchange office or an additional financial instruments exchange at which it has trading participant rights, supervisors shall confirm the appropriateness of the personnel structure and business operations of the said transaction-at-exchange office, and confirm that no reasons exist for the refusal of permission under each item of Article 60-3(1) of the FIEA.

X-3-1-3 Account Documents Related to Business Operations

III-3-3 shall be applied mutatis mutandis to the compilation and storage of account documents related to business operations. It should be noted that the term “branch office” in III-3-3 shall be replaced with “transaction-at-exchange office.”

X-3-2 Various Administrative Procedures (Authorized Service Providers of Electronic Over-the-Counter Derivative Transactions)

X-3-2-1 Permission

III-3-1 shall be applied mutatis mutandis to the treatment of registration applications based on Article 60-2 of the FIEA applied mutatis mutandis pursuant to Article 60-14(2) of the same act, and attention shall also be paid to the following points.

(1) Permission Procedures

(i) Documents to be attached to the application for permission

A. The abstract of residence certification to be submitted shall contain the following items:

- a. Address
- b. Name, and
- c. Date of birth

B. A copy of the residence card or a copy of the special permanent resident certificate submitted by a foreign resident living in Japan, and a copy of residence certification of the home country submitted by a foreigner living outside Japan, or any other documents equivalent thereto (a Japanese translation shall be attached to all documents in English, etc.) shall fall under the "documents in lieu thereof" pursuant to the provisions of Article 232-5(vi) of the FIB Cabinet Office Ordinance.

- (ii) Points of attention during the period up until permission is granted
  - A. Applicants shall be reminded to abstain from conducting any electronic over-the-counter derivative transaction service until they are granted permission.
  - B. In the case where an applicant for permission is engaged in another business related to laws and regulations under the supervision of the Financial Services Agency and an administrative reprimand concerning the said business has been issued, the details of such a reprimand shall be confirmed and, when necessary, the progress of improvement measures shall be verified through hearings and other means.

In cases where the said disposition is related to legal compliance, attention shall also be paid to X-2-2 as applied mutatis mutandis pursuant to X-2-1.

- (iii) Notification to applicants for permission

When permission under Article 60-14(1) of the FIEA has been granted, notification of permission shall be issued to the applicant for permission.

- (iv) Refusal of permission (Refer to II-5-6)

- A. When permission is refused, a notification of refusal of permission shall be issued to the applicant. The notification shall include the grounds for refusal and state that the applicant is entitled to request examination to the Commissioner of the FSA and to file a suit to seek the rescission of disposal, with the government as the counterparty.
- B. The notification of refusal of permission shall specifically indicate the grounds for refusal and which of the items set out in Article 60-3(1) of the FIEA applied mutatis mutandis pursuant to Article 60-14(2) of the same act correspond to the grounds for refusal, or shall specifically indicate the parts of the application for permission or attached documents which contain misstatements on important matters or which have material facts missing.

## (2) Matters for Examination

- (i) Items regarding corporate form

When examining whether or not a foreign securities company is a juridical person of the same type as a company with board of directors as specified under Article 60-3(1)(i)(a) of the FIEA, applied mutatis mutandis pursuant to Article 60-14(2) of the same act, supervisors shall check the following points based on the application for permission and the attached documents, as well as hearings.

- A. Whether the foreign securities company has established a consultative body comprised of two or more officers and employees to act as a decision-making body.
- B. Whether consideration has been given to the structure of the decision-making body so that the respective checks by each participant are functioning and so that management of the authorized provider of electronic over-the-counter derivative transaction service is not being influenced by the wishes of any specific officers.
- C. Whether representative persons are determined by counsel or other means comprised of two or more officers and employees.
- D. Whether the foreign securities company has arrangements and procedures to ensure that checks by the

internal control division on the sales and other divisions function properly.

E. Whether the foreign securities company has arrangements and procedures for audits to be conducted effectively by an independent internal audit division, external auditors or the like.

