(Provisional Translation)
April 16, 2013
Securities and Exchange Surveillance Commission

The Securities Inspection Policy and the Program for 2013

I. Securities Inspection Policy

1. Basic Direction

(1) Role of securities inspections

The mission of the Securities and Exchange Surveillance Commission ("SESC") is to ensure fairness and transparency of the Japanese capital and financial markets and to protect investors.

The objective of securities inspections for the achievement of this mission is to ensure investor confidence in the markets, through conducting on-site examination of the business operations and financial soundness of financial instruments business operators ("FIBOs"), and by urging them to conduct businesses in accordance with laws, regulations and market rules on the basis of self-discipline, and play the market intermediary function including duties as gatekeepers, in a proper manner.

Therefore, the SESC should, through securities inspections, examine FIBOs' compliance of laws and regulations, and verify the internal control systems behind individual problems.

The SESC will continue to take rigorous actions against illegal activities that undermine confidence in the fairness and transparency of the markets or impair investors' rights, by exercising its own authority and mobilizing all its human resources and capabilities, and will thus play a role in sending alerts to the markets.

(2) Environmental changes, surrounding securities inspection
—diversification and increase in the number of BOs—

As a result of a series of regulatory reforms, including the implementation of the Financial Instruments and Exchange Act ("FIEA"), business operators subject to inspection ("BOs") have diversified and they have increased to around some 8,000 in total. In addition, technological developments in finance, and prevalent cross-border transactions and international activities of market participants, such as investment funds, lead to more diverse and complex financial instruments and transactions being dealt by FIBOs.

In the wake of the recent global financial turmoil, authorities around the world have been making efforts to be able to ascertain the business and risks of entire financial groups. Under these circumstances, it is necessary to constantly monitor the groups' financial soundness as a whole for large-scale securities groups that engaged in complex business operations as a group.

It has become more important than ever to ensure the security of IT systems as a trading infrastructure, because individual investors have increased transactions via the Internet, and institutional investors have increased the execution of massive and complex transactions, using the systems that process a large volume of diverse and high speed orders.

In particular, a systems failure at a financial instruments exchange or FIBO could have a significant impact on the market and on customer transactions. Therefore, the IT system needs intensive verification in terms of the appropriateness of risk management.

(3) Challenges surrounding securities inspections

Recently, securities inspections have revealed cases of extremely serious violations of laws and regulations in succession with regard to market integrity and investor protection, such as the AIJ incident, a case in which the Japan Investor Protection Fund had to make compensations, and the insider trading cases concerning public stock offerings.

These cases caused serious damage to investors' confidence in the market intermediary function of FIBOs.

In the light of this circumstance, securities inspections need not only verify the compliance of individual laws and regulations, but also urge FIBOs to improve compliance posture and professional ethics in the course of business management and internal control activities, in order to recover investors' confidence in the market intermediary functions.

In addition, there have been many cases of illegal sales and solicitation of unlisted stocks and funds by unregistered business operators causing losses to personal investors and consumers, resulting in social problems in recent years. Therefore, as for unregistered business operators and persons making notification for business specially permitted for qualified institutional investors ("QII business operators"), committing violations of the FIEA, the SESC will need to continue to take rigorous action in close cooperation with relevant authorities to make full use of its faculty to file petitions for court injunctions and to conduct investigations therefor.

(4) Towards efficient, effective and viable securities inspections corresponding to the characteristics of the business operators subject to inspection

In order to adjust to environmental changes surrounding securities inspections such as diversification and the increase in the number of BOs, and in order to tackle the challenge of recovering investors' confidence in the market's intermediary function, the SESC needs to utilize limited human resources appropriately and effectively in order to conduct efficient, effective and viable inspections.

Toward this direction, it will be required to properly determine inspection priorities. Therefore, the SESC will further enhance its ability to identify potential problems with consideration of (i) the characteristics of diverse business types of FIBOs, (ii) the characteristics of customers, and (iii) the characteristics of increasingly complex and diverse financial instruments and transactions. Also, the SESC will strengthen its capabilities to collect and analyze information accordingly.

