

Overview of Japan Exchange Group and recent developments in Japanese capital market

1 October 2015

Japan Exchange Group, Inc.



Establishment of JPX

- The January 2013 merger combined the complementary strengths of TSE and OSE in the cash equity and derivatives markets.
- JPX aims at market expansion and improved efficiency to improve user convenience and raise competitiveness.



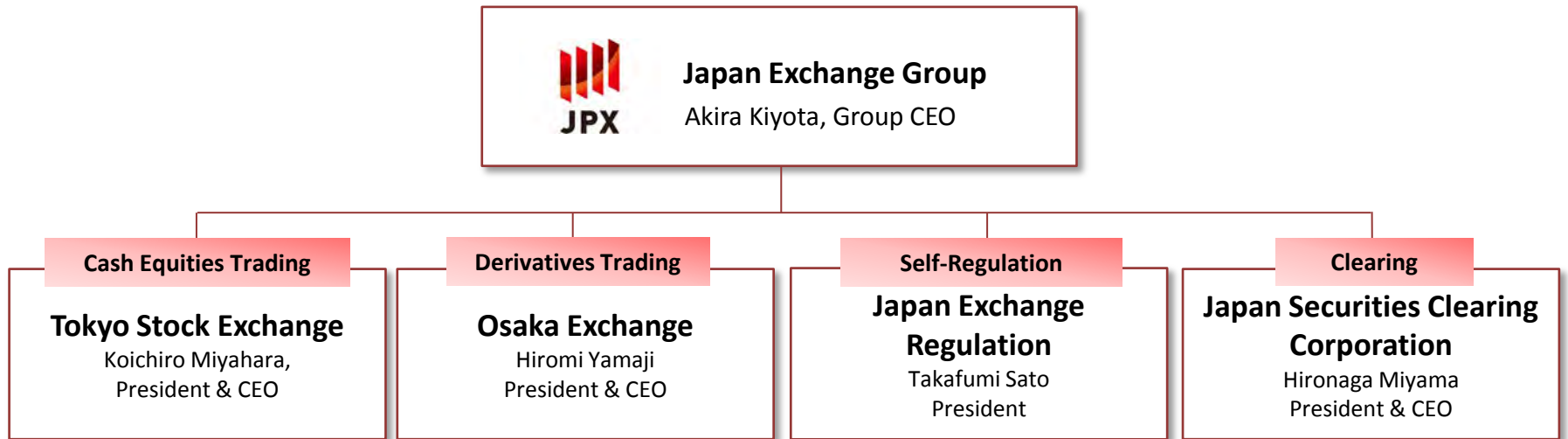
【Tokyo Stock Exchange Group】

- A global leader boasting a comprehensive exchange centered on the TSE 1st Section, TOPIX futures and JGB futures
- Vertically integrated group offering listing, trading, and clearing & settlement services
- Dominant domestic stock market with strong brand image



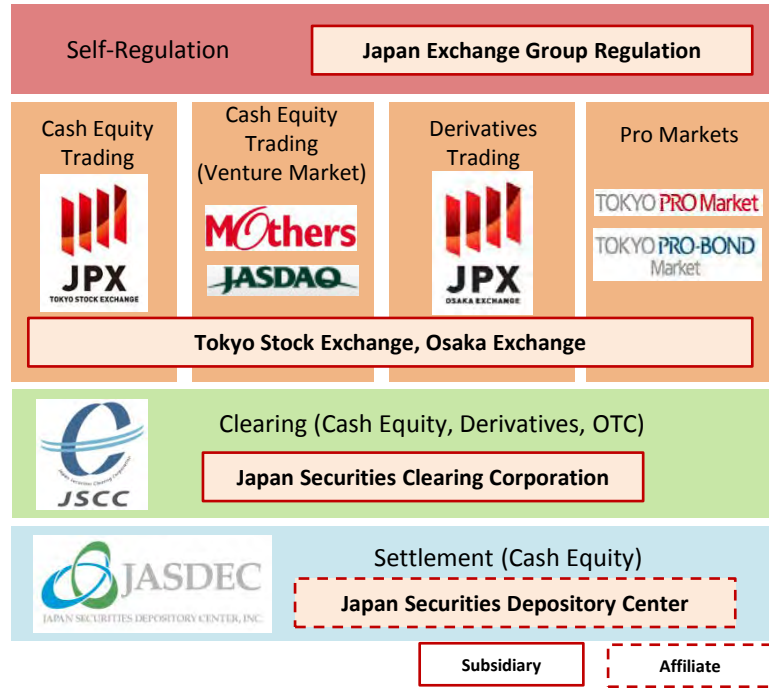
【Osaka Securities Exchange】

- Largest derivatives market in Japan with leading Nikkei 225 futures and options
- Operates the JASDAQ venture market
- Japan's only listed exchange



- Change in trade/corporate names : Osaka Securities Exchange → Osaka Exchange (March 24, 2014),
Tokyo Stock Exchange Regulation → Japan Exchange Regulation (April 1, 2014)

Markets and Products on JPX



Cash Equity Market (Tokyo Stock Exchange)

<p>More than 3,400 Issues</p> <ul style="list-style-type: none"> ■ 1st Section (blue chips) ■ 2nd Section ■ Markets for Emerging companies ■ Market for Professionals <p>JASDAQ Mothers TOKYO PRO Market TOKYO PRO-BOND Market</p>	<p>ETF/ETNs 217 Issues</p> <p>REITs 53 Issues</p> <p>Listed Infrastructure Funds (planned)</p>
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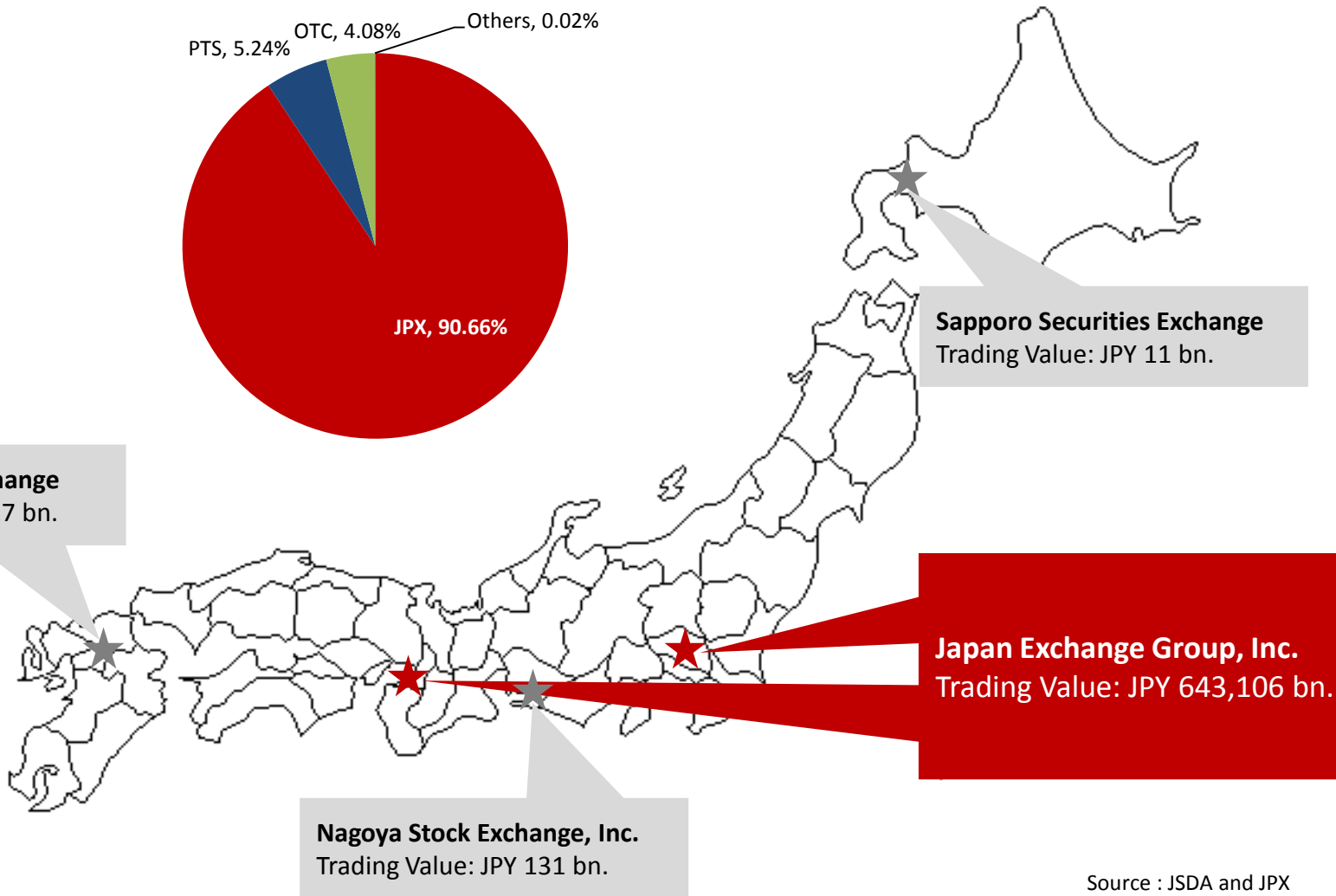
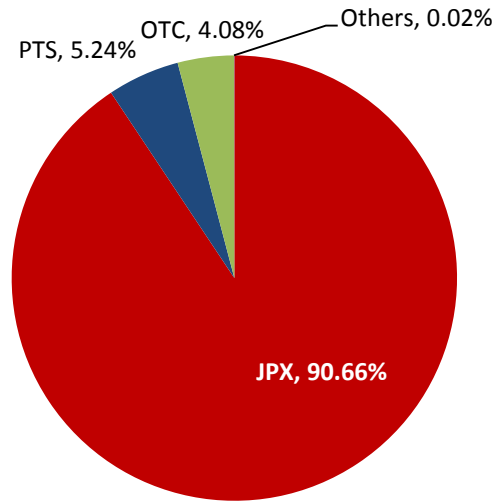
Derivatives Market (Osaka Exchange)

<p>Equity Derivatives</p> <ul style="list-style-type: none"> ■ TOPIX Futures / mini ■ Nikkei 225 Futures / mini ■ Nikkei/Dividend Futures ■ JPX-Nikkei 400 Futures ■ TOPIX Options ■ Nikkei 225 Options ■ Equity Options etc. 	<p>Fixed-Income Derivatives</p> <ul style="list-style-type: none"> ■ JGB Futures (5/10/20yr) ■ Mini-JGB Futures (10yr) ■ Options on 10-yr. JGB Futures etc.
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As of the end of Aug. 2015

Securities Markets in Japan (2014)