(ii) Items regarding examination of staffing level

When examining whether or not an authorized provider of electronic over-the-counter derivative transaction service is sufficiently staffed to properly conduct its service, as specified under Article 60-3(1)(i)(k) of the FIEA, applied mutatis mutandis pursuant to Article 60-14(2), supervisors shall check the following points based on the application for permission and the attached documents, as well as hearings:

A. Whether it can be confirmed that officers or employees with sufficient knowledge and experience have been secured and a sufficient organization has been established to conduct the relevant business operations in light of the following requirements:

a. Top managers and managing directors must be sufficiently qualified to conduct electronic over-the-counter derivative transactions services in a fair and appropriate manner, in terms of their backgrounds and capabilities.

b. The foreign securities company must secure permanent officers and employees who understand the viewpoints regarding the appropriateness of business operations indicated in the FIEA and other relevant regulations, as well as supervisory guidelines, and who have the knowledge and experience necessary for exercising such viewpoints, and sufficient knowledge and experience regarding compliance and risk management to conduct electronic over-the-counter derivative transactions in a fair and appropriate manner.

c. The foreign securities company must be staffed and organized so that it can execute business operations appropriately, including having personnel necessary for conducting electronic over-the-counter derivative transaction services in an appropriate manner allocated to appropriate divisions, and having managers in charge of internal control and other matters appropriately allocated to divisions independent from sales divisions.

d. The foreign securities company must have at each electronic over-the-counter derivative transaction office (referring to the electronic over-the-counter derivative transaction office, prescribed in Article 60-2(1)(iii) of the FIEA, applied mutatis mutandis pursuant to Article 60-14(2) of the same act; the same shall apply hereafter), two or more permanent officers and employees who have each conducted business operations pertaining to transactions of the same type as electronic over-the-counter derivative transactions for a period of no less than one year.

e. Staff capable of conducting the following processes should be secured with regard to electronic over-the-counter derivative transaction service.

- i) Compilation and management of account documents, reports and other documents.
- ii) Computer system management
- iii) Customer management
- iv) Processing of complaints and resolution of disputes
- v) Internal audits

vi) Training

f. Representative persons in Japan must be designated from among persons who are able to coordinate appropriately with electronic over-the-counter derivative transaction office and the head office and who are able to respond appropriately to requests by supervisory authorities for the submission of reports and so forth.

B. Whether, as a result of examining the following matters in a comprehensive manner, there is a risk that public confidence in the authorized provider of electronic over-the-counter derivative transaction service could be damaged because of the inclusion of persons with inappropriate qualifications for managing electronic over-the-counter derivative transaction service among its officers or employees who conduct such a service.

a. Officers and employees should not have been previously sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.

b. Officers and employees should not have been previously sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion, as well as attempts at these crimes).)

(iii) Others

A. When conducting examinations under Article 60-3(1)(i)(b) of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2), supervisors shall confirm that the foreign securities company is registered in all the countries where its head office and electronic over-the-counter derivative transaction offices are located, by using such means as attached documents and, as necessary, agreements with overseas authorities on the provision of information.

B. When conducting examinations under Article 60-3(1)(ii) of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2), supervisors shall confirm the effectiveness of the assurance given by overseas authorities that they will respond to requests for cooperation in investigations conducted by Japan, such as by liaising with the overseas authorities.

### X-3-2-2 Notification

III-3-2(3) shall be applied *mutatis mutandis* to notifications made by authorized provider of electronic over-the-counter derivative transaction services, and attention shall also be paid to the following points.

When a notification pursuant to Article 60-5(1) and (2) of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2) of the same act, is received from an authorized provider of electronic over-the-counter derivative transaction service, supervisors shall ascertain and confirm the content and appropriateness thereof, by holding in-depth hearings with the said authorized provider of electronic over-the-counter derivative transaction service such as through representative persons in Japan, and, when necessary, requiring the submission of reports based on Article 60-11 of the FIEA, applied *mutatis mutandis* pursuant to Article 60-14(2) of the same act. Furthermore, when the authorized provider of electronic over-the-counter derivative transaction service is deemed to have committed a



serious and malicious violation of law, the supervisors shall consider necessary actions, including rescinding permission or issuing an order for business suspension based on Article 60-8(1) of the FIEA, applied mutatis mutandis pursuant to Article 60-14(2) of the same act.

