

Compliance System Checklist

The purpose of this checklist is to encourage financial institutions to serve the public good and to confirm their systems for accomplishing this. It does this by re-articulating the roles that the board of directors etc. and auditors etc. are expected to play, describing the programs etc. that will achieve compliance, seeking to make directors etc. aware of compliance issues, and cultivating compliance-oriented corporate cultures at financial institutions. This checklist is to be used to verify financial-institution compliance system.

This checklist applies to all deposit-taking financial institutions, including the foreign offices of Japanese banks (foreign branch offices, foreign subsidiaries, and foreign liaison offices, etc., though whether to include these offices in the inspection will be determined in light of applicable laws and ordinances, including applicable foreign-country laws and ordinances) and the Japan offices of foreign banks. In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select external auditors in limited cases.

Notes on the use of this manual in inspections

This manual is only a handbook to be used by inspectors in the inspection of financial institutions. It is expected that, as part of their efforts to ensure sound and proper operations and in accordance with the principle of self-responsibility, individual financial institutions will fully exercise their creativity and innovation to voluntarily create their own detailed manuals. These institutional manuals should make note of the content of this manual and be adapted to the size and nature of the institution.

The check points in this manual represent criteria to be used by inspectors in evaluating the compliance systems of financial institutions. They do not constitute direct statutory obligations to be achieved by institutions. Care must be taken that the manual is not employed in a manner that is mechanical and unvarying. There may be cases in which the letter of the checklist description has not been fulfilled, but the institution has nonetheless taken measures that are, from the perspective of ensuring the soundness and appropriateness of its operations, rational, and these measures are equivalent in their effects to the descriptions for the check point or are sufficient given the size and nature of the institution. In such cases, the institution's measures should not be deemed inappropriate.

Inspectors will therefore need to engage in full discussion of relevant points with financial institutions during on-site inspections.

Explanation of check points

1. Unless explicitly stated otherwise, items expressed in the question form such as “does the institution” or “is the institution” are minimum standards that are expected of all financial institutions. Inspectors, as they go through their checklists, need to fully verify the effectiveness of these items.
2. Unless explicitly stated otherwise, items worded in the form of “it would be desirable that” constitute “best practice” for all financial institutions. Inspectors need only confirm these items.

3. Items that are a combination of the two represent minimum standards for internationally active banks (those financial institutions calculating their capital adequacy ratios according to the Basle standards) but serve only as best practices for other financial institutions (those calculating their capital adequacy ratios according to domestic standards).

Distinction between “board of directors” and “board of directors etc.”

1. Items that are defined as roles of the “board of directors” are items for which the board of directors itself needs to determine all essential matters. This does not, however, preclude the board of directors from delegating consideration of draft documents to the management committee or similar bodies.

2. The phrase “board of directors etc.” includes the board of directors, the management committee, the business steering committee, and similar bodies. Items that are defined as roles of the “board of directors etc.” would ideally be determined by the board of directors itself, but may be delegated to the management committee etc. provided that there has been a clear delegation of this authority from the board of directors, the management committee etc. has kept minutes of its proceedings and other materials that would allow after-the-fact confirmation, and there are adequate internal controls in place, e.g., the results are reported to the board of directors, and auditors are allowed to participate in the management committee etc.

Item	Compliance Check Point	Explanation of Compliance Check Points	Remarks
I. Establishment of compliance systems	1. Functions of the board of directors as the body making decisions on business-execution and supervising director activities	1. The responsibilities and obligations of directors for business execution <ol style="list-style-type: none"> (1) Do the directors, from the perspectives of checking and restraining unilateral actions of the representative directors in the execution of business activities, facilitating appropriate business execution and, maintaining and improving the trust of the financial institution, take active part in the decision-making process of the board of directors and in the supervision of business execution by directors? (2) Do the directors fulfill their good stewardship obligations and good faith obligations in the execution of business based on substantive discussions from the perspective of strengthening the institution's base of trust. (3) Does the board of directors position the formulation of corporate ethics, as defined by social responsibilities, public duties, and similar considerations, as a priority task and does it erect systems to achieve this? (4) Does the board of directors discuss, not only ways to promote business, but also compliance issues related to the management and operation of the institution? 	Note: "Compliance" and "laws and ordinances" refer to compliance with internal rules and regulations in addition the laws and ordinances listed in Section VI of this checklist.
	2. Minutes etc. of board of directors meetings	2. Creation and storage of the minutes of board of directors' meeting <ol style="list-style-type: none"> (1) Are there minutes kept of board of directors meetings? (2) Are the minutes of board of directors meetings stored for periods of time as specified by law? (3) Are base documents created showing the issues on the board of directors' agenda? (4) Are the documents described in the above question stored for the same period of time as the minutes of board of directors meetings? (5) Do the minutes of board of directors meetings and base documents record compliance-related decisions by the representative directors, and allow verification of the status of various risks and problems related thereto, and reports of improprieties and other problems? 	