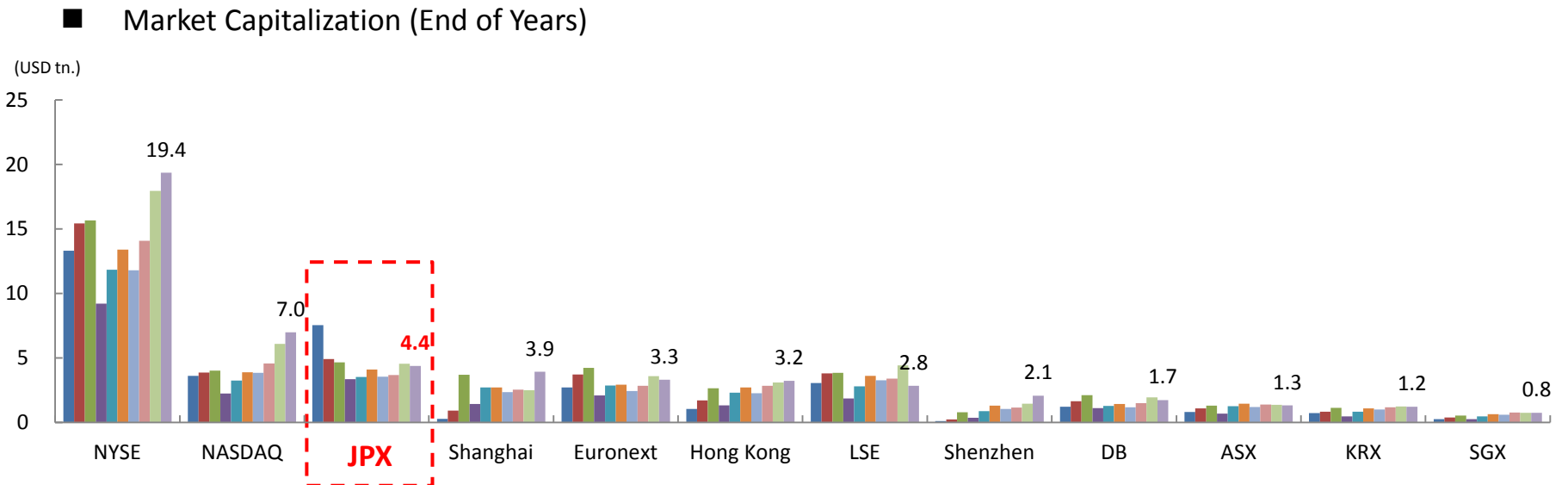
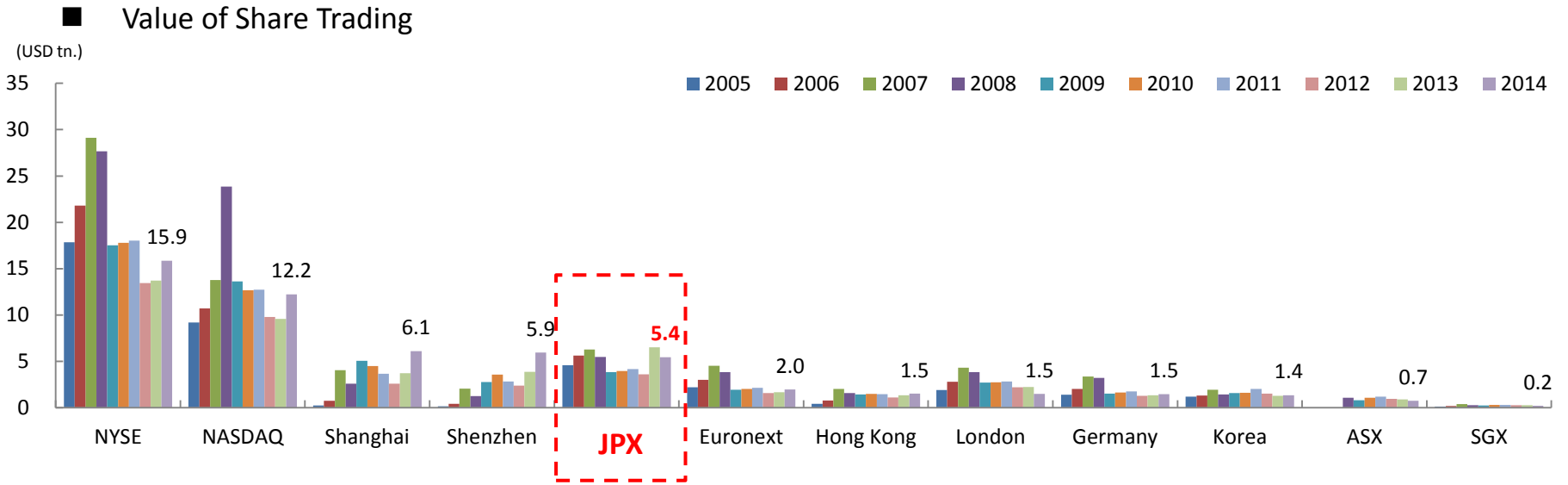
- There are 4 exchanges and 2 PTSs in Japan.
- JPX occupies more than 90% of market share.



Source : JSDA and JPX



JPX's Position in Relation to Major Exchanges (Cash Equity)



JPX's Position in Relation to Major Exchanges (Derivatives)

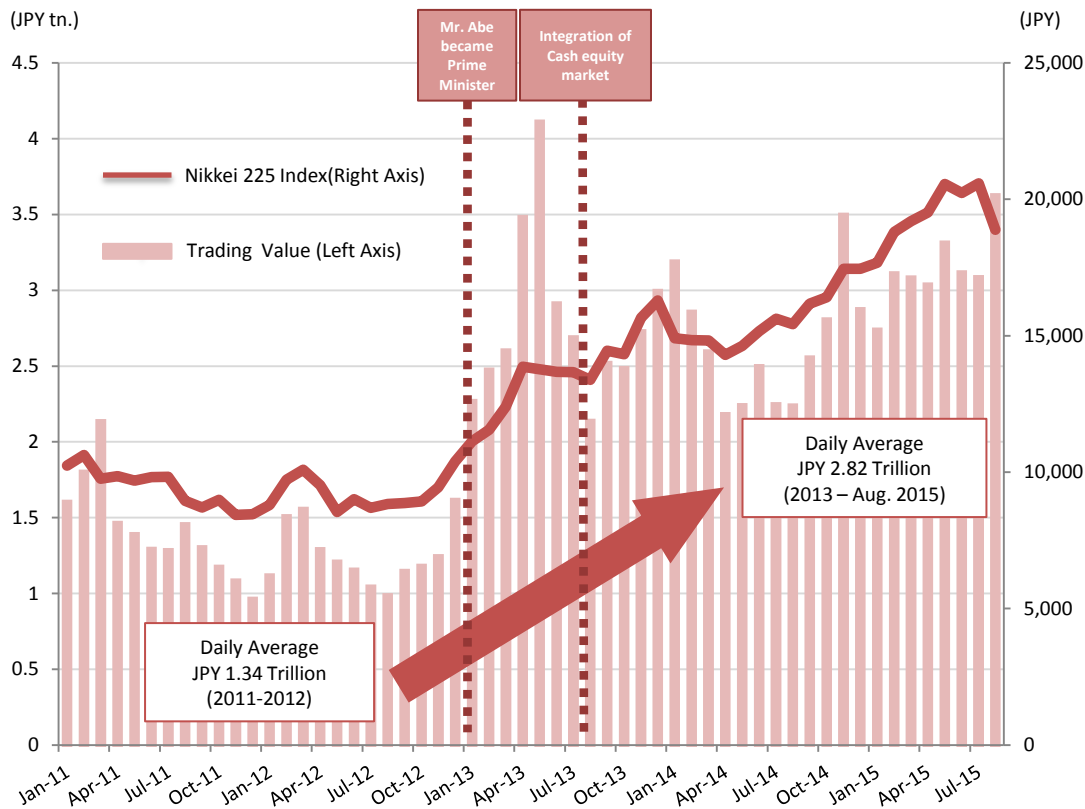
Rank	Exchange	Region	2014 Volume
1	CME Group	North America	3,442,766,942
2	Intercontinental Exchange	NA / Europe	2,276,171,019
3	Eurex	Europe	2,097,974,756
4	National Stock Exchange of India	Asia	1,880,362,513
5	BM&FBovespa	Latin America	1,417,925,815
6	Moscow Exchange	Europe	1,413,222,196
7	CBOE Holdings	North America	1,325,391,523
8	Nasdaq OMX	North America	1,127,130,071
9	Shanghai Futures Exchange	Asia	842,294,223
10	Dalian Commodity Exchange	Asia	769,637,041
11	BSE	Asia	725,841,680
12	Korea Exchange	Asia	677,789,082
13	Zhengzhou Commodity Exchange	Asia	676,343,283
14	Hong Kong Exchange & Clearing	Asia	319,577,388
15	Japan Exchange	Asia	309,732,384
16	JSE Securities Exchange (South Africa)	Other	304,003,143
17	ASX Group	Asia	244,070,858
18	China Financial Futures Exchange	Asia	217,581,145
19	Taiwan Futures Exchange	Asia	202,227,653
20	BATS Exchange	North America	201,985,667

Source : FIA

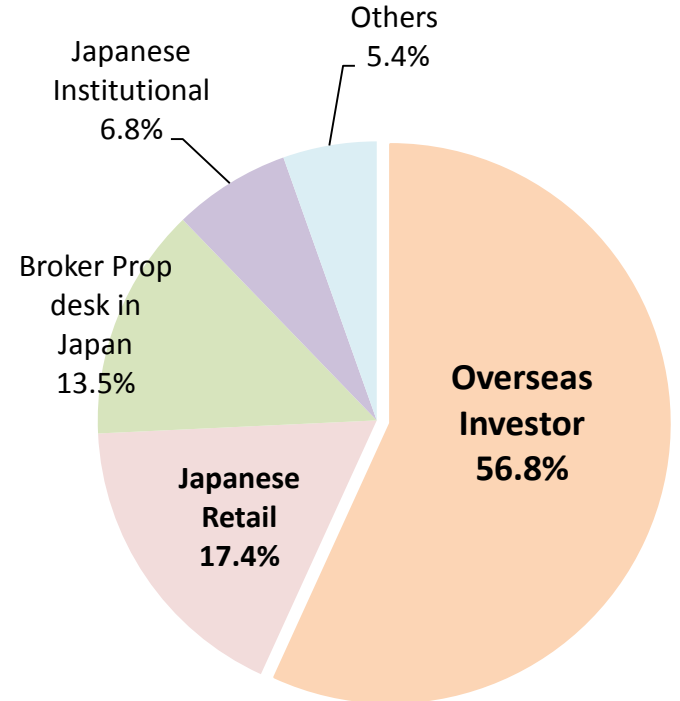
Cash Market - Trading Volume -

- Average Daily Trading Value more than doubled in 2013- Aug.2015 vs. 2011-2012.
- Overseas investors have had the highest participation in Japanese market but the retail participation ratio has rebounded after 'Abenomics'.