#### X-3-2-3 Account Documents Related to Business Operations

III-3-3 shall be applied mutatis mutandis to the compilation and storage of account documents related to business operations. It should be noted that the term "branch office" in III-3-3 shall be replaced with " electronic over-the-counter derivative transaction office."

**XI. Supervisory Evaluation Points and Various Administrative Procedures (Financial Instruments Intermediary Service Providers)**

XI-1 Appropriateness of Business Operations (Financial Instruments Intermediary Service Providers)

III-2 (excluding III-2-5-2, III-2-5-3 and III-2-6), IV-3-1 (excluding IV-3-1-2(2), IV-3-1-3(1) and (2) and IV-3-1-6), IV-3-3-2(3) and (6) (limited to the sections related to the sale of complex structured bonds and investment trusts that are similar to over-the-counter derivative transactions) and IV-3-4-2 and IV-3-6-2 shall be applied mutatis mutandis to the examination of the appropriateness of the business operations of financial instruments intermediary service providers, and regarding the Explanation Documents as specified under Article 66-18 of the FIEA, supervisors shall instruct financial instruments intermediary service providers to keep the documents available at any time for inspection by customers upon their request. On that occasion, supervisors shall encourage them to display the documents using the internet wherever possible.

Regarding theoretical prices mentioned in IV-3-1-2(6)(iii)A. and B. and internal rules mentioned in IV-3-1-2(6)(iii)B. and C., financial instruments service providers may use prices calculated and rules established by Financial Instruments Business Operators to which their business operations are entrusted.

XI-2 Various Administrative Procedures (Financial Instruments Intermediary Service Providers)

XI-2-1 Registration

III-3-1 (excluding (2), (4) and (10)(iii)) shall be applied mutatis mutandis to the treatment of registration applications based on Article 66-2 of the FIEA, and attention shall also be paid to the following points. It should be noted that terms used in the relevant formats specified in the Attached List of Formats shall be replaced as necessary.

(1) Registration Procedures

(i) The registration numbers to be recorded in a registry of financial institutions shall be specified as follows:  
(Example) Director-General of XX Local Finance Bureau (Financial Instruments Intermediary Service Providers) No. XX

(ii) Proxy Application for Registration

Regarding registration application concerning financial instruments intermediary service providers, it should be kept in mind that proxy application may be made by the primary Financial Instruments Business Operators and other entities, based on their examination of the applications for the purposes of facilitating the convenience of the applicants and their proxies, streamlining the applicants' clerical work, ensuring the preciseness of the items specified in the application and speeding up the processing of the application.

When supervisors have received a proxy registration, they shall examine the letter of proxy in order to check the validity and scope of the proxy. It should be kept in mind that when the scope of the proxy includes the authority to revise the application and receive the notice of registration, supervisors may request the proxy applicant to make revision and give the notice thereto.

## (2) Matters for Screening

- (i) Regarding an applicant service provider which undertakes service on behalf of two or more primary Financial Instruments Business Operators under Article 258(iii) of the FIB Cabinet Office Ordinance, supervisors shall check whether the following requirements are met in judging whether the names of the primary Financial Instruments Business Operators responsible for compensating for losses that may arise from problematic conduct are properly indicated.
  - A. Whether possible problematic conduct is categorized and whether the name of the primary Financial Instruments Business Operator responsible for compensating for losses in the event of each category of problematic conduct is clearly specified.
  - B. Whether the name of the primary Financial Instruments Business Operator responsible for compensating for losses in the event of problematic conduct that does not fall under any category or that cannot be clearly put into any category is clearly specified.
- (ii) Supervisors shall check whether the contents and methods of business operations as specified under Article 259 of the FIB Cabinet Office Ordinance include the following items:
  - A. Service area
  - B. Business style (e.g., whether the business involves physical contact with customers, is conducted through a computer system linked to a telecommunications network and, in the case of an applicant who is an individual person, whether the service provider employs persons engaging in financial instruments intermediary service)
  - C. Types of sales branch (manned branches, unmanned branches)
  - D. Types of securities handled by the service provider
  - E. Types of domestic and foreign market derivatives transactions for which the service provider acts as a broker (the types of transactions and as specified under each item of Article 2(21) and Article 23 of the FIEA)
  - F. In cases where the service provider intends to act as a broker for investment advisory contracts or discretionary investment contracts, the intention must be indicated.