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	3. Functions of board of auditors etc.	<p>3. Are the auditors and board of auditors assured of their independence and do they perform effective operational audits of the directors and audits of accounts? (In inspections of cooperative financial institutions, inspectors should be aware that cooperative financial institutions are only required to select external auditors in limited cases.)</p> <p>(1) Does at least one auditor attend meetings of the board of directors when compliance issues are on the agenda? It is desirable that a full-time auditor attend for financial institutions that fall under Article 18 Paragraph 2 of the Law Concerning Special Exceptions to the Commercial Code or the <i>mutatis mutandis</i> application thereof.</p> <p>(2) Is the board of auditors assured of its independence as intended by the law?</p> <p>(3) Does the board of auditors appropriately exercise the wide-ranging authority granted to it to perform operational audits in addition to accounting audits? Does the board of auditors have necessary and appropriate adjunct staff?</p> <p>(4) Are external auditors used to complement the functions of the board of auditors etc.? Does the institution use the services of law offices etc. when necessary?</p> <p>(5) Do auditors understand that they are still independent agents even when there is a board of auditors, and do they actively perform audits on their own personal responsibility?</p> <p>(6) Are there systems in place to enable the board of auditors to check that the findings of external audits by external auditors etc. are themselves appropriate and, if necessary, to take measures such as replacing external auditors etc?</p>	
	4. Check for basic compliance policies and standards	<p>4. Check for basic compliance policies etc.</p> <p>(1) Does the institution position compliance as one of its top managerial priorities? Has the board of directors formulated basic policies and standards for compliance practice?</p>	

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		<p>(2) Are all personnel fully aware of basic policies and compliance standards? For example, are documents such as those listed below (reference) available in directors' offices, in individual business departments, and in branch offices etc. (including foreign offices)?</p> <p>(3) Does the institution work in cooperation with the police and other relevant agencies to take a firm stand against antisocial elements?</p> <p>(4) Do the basic policies and compliance standards articulate specific, concrete behavioral guidelines and standards, not just ethical rules?</p> <p>Reference:</p> <p>“Keidanren Corporate Behavior Charter” and “Good Practice Handbook” (17 December 1996)</p> <p>“Federation of Bankers Associations of Japan: Bank Social Responsibilities and Compliance” (15 July 1997)</p> <p>“Federation of Bankers Associations of Japan: Ethics Charter” (9 September, 1997)</p> <p>“Compliance Issues and Responses for Regional Banks” (17 December 1997)</p> <p>“Compliance for Managers” (24 April 1998)</p> <p>“Checklist for the Erection of Compliance Systems” (Second Association of Regional Banks, 21 January 1998)</p> <p>“Compliance Guide for Bank Employees” (Second Association of Regional Banks, 15 April 1998)</p> <p>“Compliance Check Systems” (Second Association of Regional Banks, 16 September 1998)</p> <p>“National Association of Shinkin Banks: Social Responsibilities and Compliance at Shinkin Banks” (23 October 1997)</p> <p>“National Association Of Shinkin Banks: Ethical Guidelines for Shinkin Banks” (23 October 1997)</p> <p>“National Central Society of Credit Cooperatives: Social Responsibilities and Compliance at Credit Cooperatives” (National Central Society of Credit Cooperatives, December 1998)</p>	