**Daily Average Trading Value of Cash Equity Market
(Jan. 2011 – Aug. 2015)**



**Trading Value by Investor type in 2014
(TSE 1st Section)**

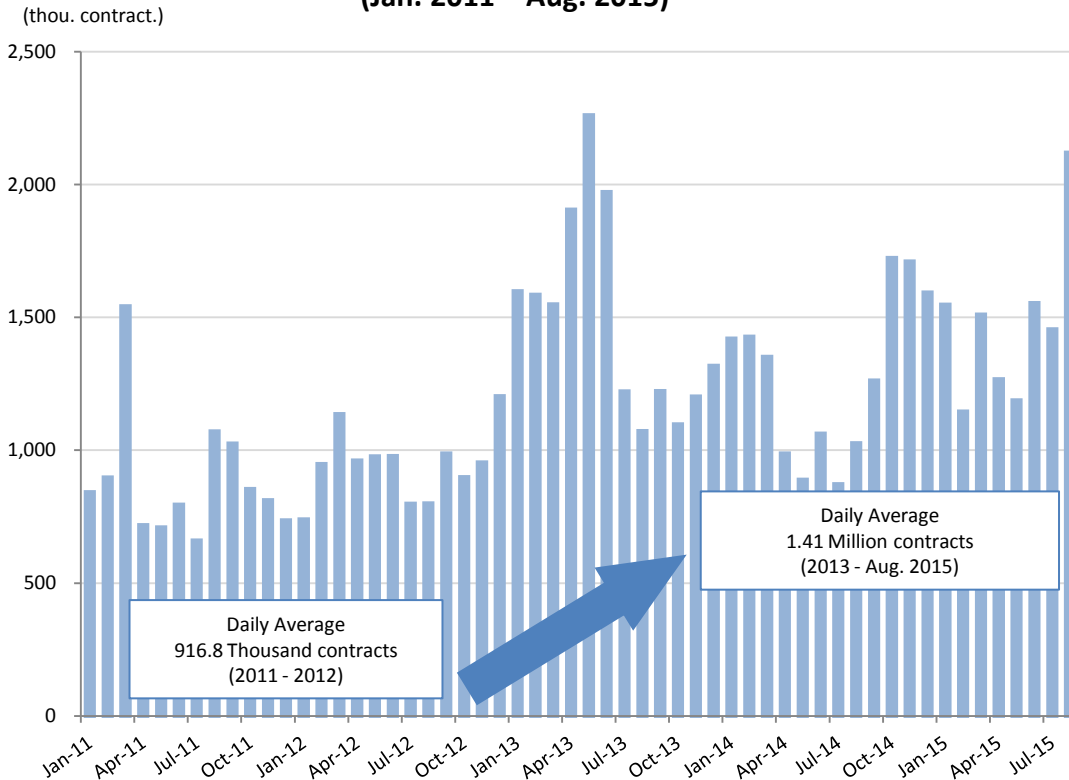


Derivative Market - Trading Volume -

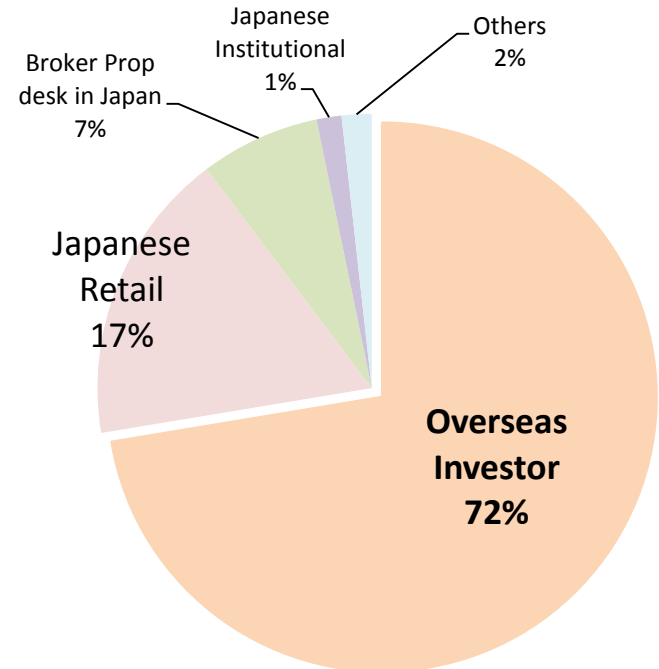
- Consolidated derivatives markets under OSE (Mar. 24, 2014)
- Facilitated trading of a wide range of derivatives products on a single platform
- Launched Nikkei 225 Weekly Options (May 2015)
- Trading Participants in OSE: 84 securities firms, and 27 banks

(* Banks trade Government bond futures and Government bond futures options only.)

**Daily Average Contract of Derivatives Market
(Jan. 2011 – Aug. 2015)**



**Trading Value by Investor type in 2014
(Index Futures* in OSE Market)**

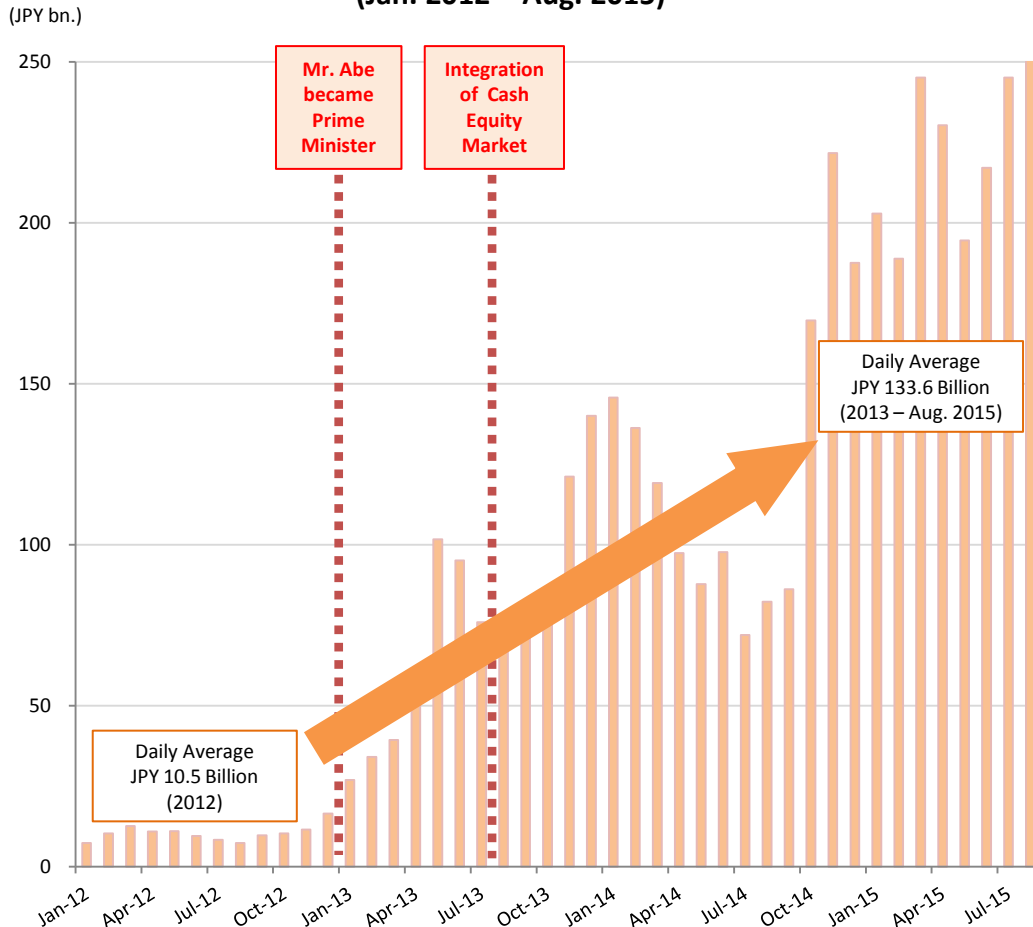


*Nikkei225 Futures, Nikkei225 mini Futures, TOPIX Futures and mini-TOPIX Futures

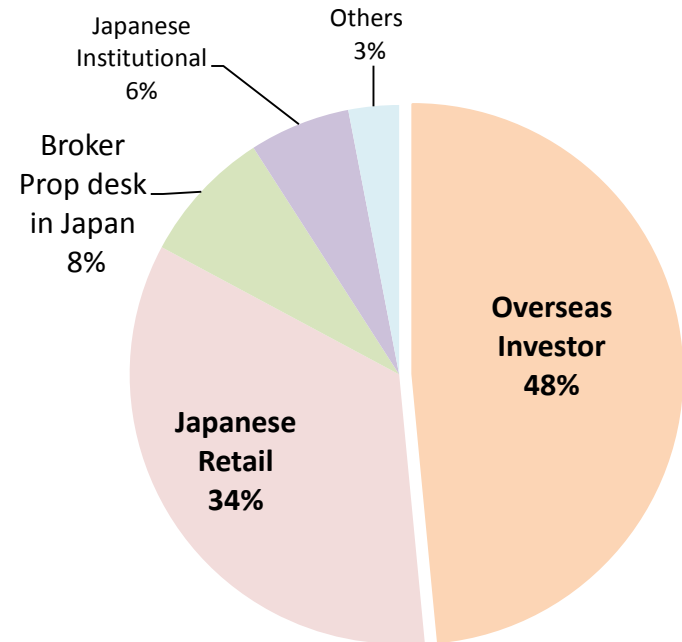
Increasing Trading Value of ETF/ETN products

- Trading value of ETF/ETN market increased dramatically after 2013.
- The Retail ratio for TSE ETF market is higher than the ratio for the TSE 1st section.

Daily Average Trading Value of ETF/ETN Market (on auction)
(Jan. 2012 - Aug. 2015)



Trading Value by Investor type in 2014
(ETF/ETN market)

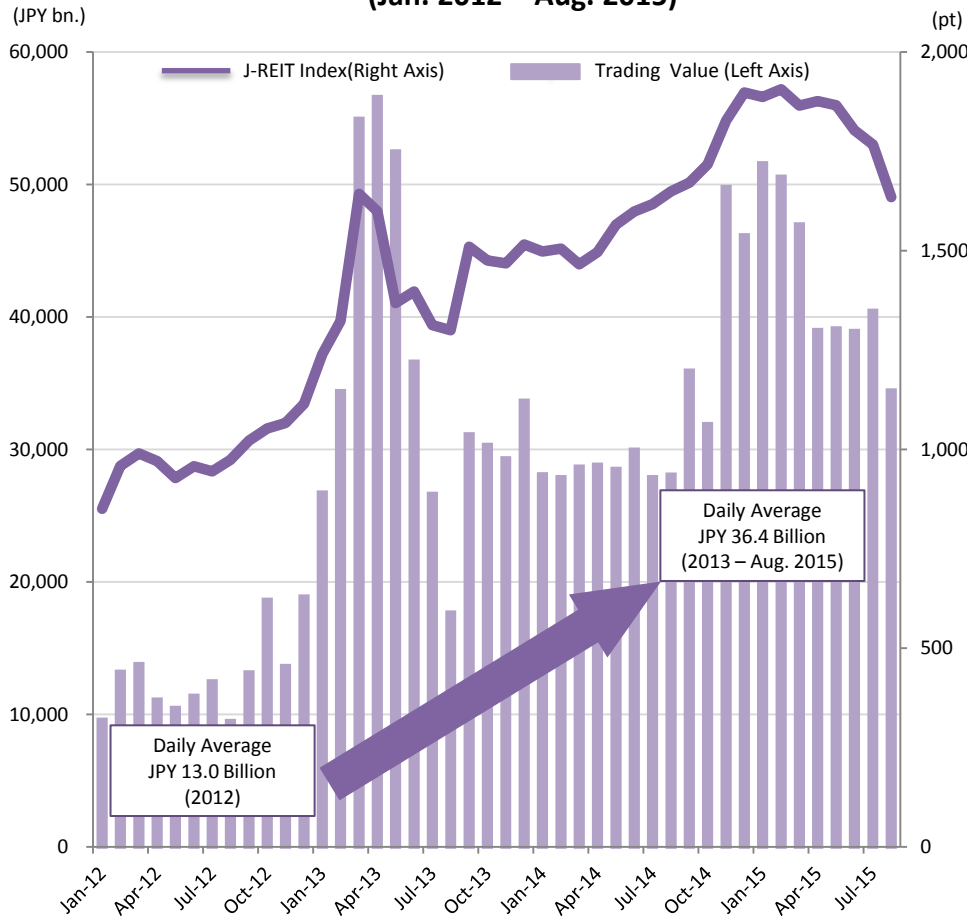




Increasing Trading Value of REIT products

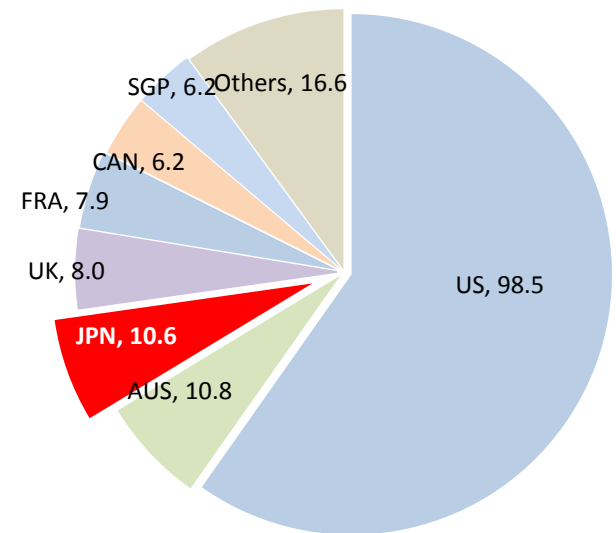
- The improving real estate market has contributed to a 280% jump in average daily trading value since Jan, 2013.
- AUM has also increased rapidly, making the JPX J-REIT market the third largest REIT market in the world.