## (3) Others

When examining whether officers and employees of a financial instruments intermediary service provider have sufficient knowledge and experience to properly conduct financial instruments intermediary services, supervisors shall check the following points in reference to the submitted applications and documents attached thereto. It should be noted that when the applicant is a foreign corporation, they shall check the status of officers and employees stationed in Japan with regard to (i) below and the corporation's status in Japan with regard to (ii) and (iii).

- (i) Whether persons engaging in financial intermediary services (officers and employees engaging in financial intermediary services and managers in charge of internal control and other matters) have passed a sales representative qualification examination conducted by a financial instruments firms association related to such services and have a prescribed level of knowledge regarding relevant laws, regulations and rules.
- (ii) In cases where the applicant is a corporation or an individual person who employs persons engaging in

financial instruments intermediary services, whether the applicant has a staff and an organization that ensure an appropriate allocation of personnel necessary for conducting the relevant service in an appropriate manner and managers in charge of internal control, according to the nature and scale of the relevant service.

(iii) In cases where the applicant is a corporation or an individual person who employs persons engaging in financial instruments intermediary services, whether the applicant has established arrangements and procedures necessary for the following matters. (Regarding A. and B., the intermediary service provider may entrust the compilation of accounts and other documents to the primary Financial Instruments Business Operator while managing the compiled documents itself. C. to E. may be disregarded in cases where the primary Financial Instruments Business Operator has established appropriate arrangements and procedures.)

- A. Compilation and management of account documents, reports, etc.
- B. Customer due diligence
- C. Computer system management
- D. Processing complaints and disputes
- E. Internal audits

#### XI-2-2 Notification

III-3-2(1) shall be applied mutatis mutandis to notifications made by financial instruments intermediary service providers. It should also be noted that when receiving a notification for discontinuation of business based on Article 66-19(1) of the FIEA from a financial instruments intermediary service provider, supervisors shall make sure, through a hearing with the service provider, for example, that no reason exists for the rescission of registration as specified under Article 66-20(1) of the FIEA.

#### XI-2-3 Account Documents Related to Business Operations

III-3-3 (excluding III-3-3(4) and (5)) shall be applied mutatis mutandis to the treatment of the compilation and storage of account documents related to business operations. Financial instruments intermediary service providers may compile the account documents on the financial instruments intermediary service, as specified under Article 282 of the FIB Cabinet Office Ordinance, with the use of computer systems and formats adopted by the primary Financial Instruments Business Operators or entrust the establishment of systems and formats necessary for the compilation of the account documents to them. However, it should be noted that the financial instruments intermediary service providers bear the responsibility for the compilation and storage of the account documents.

#### XI-2-4 Registration of Sales Representatives

IV-4-3 and V-3-2 shall be applied mutatis mutandis.

## **XII. Supervisory Evaluation Points and Various Administrative Procedures (Securities Finance Companies)**

### XII-1 Governance (Securities Finance Companies)

III-1 (excluding (1)(ii) F) shall be applied mutatis mutandis to the examination of the governance of securities finance companies. In addition, IV-1-2 shall be applied mutatis mutandis to the examination of whether officers and employees are sufficiently qualified to conduct securities finance business.