Furthermore, when determining inspection priorities for individual BOs, the SESC will collect and analyze a variety of information concerning them, corresponding to their business types, sizes, other characteristics and the market conditions at the time, and then utilize a risk-based approach to decide which BOs to inspect, considering their market positions and inherent problems in a comprehensive manner. In addition, with regard to the execution of inspections, the SESC also clarifies the scope of inspections and inspection measures according to its inspectorial targets and its issues.

As for business operators conducting discretionary investment management business ("DIM business operators"), the SESC will continue the Intensive Inspection starting last year based on the results of the sweeping surveys conducted by the Financial Services Agency (FSA).

On the other hand, it is pointed out that the situation where no securities inspections have been conducted for many of the small and medium-sized FIBOs for a long period of time constitutes a risk to investor protection. Therefore, it is necessary to increase the ratio of inspected BOs (the coverage of the inspection).

In addition, the SESC will conduct a broad and prospective review on how to conduct more efficient, effective and viable inspections, and continue working to strengthen its posture and capabilities.

2. Inspection Implementation Policy

(1) Focuses of verification corresponding to the characteristics of BOs

1) Verifications focused on business types and other characteristics

A. Verification of the market intermediary functions of FIBOs

In order to secure fair, transparent and high-quality financial and capital markets, it is extremely important for FIBOs to fully exercise their duties of gatekeepers in preventing market abuse by persons and entities from participating in financial and capital markets, through customer management, transaction surveillance, and underwriting examination. The SESC therefore focuses on verifying whether FIBOs fulfill these missions properly.

Specifically with regard to the revised Act on Prevention of Transfer of Criminal Proceeds on April 1, 2013, taking into consideration the importance of personal identification at the time of transactions and the appropriate reporting of suspicious transactions in terms of international cooperation in anti-money laundering and combating against terrorist financing, the SESC verifies whether FIBOs examine their customers' objectives of transactions and their occupations when a new account is opened, whether they properly conduct re-identification of customers when identity theft is suspected, whether they properly report suspicious transactions, and whether they have established systems for conducting these activities properly. The SESC will also, through information gathering, examine whether FIBOs have developed preventive measures against transactions with anti-social forces.

FIBOs play an important role in intermediary functions through the securities underwriting business by which enterprises can raise funds for business operations from investors in the market. The SESC will examine whether FIBOs properly engage in securities underwriting business, including underwriting examinations, information control, transaction surveillance and securities allotment from the perspective of the capital markets' integrity and investor protection. In particular, in connection with new listings, the SESC will verify whether examination systems appropriately function in underwriting public offering. In addition, as for FIBOs that arrange and distribute securitized instruments and high-risk derivatives products, their risk management systems and sales management systems will be examined.

B. Verification of the management of material non-public information (prevention of unfair insider trading)

In the wake of insider trading problems occurring in connection with public stock offerings, the SESC will focus on verifying whether FIBOs strictly manage material non-public information from the perspective of preventing unfair insider trading. Specifically, the SESC will verify whether FIBOs have developed viable management systems with regard to registration and information barriers (e.g. Chinese wall) of such material non-public information as public stock offerings of listed companies, surveillance of insider transactions, and prevention of any improper distribution and misuse of information.

C. Verification of measures against conduct that may hinder fair pricing

The SESC will verify whether there are any practices that could hinder fair pricing by means of direct and/or brokered orders, and further examine the transaction surveillance systems of FIBOs to prevent such practices. In doing so, the SESC will verify whether viable transaction surveillance is conducted from the viewpoint of preventing unfair trading. In particular, the SESC will examine whether surveillance is focused on specific dates, such as the pricing date for public stock offering, and on specific trading timing, such as just before closing, or on specific customers who repeatedly place large orders that could affect pricing in the market, as well as whether measures are taken to identify the original customers for orders consigned from foreign-related entities. The SESC will also examine management systems, including the management of delivery failures, for short selling regulations (such as checking the indication of short selling, price regulations, the prohibition of naked short selling, and the obligation to deliver documents related to public stock offering).