**Daily Average Trading Value of REIT Market
(Jan. 2012 - Aug. 2015)**



Source: JPX

Market Cap (as of Dec, 2014)



Source: Bloomberg



These materials are prepared solely for the purpose of providing information regarding Japan Exchange Group Inc., and as such, they are not intended as any offer or sale of securities or other similar action whether inside or outside Japan. Our securities have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act"), and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

These materials contain forward-looking statements. These statements are based on our assumptions and beliefs in light of the information currently available to us and are subject to risks and uncertainties. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results may vary materially from those we currently anticipate. Given these risks and uncertainties, you are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of these materials. We disclaim any obligation to update any of the forward-looking statements contained in these materials to reflect future actual events or developments.

Listing Examination

Oct, 2015
Department of Listing Examination
Japan Exchange Regulation

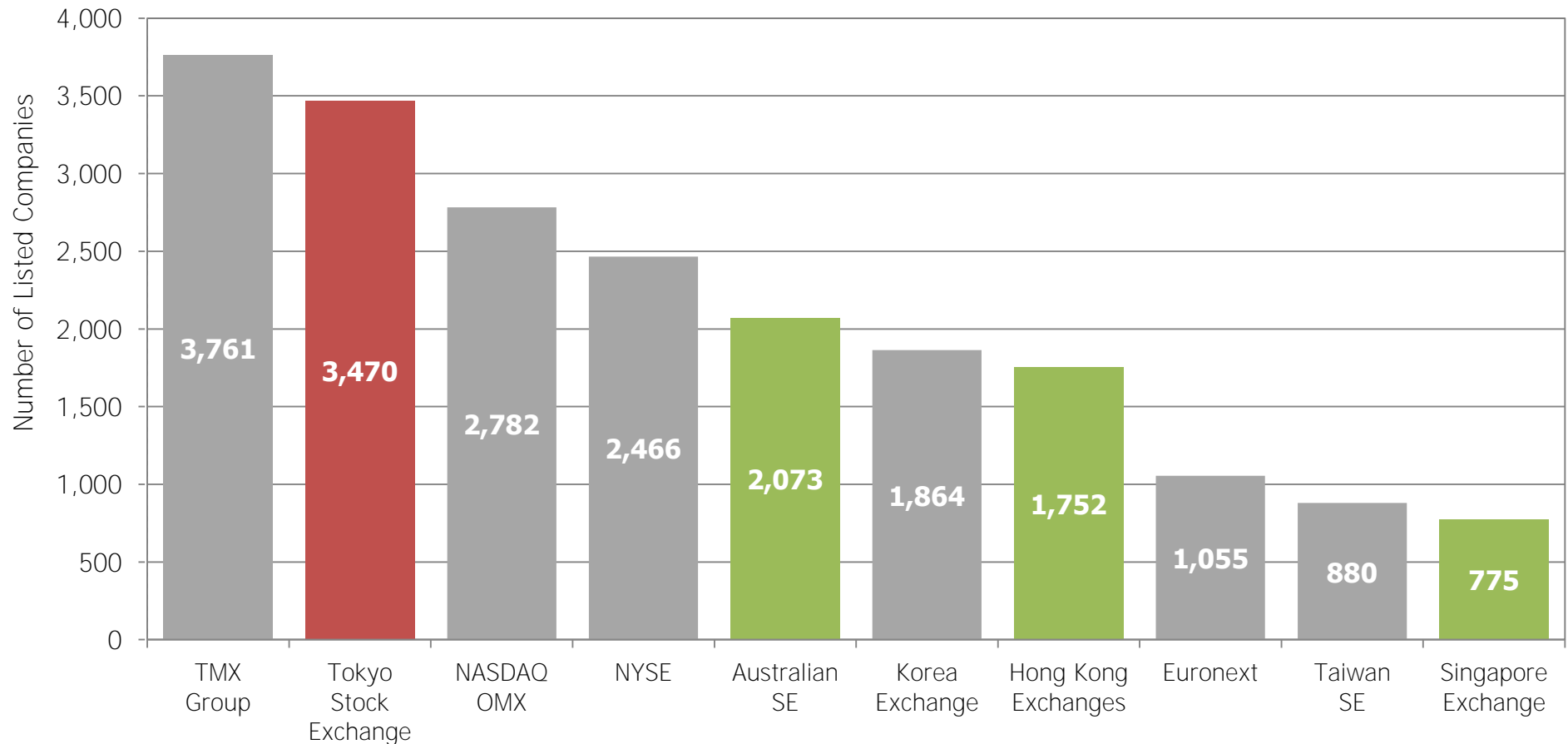
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1. About the Market

Number of Listed Companies

Tokyo Stock Exchange exceeds NYSE and NASDAQ in terms of number of listed companies.



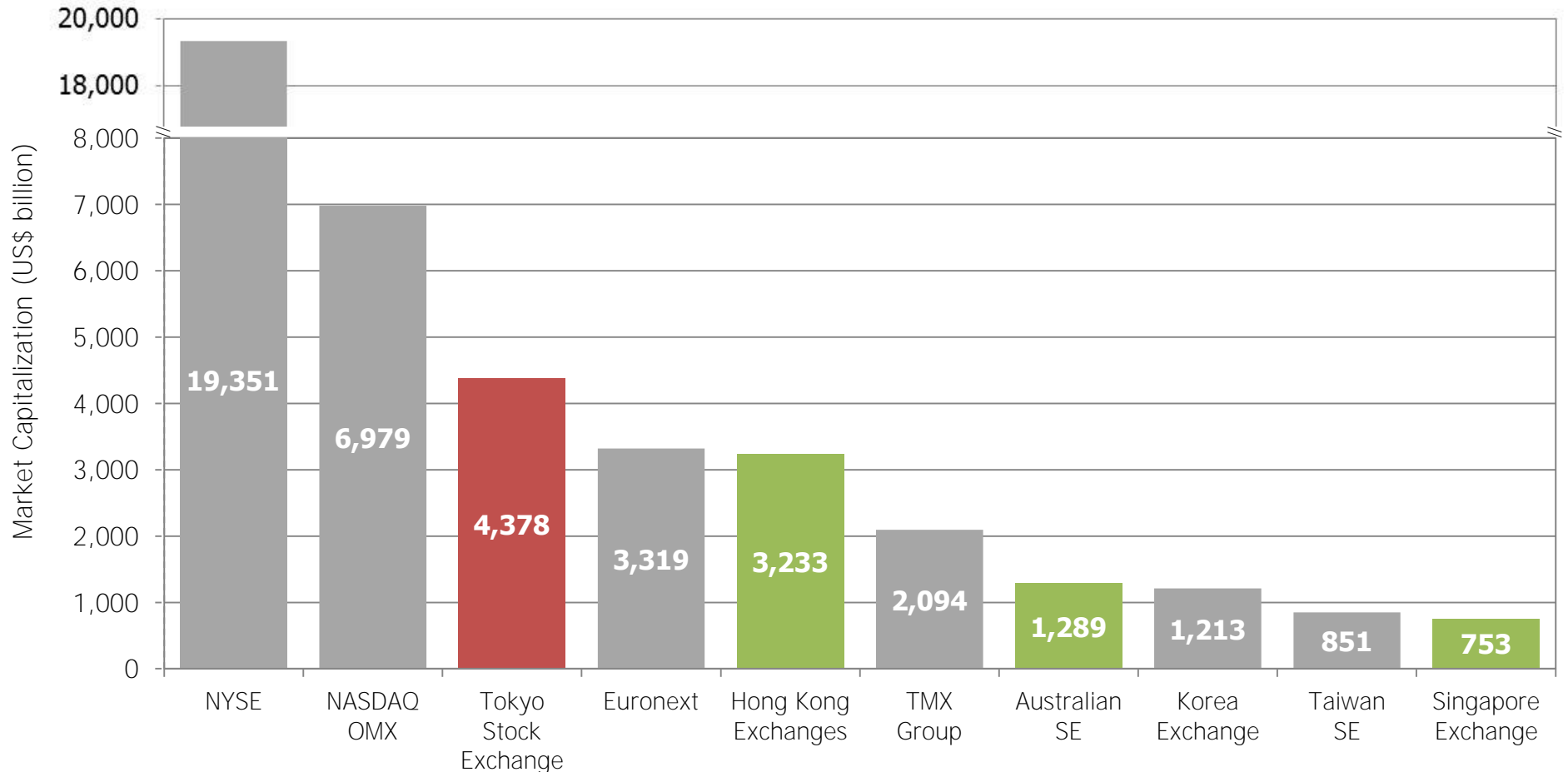
Source: WFE

Note: Number of listed companies as of the end of December 2014

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Market Capitalization

Tokyo Stock Exchange ranks No.3 globally and No. 1 in Asia by market capitalization.