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	5. Check for “specific actions as directors” related to compliance	5. Check of “director awareness” <ul style="list-style-type: none"> <li data-bbox="1454 270 2148 537">(1) Do the directors take the initiative in good-faith efforts to ensure compliance? Does the board of directors take responsibility for promoting high ethical and integrity standards, and for establishing a culture within the organization that emphasizes and demonstrates to all levels of personnel the importance of internal controls? <li data-bbox="1454 556 2148 1348">(2) Do the directors have specific programs for ensuring that employees understand compliance issues? <ul style="list-style-type: none"> <li data-bbox="1522 672 2148 834">1) Do the representative directors use the new year’s message, branch manager meetings, and other possible occasions to communicate the institution’s efforts to ensure compliance? <li data-bbox="1522 853 2148 1116">2) Do directors position the compliance department on par with profit center departments, ensure that it has appropriate staffing and adequate size, take an interest in its management, evaluate its results, and appropriately value its contributions in personnel evaluations? <li data-bbox="1522 1136 2148 1271">3) Do the directors themselves take fair, impartial, firm, rule-based attitudes towards internal and external compliance issues? <li data-bbox="1522 1290 2148 1348">4) Are compliance-related programs regularly evaluated? 	

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II. Formulation of compliance standards (behavioral rules)	Check for compliance manual	<p>(1) Has the institution formulated specific handbooks for the achievement of compliance? (These handbooks should explain the laws and ordinances to be adhered to, and provide specific means of dealing with any illegal actions discovered. Referred to as the “compliance manual” hereinafter.)</p> <p>Did the board of directors approve the content of the compliance manual when it was formulated and does the board of directors approve all major revisions?</p> <p>(2) Does the compliance manual contain the matters listed in Section V of this checklist?</p> <p>Is the content of the compliance manual appropriate and specific, reflecting the social responsibilities and public duties of banks as discussed in the “Federation of Bankers Associations of Japan: Ethics Charter” and other documents in the “Reference” materials above, and also reflecting the culture of the corporation?</p> <p>(3) Are all personnel fully aware of the existence and content of the compliance manual?</p> <p>(4) Is the content of the compliance manual reviewed and revised as appropriate?</p> <p>(5) Are legal checks performed when basic policies and compliance standards are formulated and revised? Are legal checks performed when new activities are initiated or new products launched?</p>	
III. Establishment of checks to determine if compliance systems are functioning adequately	1. Check for compliance program	<p>1. Does the board of directors approve the content of specific programs for the achievement of compliance (formulation of rules and regulations, internal checking and control programs, employee training and the like, referred to as the “compliance program” hereinafter) and any major revisions thereto?</p> <p>(1) Is the compliance program formulated at an appropriate time and in a rational manner? Is it formulated in yearly intervals at the longest?</p> <p>(2) Is there follow-up on the progress and achievement of the compliance program?</p>	

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		<p>(3) Are the responsibilities of the department in charge of the compliance program clear? Do the representative directors and board of directors measure and evaluate programs and achievement?</p> <p>(4) In formulating the compliance program, does the institution take account of the size and nature etc. of offices etc. and does it fairly reflect implementation of the program in performance evaluations and personnel evaluations?</p> <p>Rf: Excerpt from “Federation of Bankers Associations of Japan: Bank Social Responsibilities and Compliance” (15 July 1997)</p> <p>“3. Future efforts</p> <p>(1) Efforts by individual banks</p> <p>3) Establishment of compliance programs</p> <ul style="list-style-type: none"> • It is desirable that compliance programs be established in order to maintain steady compliance practices. These programs should focus on the functions of the three phases discussed above, adjusted for conditions at the individual bank. <p style="padding-left: 40px;">Phase 1: Initial check within the business divisions</p> <p style="padding-left: 40px;">Phase 2: Secondary check by independent division</p> <p style="padding-left: 40px;">Phase 3: Objective evaluation and auditing by external auditors etc.</p> <ul style="list-style-type: none"> • Heed should be paid to the following issues to ensure that compliance programs are effective. • Individual banks must take responsibility for their own compliance programs, and must exercise their creativity and innovation in tailoring programs to their business sector, size, and corporate culture. • The top management should take responsibility for formulating and implementing programs and there should be clear lines of accountability for their execution. 	