As far as FIBOs with online trading or electronic facilities for DMA (direct market access) are concerned, in view of the cases of revelation of market manipulation by means of *misegyoku* (false orders to manipulate prices) using Internet transactions, the SESC will examine whether FIBOs have established viable trade surveillance systems based on the peculiarities of electronic transactions, such as customer orders feeding directly into the market.

D. Verification of the solicitation for investment

In order to protect investors and secure genuine and fair sales and solicitation operations, the SESC will focus on verifying whether FIBOs solicit customers for investment in an appropriate manner and take good care of them.

Regarding verification of solicitation for investment, the SESC will verify, from the viewpoint of the principle of suitability, whether FIBOs are appropriately soliciting investment in light of customers' knowledge, experience, and assets, as well as investment purpose, and whether they are fully held accountable for their solicitation in accordance with the characteristics of individual customers.

In particular, the SESC will also examine whether, upon sales and cancellations, including switching of investment trusts, appropriate explanations are provided regarding important information that affects customers' investment decision-making, such as product characteristics, risk characteristics, profits/losses, dividends, commissions, and investment trust fees.

For the sale of over-the-counter ("OTC") derivatives products and complex structured bonds similar to OTC derivatives products, the SESC will examine whether appropriate explanations are provided regarding important risks and other factors that affect decisions for investment in such products, including the probable maximum losses and the settlement money on cancellation.

In addition, the SESC will verify whether widely exposed advertisements to investors include any misleading indications regarding investment returns, market factors and the state of orders. The SESC will also examine the establishment of the troubleshooting system important for investor protection.

E. Verification of the appropriateness of business and legal compliance of IMBOs

While investment management business operators, etc. ("IMBOs") are entrusted fund managements for investors' interests, it is very difficult for the investors to directly monitor how their assets are being managed. Therefore, from the viewpoint of investors protection, the SESC will examine IMBOs' compliance with relevant laws and regulations, including the fiduciary duty of loyalty and due care of a prudent manager, and the viability of their systems for managing conflicts of interest in relation to transactions with interested parties and the due diligence function.

The inspection conducted in FY2011 revealed a case in which some DIM business operators, entrusted with the discretionary investment management of corporate pension funds, provided false explanations with regard to solicitation for conclusion of discretionary investment management contracts, and also delivered customers with investment reports containing false details, thereby violating its fiduciary duty of loyalty and harming the interests of the corporate pensions. Therefore, based on the results of FSA's sweeping surveys on DIM business operators, the SESC has been conducting Intensive Inspections on DIM business operators in cooperation with the supervisory

Bureau of FSA since FY2012.

In conducting the Intensive Inspections, the SESC has strengthened its systems for collecting and analyzing information on pension fund management by setting up the dedicated channel for collecting significant and useful information from external sources (Pension Investment Hotline), with assigned specialists in pension fund management.

Active approaches by the specialists to information providers etc., their interactive method of collecting information and their high-quality analyses are viable for placing the priority on inspections and clarifying the focus in inspections. Therefore, the SESC will reinforce these efforts to conduct more effective and efficient inspections.

F. Verification of the business management systems of CRAs

The SESC will verify whether credit rating agencies ("CRAs") have established business management systems, and whether they have appropriately disclosed information relating to their rating policies from the perspective of preventing conflicts of interest and preserving the fairness of the rating process.

G. Verification of FBOs' compliance with laws and regulations

Regarding business operators engaging in the fund management and sales of interests of collective investment schemes (funds) (meaning IMBOs engaged in self-management business and Type II FIBOs, including QII business operators; "FBOs"), inspections have revealed many cases of legal violations, such as failure in segregation management of funds (misappropriation of funds and unexplained expenditure), false explanations and notices, misleading indications, name-lending to unregistered business operators, and QII business operators selling and managing funds without satisfying the conditions for specially permitted businesses of registering themselves. In light of these circumstances, the SESC will examine FBOs' compliance with laws and regulations, including the appropriateness of business operations and the segregation in fund management.