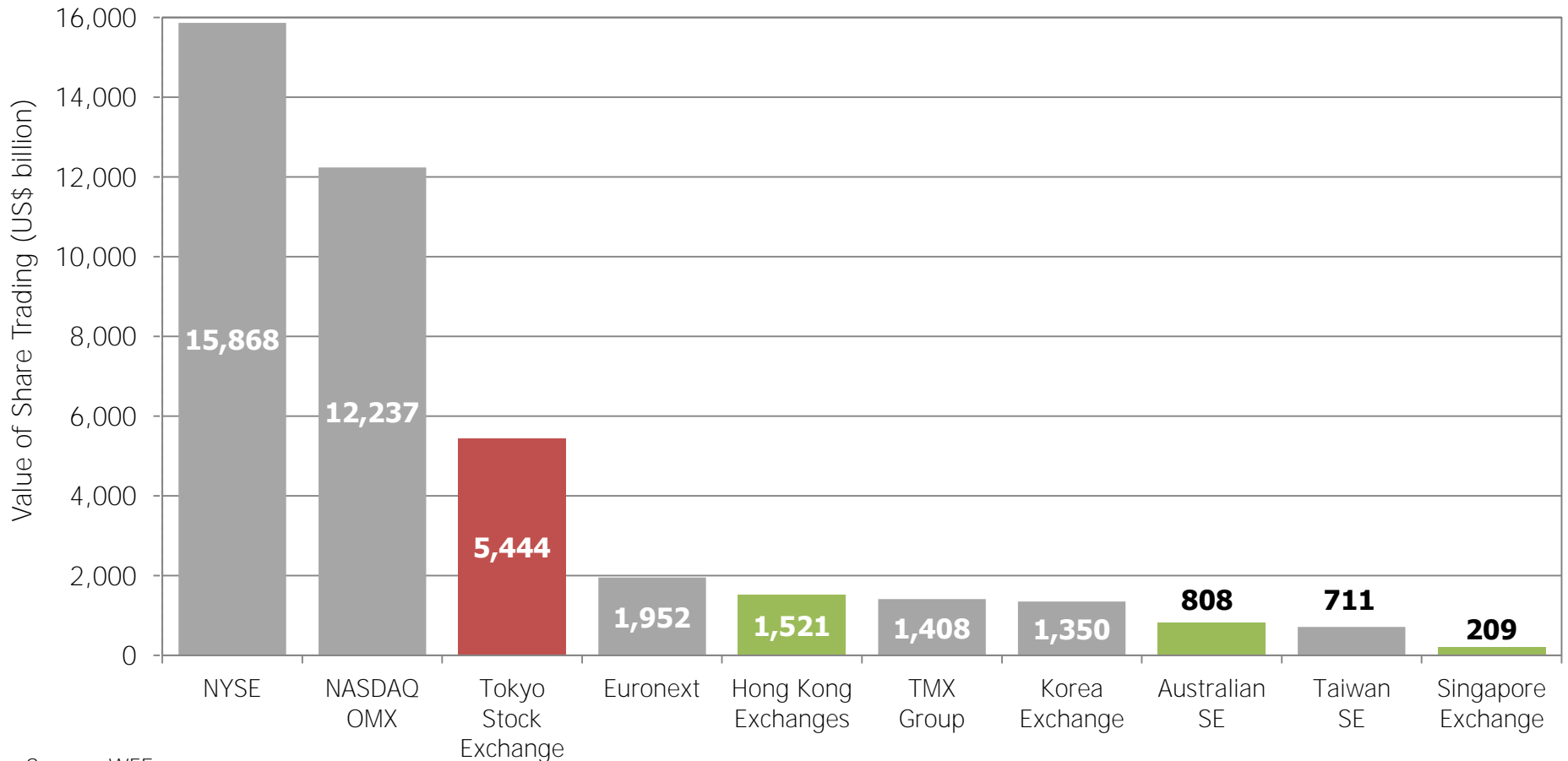
Source: WFE

Note: Domestic market capitalization as of the end of December 2014

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Value of Share Trading in the World

Tokyo Stock Exchange is about 3.6 times larger than Hong Kong Exchanges by value of share trading.



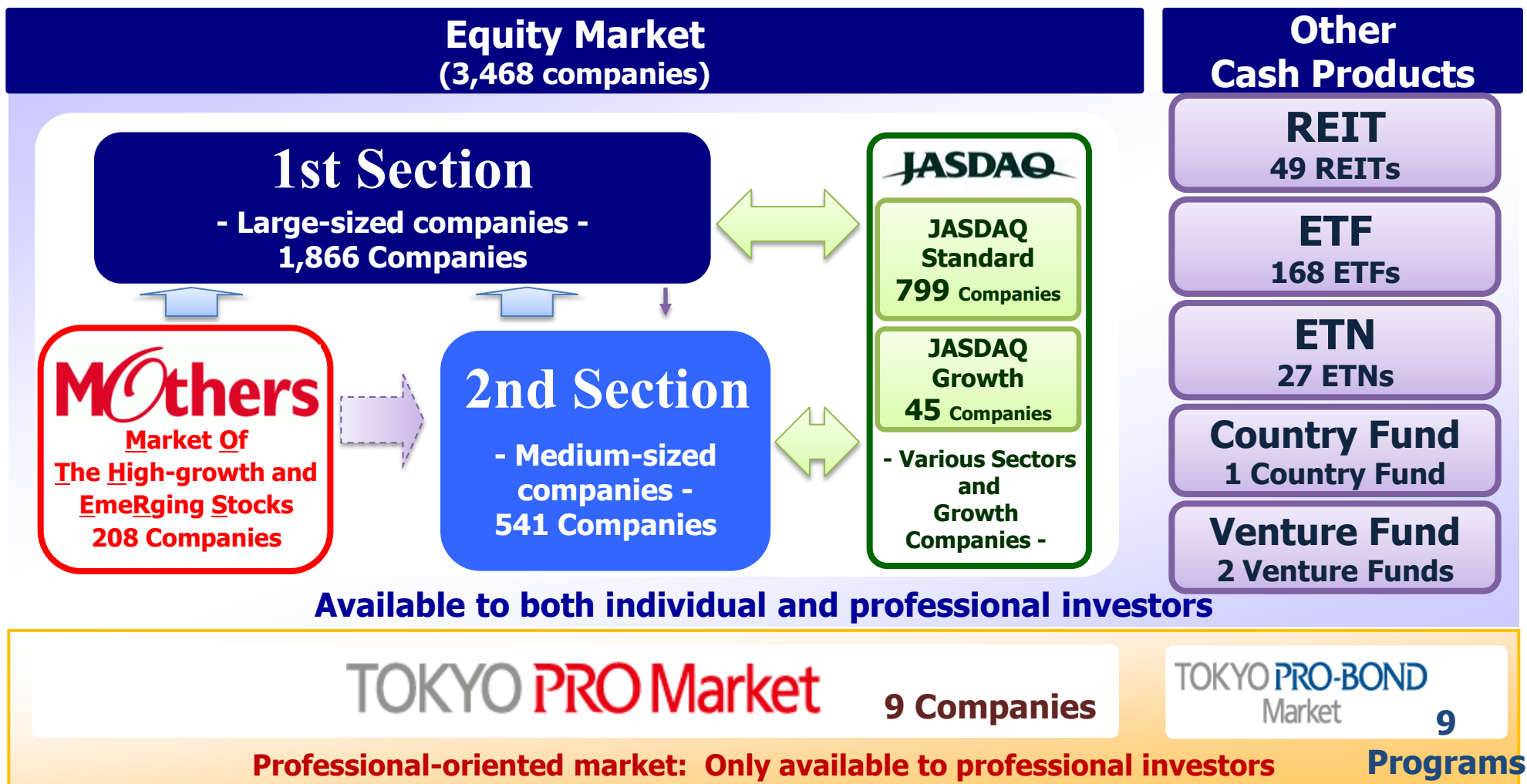
Source: WFE

Note: Value of share trading - Electronic order book trades from January 2014 to December 2014

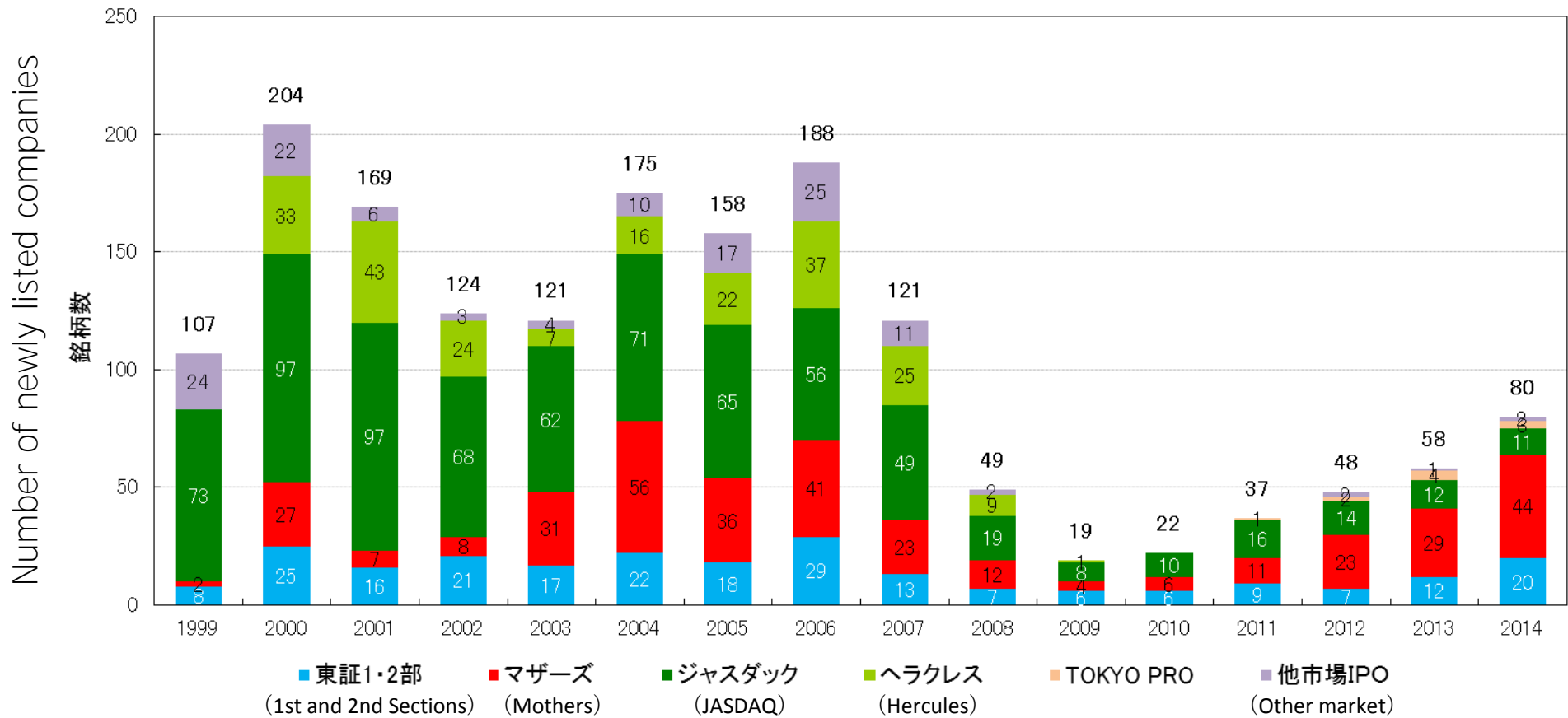
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Structure of TSE Cash Equity Market

JPX offers several markets with different concepts to allow companies to make an optimal choice.