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		<ul style="list-style-type: none"> • Top management should be furnished with timely reports, and solutions should be sought whenever there are points for improvement discovered in internal controls, not just when an impropriety or illegality is discovered at some level.” 	
	<p>2. Check for “compliance environment”</p>	<p>2. Is there a system in place for centralized management of compliance and other legal affairs?</p> <p>(1) Have internal rules been formulated for systems to provide centralized management of compliance and other legal affairs?</p> <p>1) Does the institution have a department to oversee compliance? Has it clearly articulated the authority and role of this department?</p> <p>2) Are compliance personnel stationed appropriately in each business department and office?</p> <p>3) Is a system in place for dynamic response in the event that incidents occur?</p> <p>(2) Does the institution appropriately gather and manage information on legal affairs?</p> <p>1) Are there clearly articulated rules for communicating, reporting, and discussion etc. between the compliance department and business departments and offices?</p> <p>2) Are there ties and links between the compliance department and business departments and offices? Is a system in place for immediate reporting to the compliance department by compliance personnel in the event that problems are discovered?</p> <p>3) Do the competent directors have constant and accurate information on legal affairs?</p>	

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		<p>(3) Is the institution enhancing its compliance training systems?</p> <ol style="list-style-type: none"> 1) Are the representative directors and other competent directors actively involved in training, for example, as lecturers? 2) Does the institution provide compliance training, for example, rigorous training in the laws and ordinances to be complied with in specific areas of business? Does the institution provide compliance training suited to the individual level of the employee? 3) Does the institution encourage employees to accumulate the minimum legal knowledge required for specific business areas? <p>(4) Does the institution have a system in place for dealing with incidents and complaints?</p> <ol style="list-style-type: none"> 1) Does the institution have a record of complaints, customer requests, and the like? 2) Does the compliance department provide appropriate follow-up checking of complaints etc? 3) Does the institution have a system in place to confirm the facts regarding incidents, clarify the responsibilities of those involved, hold those involved accountable, and clarify supervisory responsibility for an incident? Are incidents investigated by a division that is independent of the division in which the incident occurred? Does the institution inform the police and other relevant agencies etc. in a timely manner of any facts that may impinge upon criminal statutes? <p>Are the directors and auditors involved in the formulation of plan to prevent the recurrence of incidents etc? Do they endeavor to ensure the effectiveness of these programs?</p>	

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		<p>4) Does the institution have a system in place for appropriate disclosure pursuant to the Securities and Exchange Law?</p> <p>(5) Does the institution engage in appropriate personnel rotation so that specific employees are not engaged in the same jobs in the same departments for prolonged periods of time?</p> <p>If specific employees must be engaged in the same jobs in the same departments for prolonged periods of time, does the institution have other appropriate measures to prevent incidents from occurring?</p> <p>(6) Does the institution have programs in place to require employees (including senior management) to stay away from their jobs for a minimum of one week a year for the purpose of preventing incidents? This might include continuous leave, training, internal reassignment, or any combination thereof.</p> <p>It is desirable that this period be at least two weeks.</p>	
<p>IV. Sanctions (punishments) for compliance violations, enforcement of compliance rules</p>	<p>Check for “compliance review system”</p>	<p>Does the institution have rules covering sanctions (punishments) for violations? Does it enforce these rules?</p> <p>(1) Should directors etc. be discovered to be in violation of applicable laws and ordinances, are there mechanisms in place to enable the other directors etc. to faithfully exercise the following authority as required by law, and to quickly make such response as is necessary to restore sound and proper operation?</p> <p>1) Directors</p> <p>a. Convene a meeting of the board of directors (Commercial Code Article 259)</p> <p>b. Report to the auditors (Commercial Code Article 274-2)</p> <p>2) Auditors</p> <p>a. Enjoin directors from committing illegal actions (Commercial Code Article 275-2)</p>	<p>Note: Laws referenced in (1) apply <i>mutatis mutandis</i> to Article 42 of the Small Business Law, Article 5-4 Paragraph 6 and Article 6-2 of the Cooperative Financial Institutions Law, Article 37 Paragraph 6 and Article 39 of the Shinkin Bank Law, and Article 39 Paragraph 6 and Article 42 of the Labor Banks Law.)</p>