### XII-2 Appropriateness of Business Operations (Securities Finance Companies)

III-2 (excluding III-2-3-1, III-2-3-3, III-2-3-4, and III-2-4(2)(i) and (ii), and XII-2-15)), IV-3-1-6 and IV-3-1-7 shall be applied mutatis mutandis to the examination of the appropriateness of the business operations of securities finance companies. Regarding descriptions of “3. Status of Measures Implemented in Relation to Protection of Personal Information,” as specified under Article 3-4(1) of the Cabinet Office Ordinance Regarding Securities Finance Companies (hereinafter referred to as the “Finance Companies Cabinet Ordinance”), attention shall be paid to the following points:

#### (1) Status of Implementation of Safety Control Measures

Regarding a securities finance company’s safety control system concerning information related to individual customers, supervision of employees responsible for safety control and, in cases where the safety control is entrusted to an outside entity, supervision of the said entity, supervisors shall require a report regarding the following measures, which are appropriate and necessary from the viewpoint of preventing the said information from being leaked, lost or damaged.

(Necessary and Appropriate Measures Regarding Safety Control)

- (i) Measures based on Article 8 of the Financial Sector Guidelines
- (ii) Measures based on Section I and Attachment 2 of the Practical Guideline

(Necessary and Appropriate Measures Regarding Supervision of Employees)

- (i) Measures based on Article 9 of the Financial Sector Guidelines
- (ii) Measures based on Section II of the Practical Guideline

(Necessary and Appropriate Measures Regarding Supervision of Entrusted Entity)

- (i) Measures based on Article 10 of the Financial Sector Guidelines
- (ii) Measures based on Section III of the Practical Guideline

#### (2) Status of Implementation of Measures to Prevent Use of Specified Non-Disclosure Information for Non-Prescribed Purposes

“Other specified non-disclosure information” as specified in Note 3(2) refers to items (i)-(vii) below, while “assurance of appropriate business operations and other purposes deemed to be necessary” refers to the cases described in each item of Article 5(1) of the Financial Sector Guidelines.

- (i) Information regarding labor union membership
- (ii) Information regarding ethnicity

- (iii) Information regarding sexual orientation
- (iv) Information regarding provisions under Article 2(iv) of the Order for the Enforcement of the Personal Information Protection Act
- (v) Information regarding provisions under Article 2(v) of the Order for the Enforcement of the Personal Information Protection Act
- (vi) Information regarding the fact that the related customer has been a victim of crime
- (vii) Information regarding social status

### XII-3 Various Administrative Procedures (Securities Finance Companies)

#### XII-3-1 License Screening Criteria

##### (1) Staffing

The appropriateness of the staffing as specified under Article 156-25(1) shall be judged in light of the following criteria:

- (i) Whether the securities finance company has allocated personnel necessary for conducting the business specified under Article 156-24(1) of the FIEA (hereinafter referred to as “debt-credit transaction business”) to individual divisions.
- (ii) Whether the securities finance company’s staff includes officers and employees with three or more years of experience regarding securities-related business as well as those adept in the debt-credit transaction system.
- (iii) Whether officers and employees secured by the securities finance company are deemed to have sufficient knowledge and experience to conduct the relevant business in an appropriate and efficient manner in light of the following criteria:
  - A. Managing directors must understand the viewpoints regarding governance indicated in the FIEA and various other laws and regulations, and have sufficient knowledge and experience to conduct governance and sufficient knowledge and experience regarding compliance and risk management to conduct financial instruments business in a fair and appropriate manner.
- (iv) When the qualifications of employees and officers are examined in a comprehensive manner in relation to the following criteria regarding organized crime members and financial crimes, whether there is the risk that public confidence in the securities finance company could be damaged because of the inclusion of officers and employees with inappropriate qualifications among its staff.
  - A. Officers and employees should not be current or former members of organized crime groups.
  - B. Officers and employees should not have close relationships with organized crime groups.
  - C. Officers and employees should not have the experience of being sentenced to a fine for violation of the FIEA or other domestic financial laws and regulations or foreign laws and regulations equivalent thereto.
  - D. Officers and employees should not have the experience of being sentenced to a fine (including similar punishments imposed under foreign laws and regulations equivalent thereto) for violation of the Act on Prevention of Unjust Acts by Organized Crime Group Members (excluding the provisions of Article

32-2(7) of the same act) or other foreign laws and regulations equivalent thereto, or for committing a crime prescribed under the Penal Code or under the Act on Punishment of Physical Violence and Others.