Number of newly listed companies in Japan

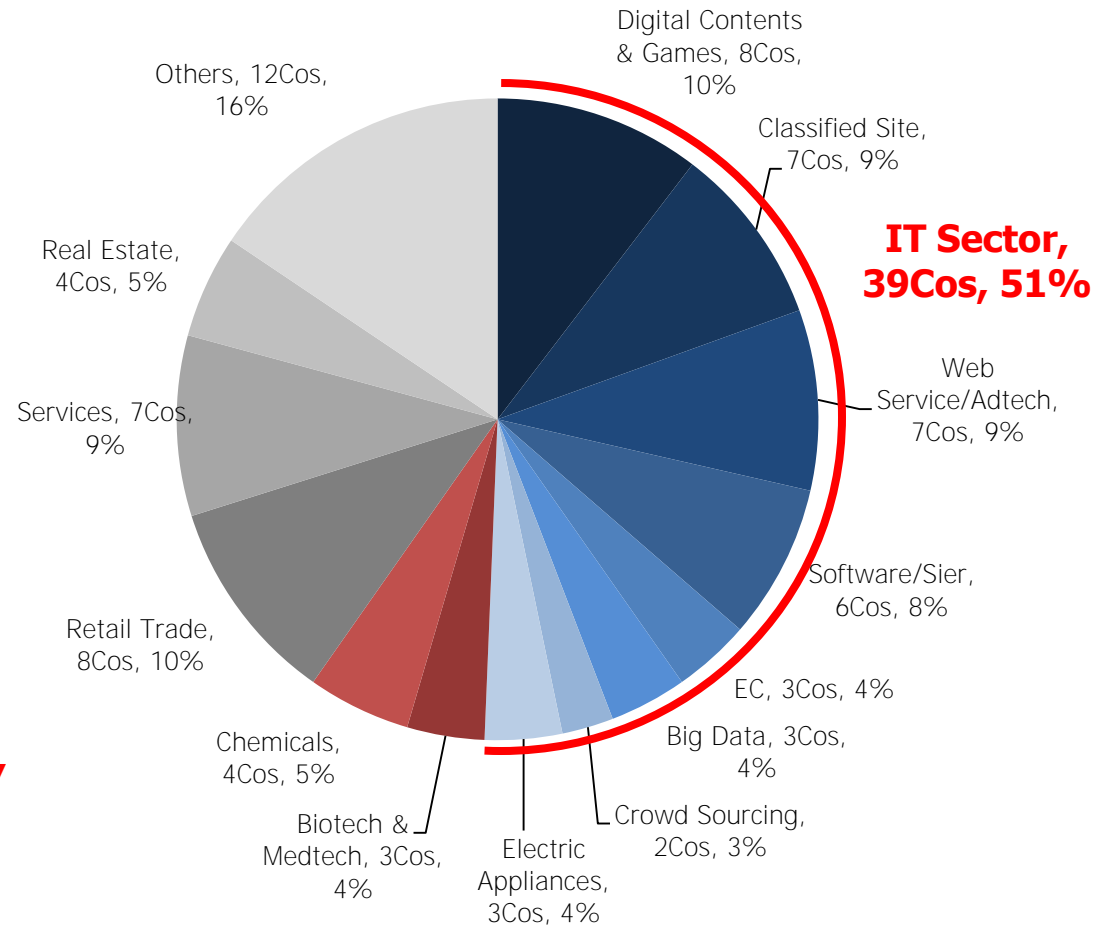
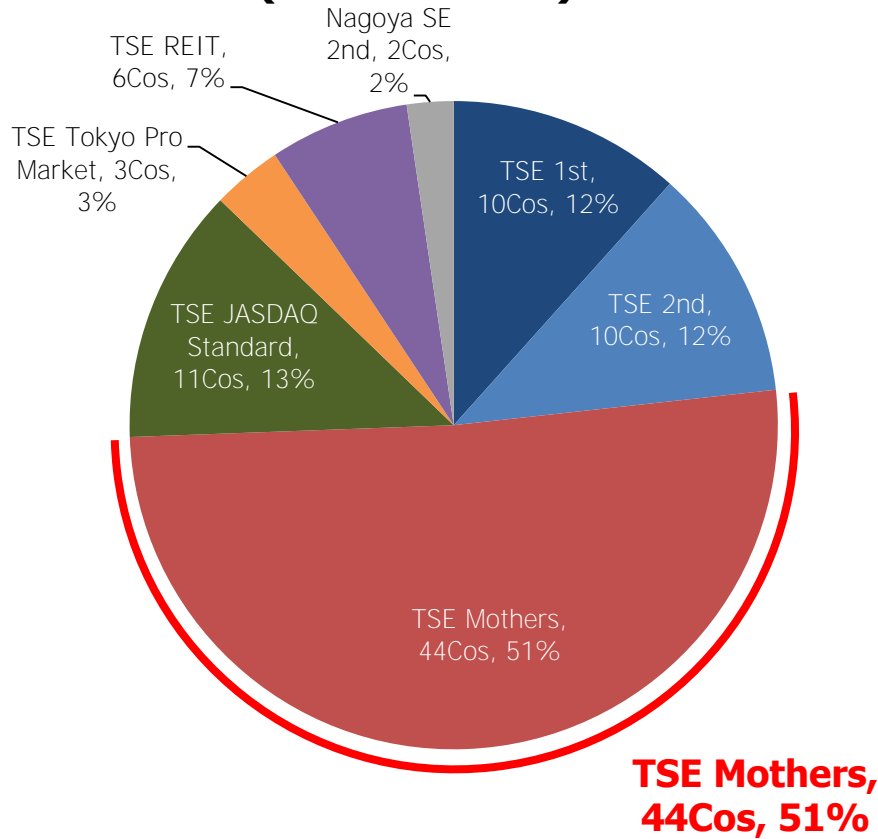


- The number of newly listed companies decreased greatly under the influence of bankruptcy of Lehman Brothers, etc. in 2009~2010.
- In recent years, it's a recovery trend.

IPOs in Japan in 2014

- Markets & Sectors

Number of IPOs by Market in Japan in 2014 (Total: 86 Cos)¹ **Number of IPOs by Sector in Japan in 2014 (Total: 77 Cos)²**



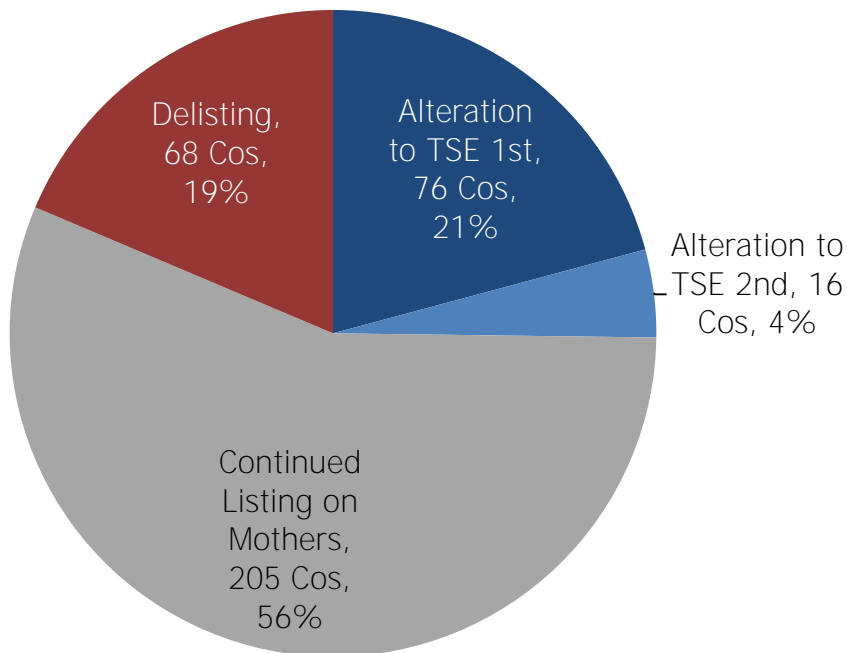
Note: 1 The data includes Tokyo Pro Market and REITs.

2 The data excludes Tokyo Pro Market and REITs.

Post-listing Trends on Mothers

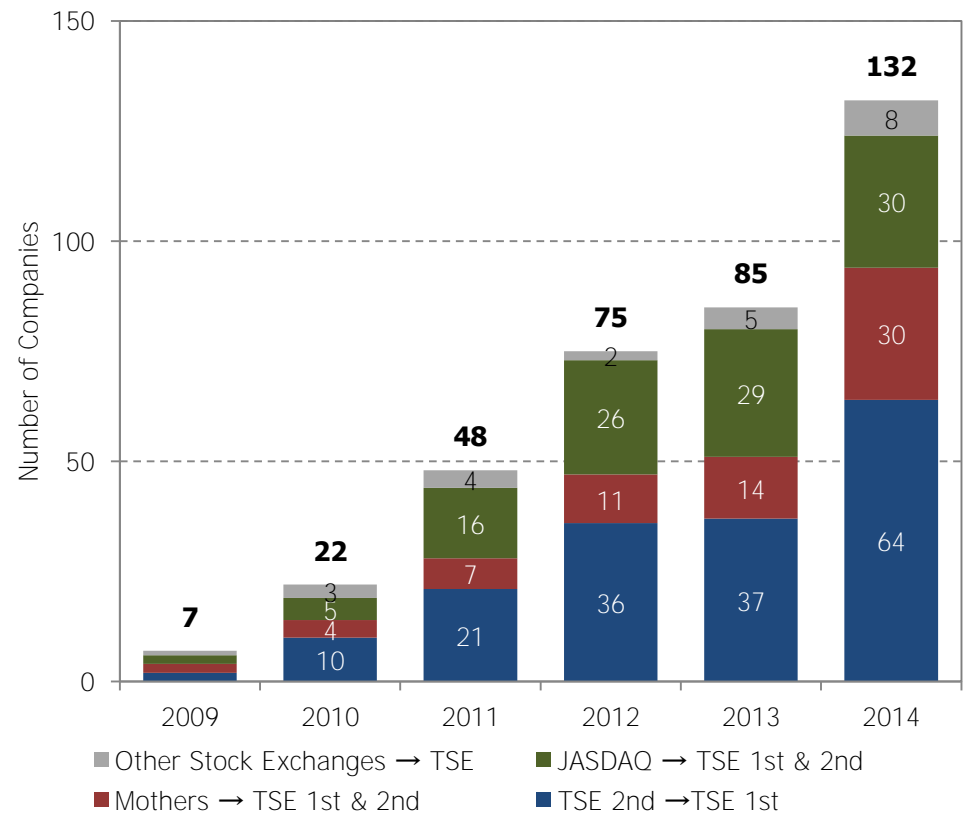
21% of Mothers IPO companies (76 cos.) moved up to the TSE 1st Section.

**Post-listing Trends on Mothers
(365 companies)**



Note: As of the end of 2014

Trend of Market Transfers



Note: As of the end of 2014

2. About Listing

Meaning of listing

Listing = The stocks are publicly traded by investors in the exchange market

➤ Benefits of listing

Gain access to direct finance



Diversified ways of financing

Become a "Listed Company"



Improved social trustworthiness and corporate profile
Increased moral of employees
Employment of highly capable manpower