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		<ul style="list-style-type: none"> b. Convene a meeting of the board of directors (Commercial Code Article 260-3, Paragraph 3 and Paragraph 4) c. Report to the board of directors (Commercial Code Article 260-3 Paragraph 2) d. Issue an opinion to the general meeting of shareholders (Commercial Code Article 275) e. Make notations in the auditors report (Commercial Code Article 281-3, Subparagraph 2:10) <ul style="list-style-type: none"> (2) Are directors aware of the mutual supervision obligation they incur as members of the board of directors, and do they take such actions as are required to faithfully discharge this obligation? (3) Does the financial institution hold accountable directors etc. and auditors etc. who have committed illegal actions? (4) Does the institution select for its auditors personnel who are able to exercise their authority independently? (5) Do auditors perform compliance audits? (6) Is there a system in place to report to directors when illegal acts are discovered? (7) Does the institution have rules in place regarding sanctions (punishments)? Does it enforce its sanction (punishment) rules rigorously and fairly? (8) Does the institution assign independent compliance officers to confirm compliance in business departments (including business offices etc.) that incur risks above a set threshold? (9) Do compliance officers function adequately? (10) Are there effective ties between departments responsible for compliance? 	

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V. Laws and ordinances etc. to be complied with by financial institutions and their managers	1. Outline of legal framework	1. Laws and ordinances regarding “financial institutions” (1) Laws 1) Banking Law 2) Long-term Credit Bank Law 3) Law Concerning Concurrent Operation of Trust Businesses by Financial Institutions 4) Foreign Exchange and Foreign Trade Control Law 5) Shinkin Bank Law 6) Small and Medium Business etc. Cooperative Unions Law 7) Law Concerning Financial Services by Cooperative Unions 8) Central Bank for Agricultural Cooperatives Law 9) Agricultural Cooperative Unions Law 10) Fishing Cooperative Unions Law 11) Forestry Law 12) Forestry Unions Law 13) Labor Banks Law 14) Credit Guarantee Society Law 15) Agriculture, Forestry, and Fishers Credit Union Law 16) Securities and Exchange Law 17) Law Concerning Foreign Securities Brokers 18) Securities Investment Trust Law 19) Insurance Industry Law 20) Investment Law 21) Money-lending Law 22) Investment Advisory Service Law 23) Mortgage-backed Securities Law 24) Commodities Fund Law	

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		<ul style="list-style-type: none"> 25) Real Estate Designated Cooperative Projects Law 26) Law Concerning the Regulation of Businesses Involved in Specific Credits etc. 27) Law Concerning Regulation of Pre-paid Certificates 28) Financial Futures Trading Law 29) Mutual Loan Association Law 30) Trusts Law (2) Government ordinances and regulations 2. Laws and ordinances related to joint-stock companies <ul style="list-style-type: none"> (1) Commercial Code Part 2 (2) Law Concerning Special Exceptions to the Commercial Code 3. Laws and ordinances related to “economic order and market order” <ul style="list-style-type: none"> (1) Anti-monopoly Law (2) Unfair Competition Prevention Law (3) Securities and Exchange Law (4) Commodities Exchange Law (5) Financial Futures Trading Law (6) Consumer Protection Law <ul style="list-style-type: none"> 1) Consumer Protection Basic Law 2) Interest Rate Restriction Law 3) Investment Law 4) Money-lending Law 5) Installment Sales Law 6) Door-to-door Sales Law 7) Law Concerning the Prevention of Pyramid Schemes 	

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		<p>4. Laws and Regulations Concerning “Financial Transactions”</p> <p>(1) Civil Code, Commercial Code, Bills Law, Checks Law</p> <p>(2) Special Malfeasance (Commercial Code Article 486 Paragraph 1), Malfeasance (Criminal Code Article 247), and Embezzlement (Criminal Code Article 253)</p> <p>(3) Interest Rate Restriction Law</p> <p>(4) Investment Law</p> <p>(5) Law Concerning Special Exceptions for Narcotics</p> <p>(6) Law Concerning the Regulation of Improper Contracts Related to Deposits etc.</p>	
	<p>2. Major laws and ordinances related to “bank management”</p>	<p>1. Capital increase rule violations (Commercial Code Article 280-2 and beyond)</p> <p>2. False disclosure (Banking Law Article 63 and Article 64, Financial Functions Revitalization Law Article 78 and Article 86, Securities and Exchange Law Article 197 and Article 207, Commercial Code Article 498)</p> <p>3. Window dressing, illegal dividends (Commercial Code Article 290, Article 496, Article 489)</p> <p>4. Violations of regulations on transactions with specific affiliated parties (subsidiaries etc.) (Banking Law Article 13-2)</p> <p>5. Violations of ban on concurrent service by directors (Banking Law Article 7 and Article 65)</p> <p>6. Violations of ban on other businesses (Banking Law Article 12 and Article 65)</p> <p>7. Reporting to supervisory authorities (Banking Law Article 53 and Article 63)</p> <p>8. Ban on relations with antisocial elements (providing benefits to <i>sokaiya</i>, Commercial Code Article 294-2, Article 497)</p>	