Furthermore, with regard to QII business operators, securities inspections have identified malicious cases in which some operators committed violations of the FIEA and other wrongdoings. The SESC will make proper use of its authority to conduct securities inspections and investigations necessary to file petitions for court injunctions, etc. If violations of the FIEA or acts impairing investor protection are confirmed in the securities inspections or investigations, the SESC will file petitions for injunctions and/or publicize the names of the inspected or investigated entities, the names of their representatives, acts of violation of laws and regulations, etc., where necessary.

H. Verification of compliance with laws and regulations by investment advisors/agencies

Regarding investment advisors/agencies, many cases of legal violations have been identified in inspections, including engagement in unregistered businesses, name lending to unregistered business operators and inappropriate provision of information to customers, due to a remarkable lack of basic legal knowledge and sense of legal compliance among their officers and employees. In view of these cases, the SESC will focus on examining their compliance with laws and regulations.

I. Verification of the functions of SROs etc.

As for self-regulatory organizations ("SROs"), the SESC will examine capabilities and functions of self-regulatory operations, as well as their systems necessary for exercising their functions properly. Specifically, the SESC will conduct verification with regard to the establishment of self-regulatory rules for their members, their regulatory enforcement, such as on-site and off-site reviews, and penalties, listing examination and transaction surveillance. In conducting verification of listing examination, the SESC will also look into the SROs' on-going measures to thwart participation of anti-social forces in the financial and capital markets, including the collection of information on the involvement of anti-social forces in issuing companies and listed companies.

As for financial instruments exchanges, clearing houses, depository trust institutions, etc., in consideration of the "Principles for Financial Market Infrastructures" finalized by the IOSCO, the SESC will examine the development of their systems, such as IT system risk management, in order to verify whether they are well prepared to function as financial market infrastructure.

J. Dealing with unregistered BOs

To deal with serious FIEA violations, such as sales and solicitations of unlisted stocks and funds by unregistered BOs, the SESC will strengthen ties with supervisory departments and investigative authorities, and, where necessary, will make proper use of its authority to conduct investigations necessary to file petitions for court injunctions. If such conducts are confirmed as violating the FIEA or impairing investor protection, the SESC will file petitions for injunctions etc., and publicize the names of unregistered business operators, the names of their representatives, facts of violation of laws and regulations, and other relevant information.

2) Verification of internal control systems and financial soundness

A. Verification of internal control systems

In the case where an inspection shows problems related to business operations, the SESC will endeavor to comprehend the whole picture of problems by examining the appropriateness and viability of the internal control systems and risk management systems ("internal control systems etc."). In examining internal control systems etc., the SESC will pay attention to the engagement and commitment of the senior management and concerned parties in the system management.

In particular, as for large-scale securities groups engaging in complex business operations as a group for which establishing internal control systems, etc. is considered to be important given their market position and business characteristics, the SESC will constantly monitor the status of the group's business operation and financial situation as a whole, put weight on the appropriateness of their internal control systems, etc., from a forward-looking viewpoint, and make inspections according to the introduction of consolidated regulations and the supervision of securities companies.

B. Verification of IT system risk management

In recent years, FIBOs have become increasingly dependent on IT systems in their business operations. At the same time, online participation in securities transactions and FX trading have become usual among individual investors, and the volume of transactions handled by the Proprietary Trading System ("PTS") has increased. Accordingly, IT systems are important infrastructures of financial transactions.

Under these circumstances, it is very important to secure the stability of IT systems and establish crisis management measures from the viewpoint of protecting investors and ensuring public confidence in the market and FIBOs. The SESC will examine the appropriateness and viability of management systems for the IT systems risk preventive measures, and the efficacy of business continuity plans, including erroneous order placement prevention, IT systems troubleshooting, information security management, and outsourcing management. The SESC will also verify the engagement of senior management in the development of the IT systems risk management.