Receive checks by third party after listing



Enhanced internal control systems

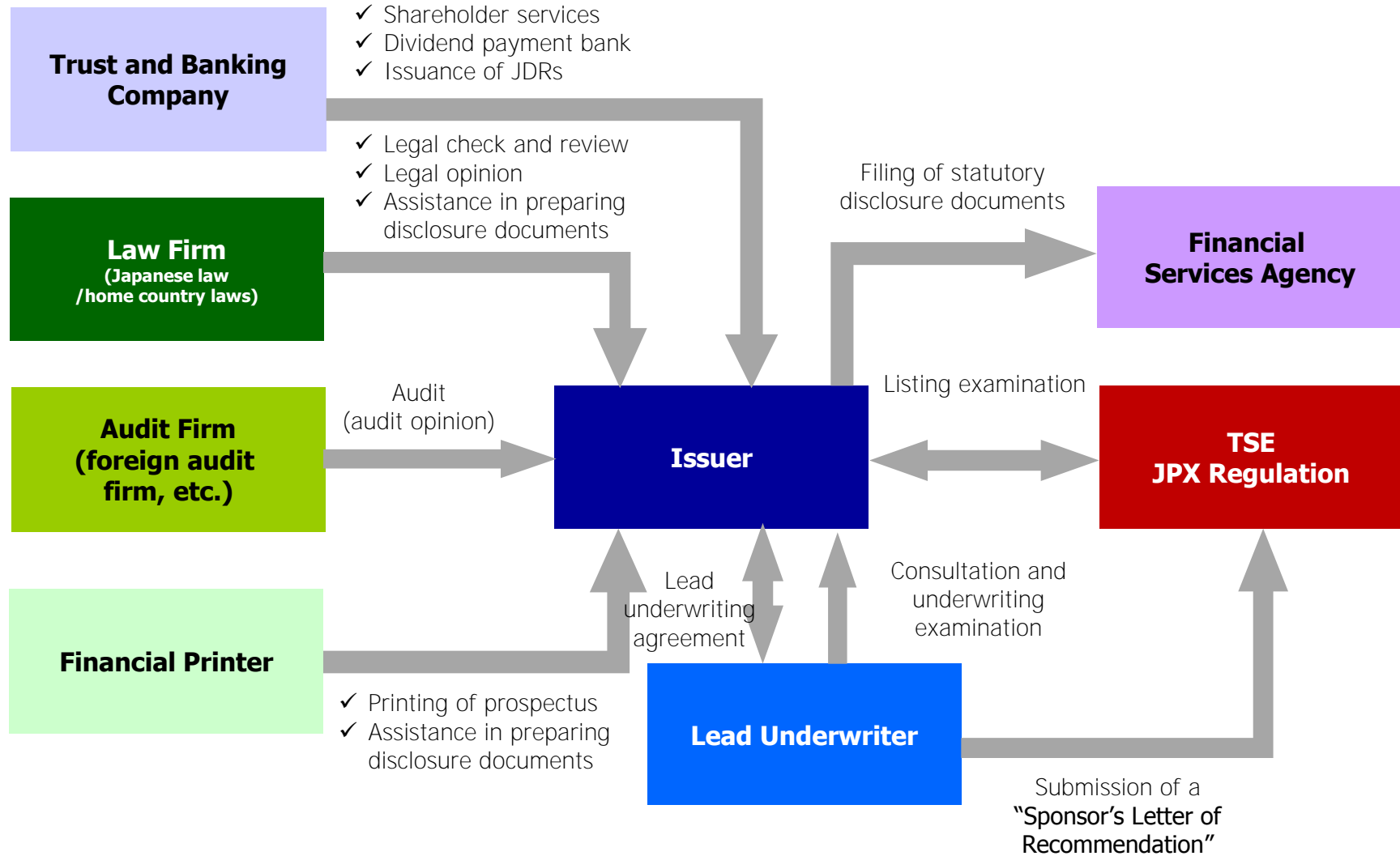
➤ Costs incurred by listing

Necessity to disclose the business results and corporate affairs, etc.

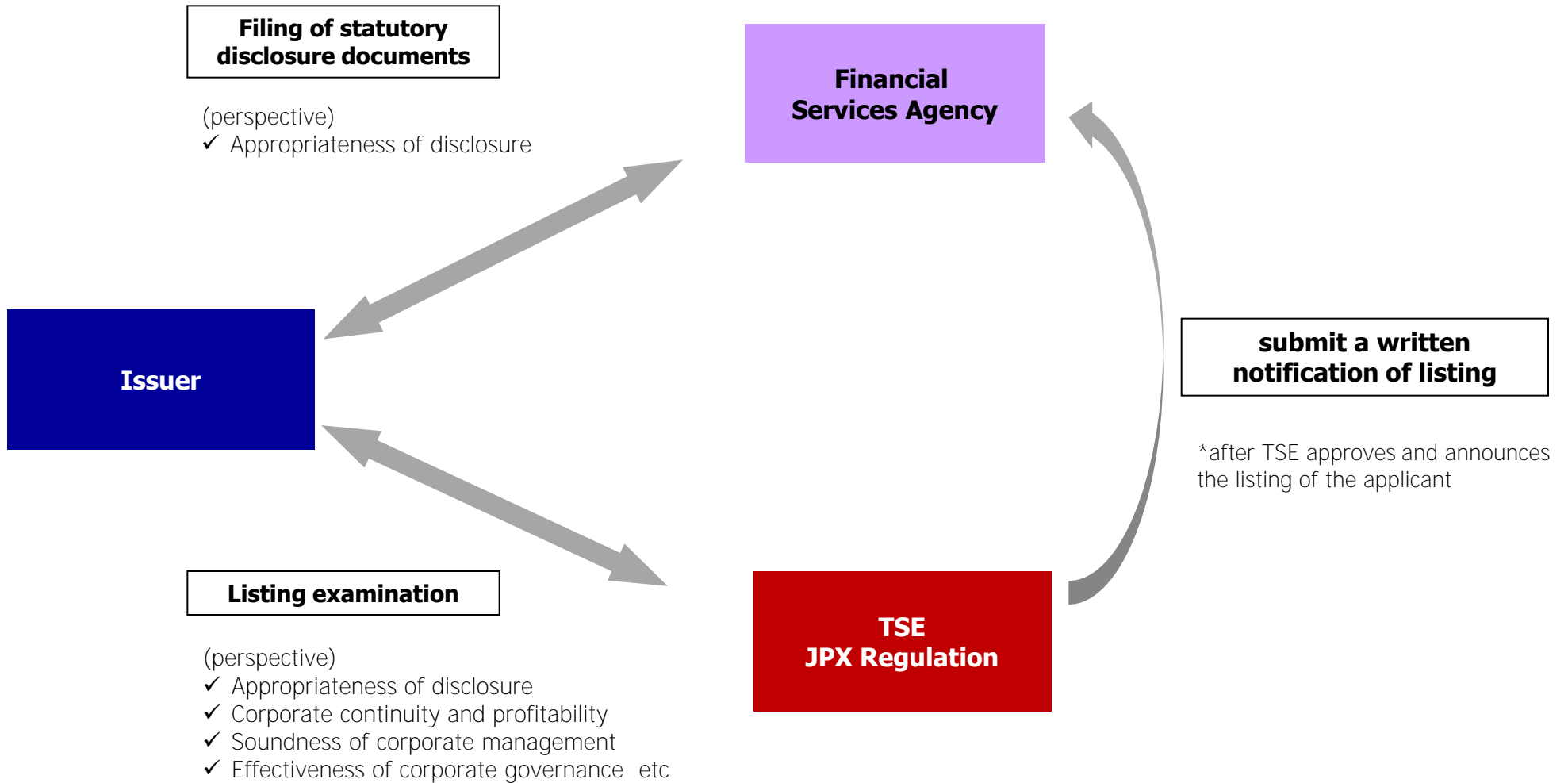


Incurring costs for documentation and improvement of internal control system, etc.

Roles of Each Party Involved in an IPO



Roles of FSA and TSE / JPXR in an IPO



3. About the Listing Examination

Significance of listing examination

➤ Significance of listing examination



Significance of listing examination

If nobody protects investor's profits and rights, what happens?



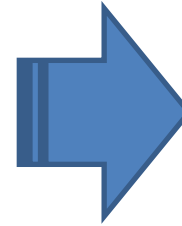
Stock market loses credibility with **investors, then, they won't invest** securities.
(It reduces inflow of investment money.)



- There is concern over the harmful effect about equity finance which can make emerging company grow.
- The number of people who are willing to start up a business decreases.



Finally, there is concern over the harmful effect which affects the national economic power.

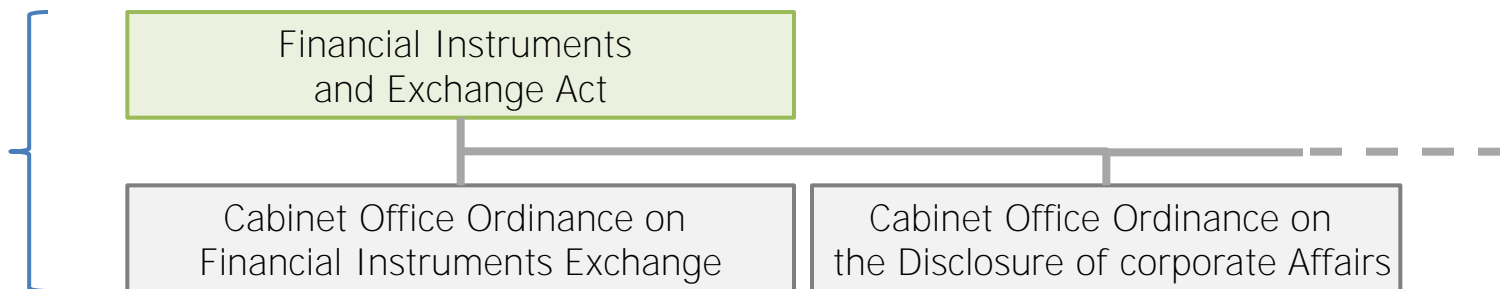


In conclusion, listing examination has an important role which is not only protecting investors, but also protecting the national economic power.

Rules related to listing examination

➤ Rules

(Jurisdiction)