- E. Officers and employees should not have the experience of being sentenced to imprisonment with work or more severe punishment (including similar punishments imposed under foreign laws or regulations equivalent thereto). (Particular attention should be paid to the case of an officer or employee being accused of committing crimes specified under Articles 246 to 250 of the Penal Code (fraud, fraud using computers, breach of trust, quasi fraud and extortion, as well as attempts at these crimes).)

## (2) Credit Status and Fund-Raising Capability

The appropriateness of a securities finance company's credit status and fund-raising capability shall be judged in light of the following criteria:

- (i) Whether the securities finance company can be objectively deemed to have sufficient stock-procurement and fund-raising capabilities for conducting the debt-credit transaction business.
- (ii) Whether the securities finance company has established arrangements and procedures for obtaining information regarding credit transactions in the exchange-based financial instruments market and the over-the-counter securities trading market at any time, and procurement and settlement systems which link it with Financial Instruments Business Operators and transactions counterparties, and which are deemed to be capable of responding quickly to procurement and settlement needs.

## XII-3-2 Notification

The revisions of the contents and methods of business operations as specified under Article 1-2(2)(ii) of the Finance Companies Cabinet Ordinance refer to those revisions of the contents of methods of business operations, excluding revisions of terms of transactions, which involve revisions of internal rules and which must be communicated to all transaction counterparties.

## XII-3-3 Approval

In granting approval based on Article 156-27(3) of the FIEA, supervisors shall pay attention to the following points:

(1) Approval should not be granted in cases where the business for which approval is sought is deemed to undermine public interests or where an excessive amount of securities held by the securities finance company could lead to significant price change risk, for example.

(2) Whether the revenue projection document as specified under Article 2(1)(i) of the Finance Companies Cabinet Ordinance indicates that the business will turn profitable within three years from its commencement and whether the projection can be objectively deemed to be feasible.

## XII-3-4 Authorization

### (1) Revision of Contents and Methods of Business Operations

When receiving an application for authorization of a revision of the contents or methods of business operations as specified under Article 156-28(1) of the FIEA, supervisors shall pay attention to the following points:

- (i) Whether the revision of the contents could undermine the smooth conduct of debt-credit transaction business.
- (ii) Whether it is ensured that the revision of the contents is quickly communicated to all necessary parties

### (2) Reduction of Capital Amount

When receiving an application for authorization of reduction in the capital amount, supervisors shall pay attention to the following points:

- (i) Whether the capital amount after the reduction will be lower than the minimum level prescribed under Article 156-23 of the FIEA.
- (ii) Whether the capital reduction could undermine the smooth conduct of debt-credit transaction business.
- (iii) Whether the reason for the capital reduction can be deemed to be one essential to continuing business, such as a need to eliminate a deficit.

### (3) Resolution for Discontinuance or Dissolution of Business

When receiving an application for authorization of the resolution for discontinuance or dissolution of business as specified under Article 156-36(i) of the FIEA, supervisors shall pay attention to the following points:

- (i) Whether no reason exists for the rescission of a license as specified under Article 156-32(1) of the FIEA.
- (ii) Whether the securities finance company has a positive net worth and is ready to proceed with the liquidation process smoothly.
- (iii) Whether measures, both institutional and physical, have been taken to avoid causing disruptions to credit transactions in the exchange-based financial instruments market and the over-the-counter securities market after the discontinuance or dissolution of business.

### (4) Merger or Transfer or Acceptance of Business

When receiving an application for authorization of the merger or transfer or acceptance of business as specified under Article 156-36(ii) of the FIEA, supervisors shall pay attention to the following points:

- (i) Whether no reason exists for the rescission of a license, as specified under Article 156-32(1) of the FIEA, with regard to the company set to be dissolved as a result of the merger or business transfer.
- (ii) Whether measures, both institutional and physical, have been taken to prevent the merger or transfer or acceptance of business from causing disruptions to credit transactions in the exchange-based financial instruments market and the over-the-counter securities market.