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		<p>9. Notification of dubious transactions (Law Concerning Special Exceptions for Narcotics Article 5 and beyond)</p> <p>10. Join actions regarding lending interest rates, collusion on deposit rates (Anti-monopoly Law Article 3)</p>	
	<p>3. Major laws and ordinances related to "money-lending"</p>	<p>1. Violations of restrictions on large lending (including lending for the purpose of circumvention) (Banking Law Article 13)</p> <p>2. Lending for illegal uses</p> <p>(1) Prostitution Prohibition Law Article 13 and beyond</p> <p>(2) Accessory if involved in any way with criminal activities (Criminal Code Article 62 and Article 60)</p> <p>(3) Violations of public morals (Civil Code Article 90)</p> <p>3. Lending in violation of authorization rules</p> <p>(1) Divided lending (loans to the same party but divided up into different names and formally loaned to different people in order to circumvent legal and internal restrictions)</p> <p>(2) Approval violations (loans made in violations of condition on approval)</p> <p>(3) Failure to seek approval (loans made without seeking approval even though approval is required)</p> <p>4. Loans to directors (Banking Law Article 14)</p> <p>(1) Loan conditions must not be disadvantageous to the bank compared to the conditions ordinarily placed on loans by the bank.</p> <p>(2) Board of directors requires a majority of a 2/3 quorum of directors.</p> <p>(3) Must be noted in business reports and mid-term reports (Banking Law Article 19)</p>	

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		5. Violations of interest-rate restrictions (Interest Rate Restriction Law etc.) 6. Improper use of office to secure lending (Investment Law Article 3, Criminal Code Article 253, Commercial Code 486) 7. Excessive insurance deposits, excessive loans secured with deposits (Anti-monopoly Law Article 19) 8. Favoritism in lending (Commercial Code Article 486)	
	4. Major laws and ordinances related to “deposit-taking”	1. Abuse of Maruyu deposit accounts (ineligible account holders, disqualified account holders, accounts in excess of deposit ceiling) (Income Tax Law Article 10) 2. Money laundering (failure to confirm identity—Foreign Exchange and Foreign Trade Control Law Article 18; notification by financial institutions of dubious transactions—Law Concerning Special Exceptions for Narcotics Article 5); Concealment and receipt of illicit profits etc.—Law Concerning Special Exceptions for Narcotics Article 9 and Article 10) 3. Provision of information to depositors etc. (Banking Law Article 12-2) 4. Introductory deposits (Law Concerning the Regulation of Improper Contracts Related to Deposits etc.) 5. Inappropriately referred deposits 6. Cooperative deposits using non-banks	
	5. Major laws and ordinances related to “ancillary businesses” <ul style="list-style-type: none"> • Securities business • Over-the-counter investment trust sales business • Foreign exchange business 	1. Securities business <ul style="list-style-type: none"> (1) Ban in improper solicitation (discretionary trading accounts etc.) (Securities and Exchange Law Article 42) (2) Ban on covering losses (Securities and Exchange Law Article 42-2) (3) Ban on fraudulent actions (Securities and Exchange Law Article 157, Article 158, Article 168, and Article 171) 	

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		<ul style="list-style-type: none"> (4) Ban on market manipulation (Securities and Exchange Law Article 159 etc.) (5) Ban on insider trading (Securities and Exchange Law Article 163 and 167) 2. Foreign exchange business <ul style="list-style-type: none"> (1) Confirmation obligations (Foreign Exchange and Foreign Trade Control Law Article 17 and Article 18) (2) After-the-fact reporting (Foreign Exchange and Foreign Trade Control Law Chapter 6-2) 	