C. Verification of financial soundness

Inspections of Type I FIBOs have shown cases that seem attributable to deterioration of financial condition, such as the misappropriation of the Trusts for the Separate Management of Money and Securities ("TSMMS") and the Trusts for the Segregated

Management of Cash Margins and Other Deposits ("TSMCM"), and the defection in net assets and capital adequacy ratios against statutory requirement. The SESC will focus its examination on the status of TSMMS and TSMCM, and the status of net assets and capital adequacy ratios in close corporation with the supervisory department, the Japan Securities Dealers Association, and the Japan Investor Protection Fund.

(2) Implementation of efficient, effective and viable inspections

1) Risk-based prioritization of the inspection reflecting business type and other characteristics

The SESC will take on a risk-based approach in selecting which BOs to inspect based on the following viewpoints in principle, taking into account the business types, sizes and other characteristics of the business operators subject to inspection, and adjusting to the market condition at the time.

When cross-sectoral issues in the market have been identified, the SESC will flexibly conduct special inspections, as needed, on the BOs facing the same issues.

Prior to the onset of the inspection of individual BOs the SESC will identify issues to be examined, and will conduct inspections focused on them.

A. BOs to inspect on a regular basis

Type I FIBOs (including registered financial institutions) conduct transactions with a large number of investors including individual investors, thereby playing a central role in the market, and IMBOs are entrusted with fund management for investors' interests. The SESC will, in principle, conduct regular inspections on Type I FIBOs and IMBOs in view of their positions to play central roles in the markets, and verify their financial soundness and the appropriateness of their business operations.

CRAs assign credit ratings highly influential on the investors' decision-making, and publish and widely provide them to users. The SESC will, in principle, conduct regular inspections on CRAs and verify their business management systems in light of their roles as information infrastructure in the financial and capital markets and in view of the purpose of the international financial regulatory reform.

In effect, however, due to the severe human resource constraint at the SESC, it would be difficult to conduct regular inspections uniformly across all the above business types. The SESC will take a flexible approach in deciding the frequency and the scope of inspection of each business type, while endeavoring to grasp its overall circumstances in close cooperation with supervisory departments.

In particular, the SESC will continue to conduct the Intensive Inspections on DIM business operators as described in (1) 1) E above.

The SESC will select BOs to inspect through actively collecting and analyzing information provided by supervisory departments and external sources, and at the same time, taking into account changes in the market conditions, the position in the market, and inherent problems of individual BOs in a comprehensive manner.

B. BOs to inspect as needed

With regard to Type II FIBOs, Investment Advisors/Agencies, Financial Instruments Intermediaries, etc., given their business types, sizes and other characteristics, and the situation where the number of BOs is extremely large compared with human resources of the SESC, the SESC will select BOs to inspect individually through actively utilizing information provided by supervisory departments and external sources, taking into account their membership in SROs and status of compliance with laws and regulations.

With regard to these BOs, the SESC will introduce new measures to check the setup status of their operational systems as early as possible after their registration.

Furthermore, with regard to QII business operators, the SESC will actively utilize information on compliance status with laws and regulations, information provided by supervisory departments and external sources to select QII business operators to inspect individually, and will make proper use of its authority to conduct securities inspections and investigations necessary to file petitions for court injunctions.

C. Unregistered business operators

In order to deal with serious FIEA violations by unregistered BOs, the SESC will, as necessary, select BOs to inspect individually as in B above, while assessing the effect of the November 2011 amendment of the FIEA to repeal illegal sales and contracts, and appropriately conduct investigations necessary to file petitions for court injunctions.

2) Implementation of viable inspection

A. Inspection with prior notice

The SESC initiates inspections without prior notice in principle. The SESC, however, will give prior notice to specific BOs, where necessary, taking into full account the characteristics of their businesses, the focuses and the efficiency of inspection, and the reduction of burden on the inspected BOs in a comprehensive manner.