## XII-4 Measures to Ensure the Effectiveness of Stay Decision in Agreements Governed by Foreign Laws

### XII-4-1 Background

The amendment of the Deposit Insurance Act (hereinafter referred to as the “DIA”) in June 2013 has provided the Prime Minister with a power to make a decision that a “Clause on Specified Cancellation, etc.” in an agreement, meaning a clause which provides Specified Cancellation (“Specified Cancellation, etc.” defined in Article 137-3(2) of the DIA) that is to be triggered by an application of “Related Measures, etc.” defined in Article 137-3(1) of the DIA, is null and void for a period set out in Article 137-3 (1) of the DIA (such a decision is hereinafter referred to as a “Stay Decision”). In the above conjunction, the 2013 amendment revised the provisions in Article 131 of the DIA with respect to special provisions for procedures of creditor protection. In order to avoid a severe disruption to Japan’s financial system, securities finance companies to which Specified Confirmation set out in Article 126-2 (1) of the DIA is applicable are required to ensure that the effectiveness of Stay Decisions and special provisions for procedures of creditor protection set out in Article 131 of the DIA (hereinafter collectively referred to as the “Effectiveness of Stay Decision”) extend to agreements governed by laws other than Japanese law.

### XII-4-2 Main Supervisory Focus

In light of the development at the global level aimed at ensuring the effectiveness of temporary stay on early termination rights in agreements governed by foreign laws, the FSA expects to set the following items as its supervisory focus in examining the firms’ controls on agreements governed by laws other than Japanese law, taking into account the circumstances of individual transactions.

#### (1) Supervisory Focus with respect to Conclusion of an Agreement

The FSA expects to examine whether a Financial Instruments Business Operator, etc. has taken necessary actions to ensure, regardless of the counterparties’ jurisdictions, that the Effectiveness of Stay Decision applies to an agreement governed by laws other than Japanese law, where the Financial Instruments Business Operator, etc. concludes or materially amends the agreement or enters into a transaction based on the existing agreement, provided that the new or the existing agreement, as the case may be, contains a Clause on Specified Cancellation; is agreed with any counterparty other than central counterparties (CCPs); and is with respect to “Subject Transactions” which refers to, among the transactions listed in Article 35-18 of Ordinance for Enforcement of the Deposit Insurance Act as “transactions of instruments that have a market price at an exchange or other markets and their equivalent transactions” over-the-counter derivative transactions, financial and other derivative transactions, the sale or purchase of securities on condition of repurchase or resale, the lending and borrowing of securities, the trading of bonds with options, forward foreign exchange transactions, over-the-counter commodity derivative transactions, and similar transactions, including transactions entered into for the purpose of collateralizing these transactions.

(Note) Actions to comply with the requirements above include:

- (i) Adhering to an internationally common protocol aimed at ensuring the Effectiveness of Stay Decision on agreements governed by laws other than Japanese law and confirming that the counterparty has adhered to such a protocol; and

- (ii) Indicating clearly in the agreement that the Effectiveness of Stay Decision applies to the Subject Transactions.

## (2) Supervisory Focus with respect to Existing Contracts

Firms that are required to take the actions set out in (1) are also expected to take those actions, as necessary, with respect to existing contracts of Subject Transactions which include a Clause on Specified Cancellation and are governed by laws other than Japanese law (excluding the cases where the firm enters into a new transaction based on the existing agreement), taking into account the significance of the potential systemic impact that may be caused by the non-enforceability of the Effectiveness of Stay Decision to the agreement.

### XII-4-3 Supervisory Approaches and Actions

Based on the supervisory focus above, the FSA expects to conduct in-depth reviews on the relevant management and control of securities finance companies. Where necessary, the FSA also expects to require securities finance companies to submit a report to the FSA, pursuant to Article 156-34 of the FIEA and Article 136 of the DIA.

If any material impediment to ensuring smooth execution of orderly resolution is identified as a sequel of requiring the submission of a report, the FSA expects to consider issuing, a business improvement order pursuant to Article 156-33 of the FIEA and an order pursuant to Article 137-4 of the DIA to securities finance companies.