B. Enhancement of interactive dialogue

The SESC will endeavor to share its recognition of problems in business operation through interactive dialogue with the inspected BOs. In particular the SESC will ascertain their perception of the senior management team responsible for the development of internal control systems, etc. through exchange opinions, and encourage them to make voluntary efforts for improvement.

C. Rigorous actions against conduct hindering the efficacy of inspections

On one hand, most BOs gain a better understanding of the importance of interactive dialogue in inspections, but on the other, some BOs refuse inspection and make other conduct hindering the efficacy of inspections. The SESC will take rigorous actions against such conduct in order to completely fulfill its mission.

3) Enhancement of cooperation with the FSA and Local Finance Bureaus

The SESC will strengthen the cooperation with supervisory offices of the FSA and Local Finance Bureaus in the Ministry of Finance by sharing information and recognition through timely exchanging useful information between supervision and inspection. Furthermore, for large-scale securities groups that engage in complex business operations as a group, the SESC will seek seamless cooperation between its on-site inspections and the supervisory departments' off-site monitoring.

With respect to the relationship with the Inspection Bureau of the FSA, in order to share common awareness of the issues and to implement effective inspection on entities within the same financial business group, the SESC will, where necessary, collaborate and exchange information with the Inspection Bureau in initiating inspections of entities constituting a financial conglomerate.

The SESC will strengthen cooperation with overseas securities regulators through exchange of necessary information and the coordination of implementation of inspection with regard to inspections on foreign-owned business operators operating in Japan, Japanese business operators with overseas offices, foreign business operators operating overseas for Japanese investors, and Japanese business operators with overseas business connections. In addition, the SESC will appropriately cooperate with major overseas securities regulators with regard to the inspection on CRAs and to its participation in supervisory colleges established for large-scale global-based securities companies.

Given the identified cases of fraudulent practices by FBOs as well as the sale and solicitation of unlisted stocks and funds by unregistered business operators, the SESC will strengthen its cooperation with the supervisory departments and police and prosecutors.

4) Cooperation with SROs

With respect to relationship with the SROs, the SESC will further enhance coordination between its own inspection and the SROs' audits and examinations on their members so as to improve all the functions of the oversight activities over FIBOs. From this perspective, the SESC will promote cooperation with the SROs, through coordination for inspection programs, information exchange and training programs.

5) Revision and publication of the Inspection guideline and the Inspection Manual

From the perspective of rigorous action against conduct hindering the efficacy of inspections as well as more efficient and effective inspections, the SESC will revise both the Securities Inspection Guideline, which stipulates the procedures and other fundamental matters for inspections, and the Inspection Manual for FIBOs in accordance with regulatory reforms. The SESC will publish updated guidelines and manuals so as to improve the transparency and predictability of its inspections.

This Inspection Policy has been prepared based on the situation surrounding the markets as of April 2013, and is subject to revision as necessary.

II. Securities Inspection Program

1. Basic Concept

(1) The SESC formulates the Inspection Implementation Program in accordance with the Inspection Implementation policy in line with the above Securities Inspection Policy. It should be noted that exceptional action may be taken in response to any changes in market conditions and/or factors related to specific BOs.

(2) In conducting inspections, the SESC and all the Securities and Exchange Surveillance Departments of Local Finance Bureaus in the Ministry of Finance ("the SESDs") will conduct efficient and effective inspections together, concerning how to actively use joint inspections and inspections exchange. The SESC will also work together with the SESDs, and support them by sharing inspection techniques and information, and the processing of

inspection results.

2. Basic Securities Inspection Program

Type I FIBOs (including Registered Financial Institutions), IMBOs, and CRAs	150 companies (110 out of 150 to be inspected by the SESDs) (including the Intensive Inspections of DIM Business Operators)
Type II FIBOs, Investment Advisories/Agencies, QII Business Operators, and Financial Instruments Intermediaries, etc.	To be inspected based on individual information and condition
SROs etc.	To be inspected as necessary
Unregistered Business Operators	To be inspected as necessary

Note: The above numbers of inspections are subject to change due to revisions of the Inspection Program within the year and/or implementations of special inspections.