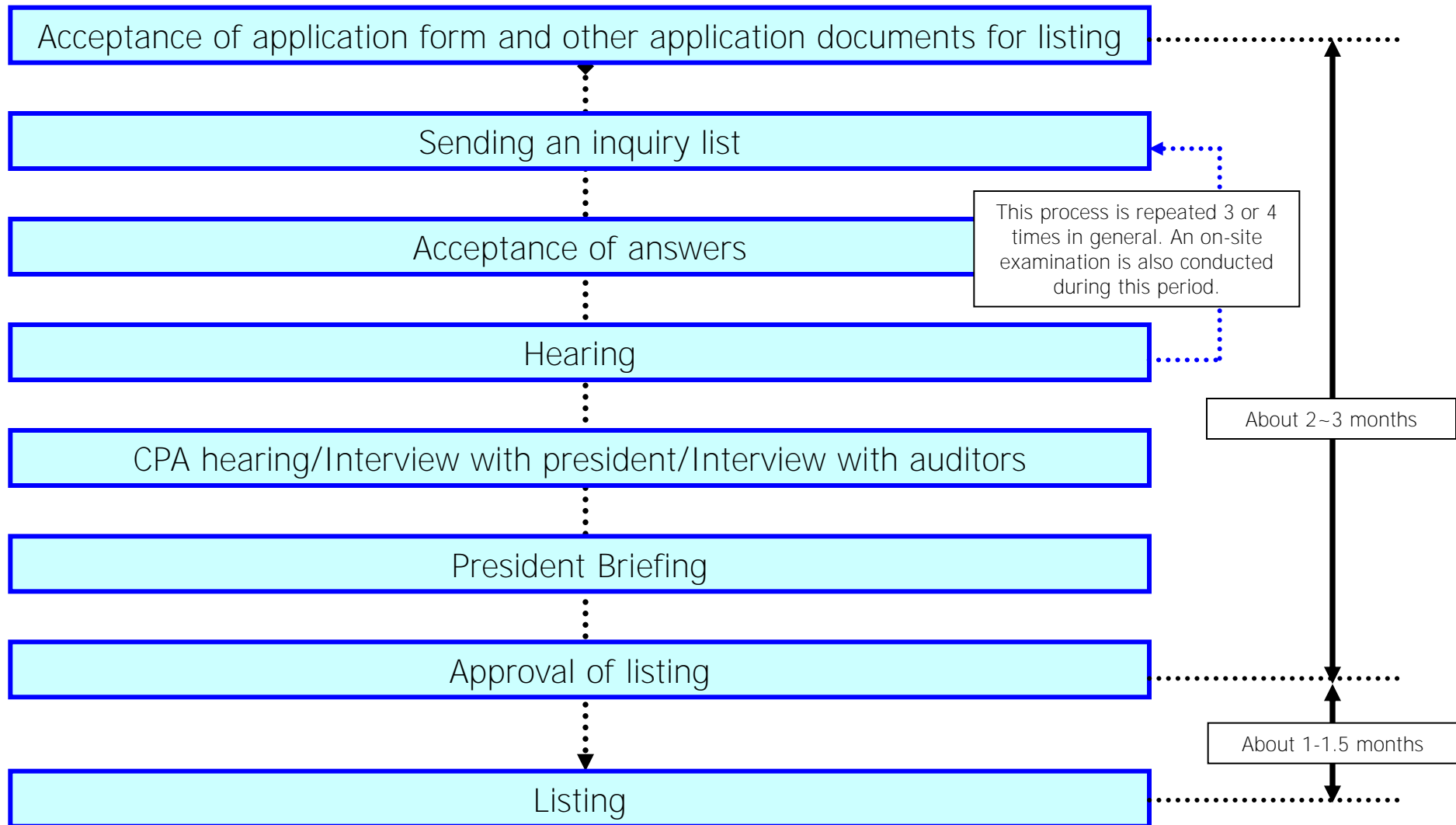


*require the authorization from or the notification to commissioner of FSA

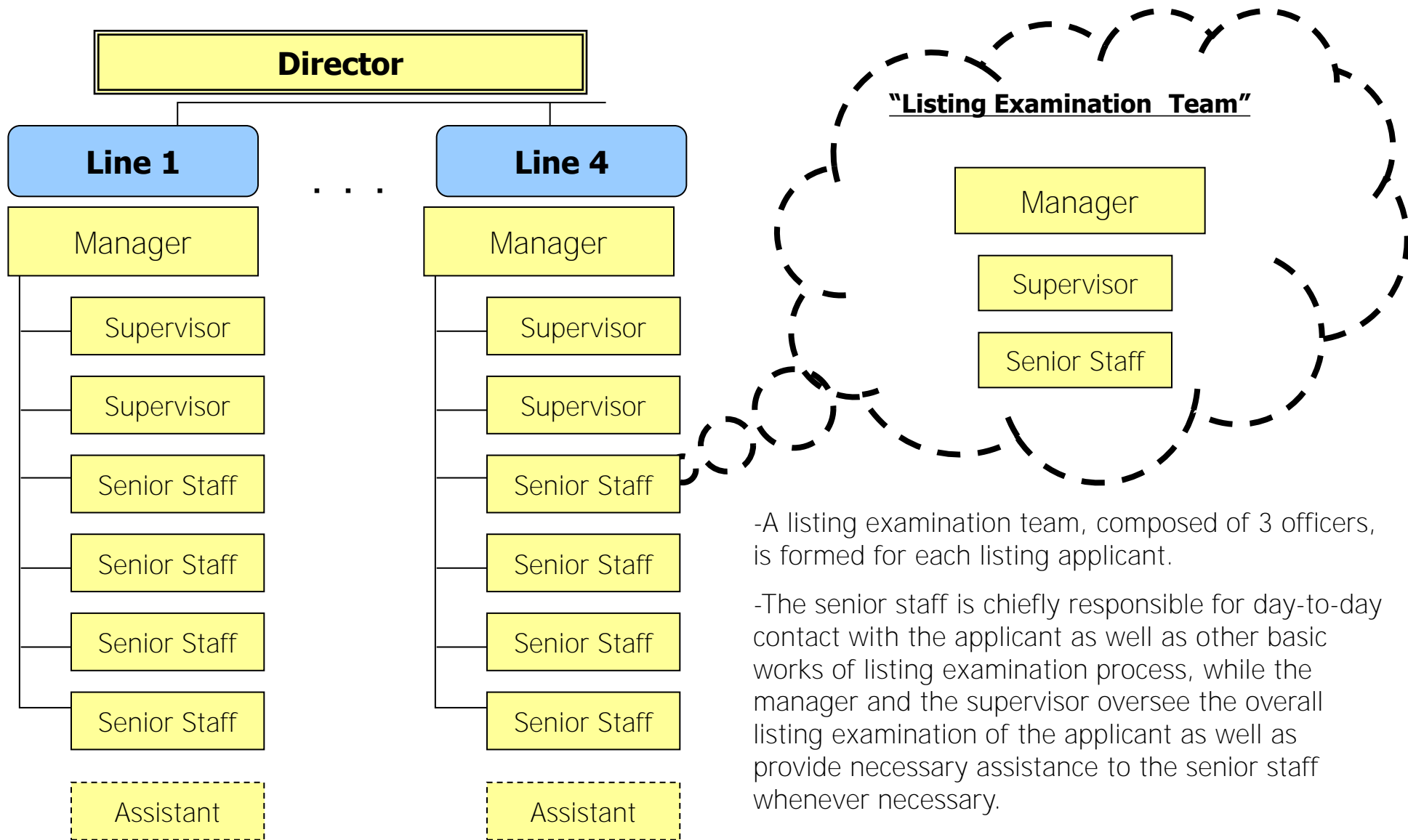
➤ Stock exchange regulations relating to the listing examination

Name of rule	Description
Securities Listing Regulations	Numerical Criteria Substance Criteria(Non-numerical criteria) Submission documents
Enforcement Regulations on Securities Listing Regulations	Interpretation and operation of Numerical Criteria Interpretation and operation of submission documents
Guidelines Concerning Listing Examination, etc	Interpretation and operation of Substance Criteria

Schedule of listing examination



Organization structure of Listing Examination Teams



-A listing examination team, composed of 3 officers, is formed for each listing applicant.

-The senior staff is chiefly responsible for day-to-day contact with the applicant as well as other basic works of listing examination process, while the manager and the supervisor oversee the overall listing examination of the applicant as well as provide necessary assistance to the senior staff whenever necessary.

Numerical Criteria (1st and 2nd Section)

Numerical criteria (summary)		1st Section	2nd Section
1. No. of shareholders		over 2,200	over 800
2. Liquidity	① No. of tradable shares(*1)	over 20,000 units	over 4,000units
	② Market Capitalization of tradable shares	over ¥ 1 billion	over ¥ 1 billion
	③ % ratio of tradable shares	over 35% of listed shares	over 30% of listed shares
3. Market Capitalization		over ¥ 25 billion(*2)	over ¥ 2 billion
4. Trading volume (Applied only to transfers from 2nd to 1st sections)		For each of the 6 months immediately prior to the latest business year-end, monthly average of 200 units	-
5. Continuous business record		over 3 years	
6. Net Assets		over ¥ 1 billion	
7. Ordinary profit OR Market Capitalization		① Total amount of over ¥ 500 million in the last two years	
		② Market capitalization is over ¥ 50 billion(*3)	
8. Certified Public Accountant's opinion		① No false statements in the financial statements for the 2 most recent fiscal years, and	
		② Auditor's opinion of 'fair' or 'fair with conditions' in the financial statements for the ex-ex-recent fiscal years, and	
		③ auditor's opinion of "fair" in the financial statements for the latest year, and	
		④ No auditor's opinion of 'No evaluation' or 'No opinion' in the internal control report for the latest year	
9. Others		Audit by audit firms which audit listed companies; contract with a shareholder services agent; no restrictions on share transfer; contract with JASDEC; no plans of M&A/Spin-off etc. within the two years resulting in an applicant losing its viability	

(*1)The term 'tradable shares' refers to listed shares excluding shares held by parties with a special interest such as officers, shares owned by the company itself, and shares held by persons who individually own 10% or more of listed shares.

(*2)Transferring or Moving up from 2nd section or Mothers to the 1st section require JPY 4 billion.

(*3) Market capitalization is over ¥ 50 billion , except for when sales for the immediately preceding year is less than ¥10 billion.

Numerical Criteria (Mothers)

Numerical criteria (summary)		
1.No. of Shareholders	over 200	
2.Tradable Shares	① No. of tradable shares	over 2,000 units
	② Market Capitalization of tradable shares	over ¥ 500 million
	③ % ratio of tradable shares	over 25% of listed shares
3.Public Offering	over 500 trading units	
4.Market Capitalization	over ¥ 1 billion	
5.Continuous business record	over 1 years with Board of Directors	
6.False Description, Independent Auditor's Unfair opinion	Fair opinion and no false description for the last 2 accounting terms	
7. Others	Audit by audit firms which audit listed companies; contract with a shareholder services agent; no restrictions on share transfer; contract with JASDEC	

Substance Criteria (1st and 2nd Section)

1. Corporate continuity and profitability

① Reasonable business plan

- The business plan of corporate group of an initial listing applicant is appropriately drawn up in light of its business model, business environment, risk factors, etc.

② Profit/loss and income/expenditure projection

- The corporate group of an initial listing applicant is reasonably expected to be able to maintain a stable profit in the future.

③ Stable and continuous business operation

- Buying, production, marketing activities, trading partners, products and services, and overall market conditions.
- Capital expenditure and other types of investments.
- “Prerequisite for main business” meaning permissions, approvals, licenses, registrations, distributionship/outsourcing agreement etc. necessary for operation of its main business.

Substance Criteria (1st and 2nd Section)

2. Soundness of Corporate Management

- ① **No related party transactions to give or receive profits wrongfully**
 - The content of transaction must be reasonable.
 - The terms of transaction must be appropriate.

- ② **No obstacle for fulfillment of directors' or statutory auditors' duty paused by :**
 - Kinship between directors
 - Make-up of BoD
 - General behaviour in office of members of BoD
 - Cross-holding of offices in other companies by members of BoD

- ③ **Independence from a parent company**
 - An applicant is not merely functioning as a part of its parent's business operation.
 - The terms of transactions with its parent company are fair.
 - An applicant is not overly relying its human resources on its parent company.

Substance Criteria (1st and 2nd Section)

3. Effective Corporate Governance and Internal Control System

- ① **Necessary corporate structure in place for ensuring appropriate and adequate fulfillment by BoD of its responsibilities**
 - Institutional structure and make up of BoD that ensures effective checks and balances and statutory audit.
 - Checks and balances and statutory audit effectively working.
- ② **Necessary internal control system in place for effective business operation**
 - Necessary corporate organization in place for efficient corporate activities and effective internal control.
 - Effective internal audit.
- ③ **Adequate human resources necessary for stable and continuous operation of its business and maintenance of internal control system**
- ④ **Appropriate accounting standards employed and necessary accounting functions in place**
- ⑤ **Necessary structure and functions in place for legal compliance and no activities deemed to violate law**

Substance Criteria (1st and 2nd Section)

4. Appropriate Disclosure of Corporate Information

- ① **Appropriate management and timely disclosure of important information to prevent insider trading**
- ② **Appropriate disclosure documents to prevent misunderstanding by investors**
- ③ **No distortion of corporate group structure by making adjustments to transactions with, or share-ownership by, related parties**
- ④ **Appropriate and adequate disclosure of corporate information of the parent company**

Substance Criteria (1st and 2nd Section)

5. Other Matters of Importance in Light of Public Interest and Investor Protection

- ① Non-unfairly-restricted rights of shareholders, and exercise thereof**
- ② No ongoing serious legal disputes that could significantly affect its operation or business results**
- ③ No connections to anti-social organizations**
- ④ Rules of shares without voting rights or shares with a small number of voting rights**
- ⑤ Other matters of importance in the light of the public interest or investor protection**

Substance Criteria (Mothers)

NO.1,NO.2,NO.3, and NO.5 are the almost same criteria with 1st and 2nd section. On mothers the lead underwriter is required to assess whether the applicant has high growth potential. JPXR examines whether the applicant has developed reasonable business plan(NO.4).

1. Appropriate Disclosure of Corporate Profile and Risk Information

2. Soundness of Corporate Management

3. Effective Corporate Governance and Internal Control System

4. Reasonable business plan

5. Other Matters of Importance in Light of Public Interest and Investor Protection

Thank you very much for your attention.



Listed Company Regulation and Supervision

- Maintaining and Enhancing the Quality of Financial Products -

October 1, 2015

**Listed Company Compliance Department
Japan Exchange Regulation**

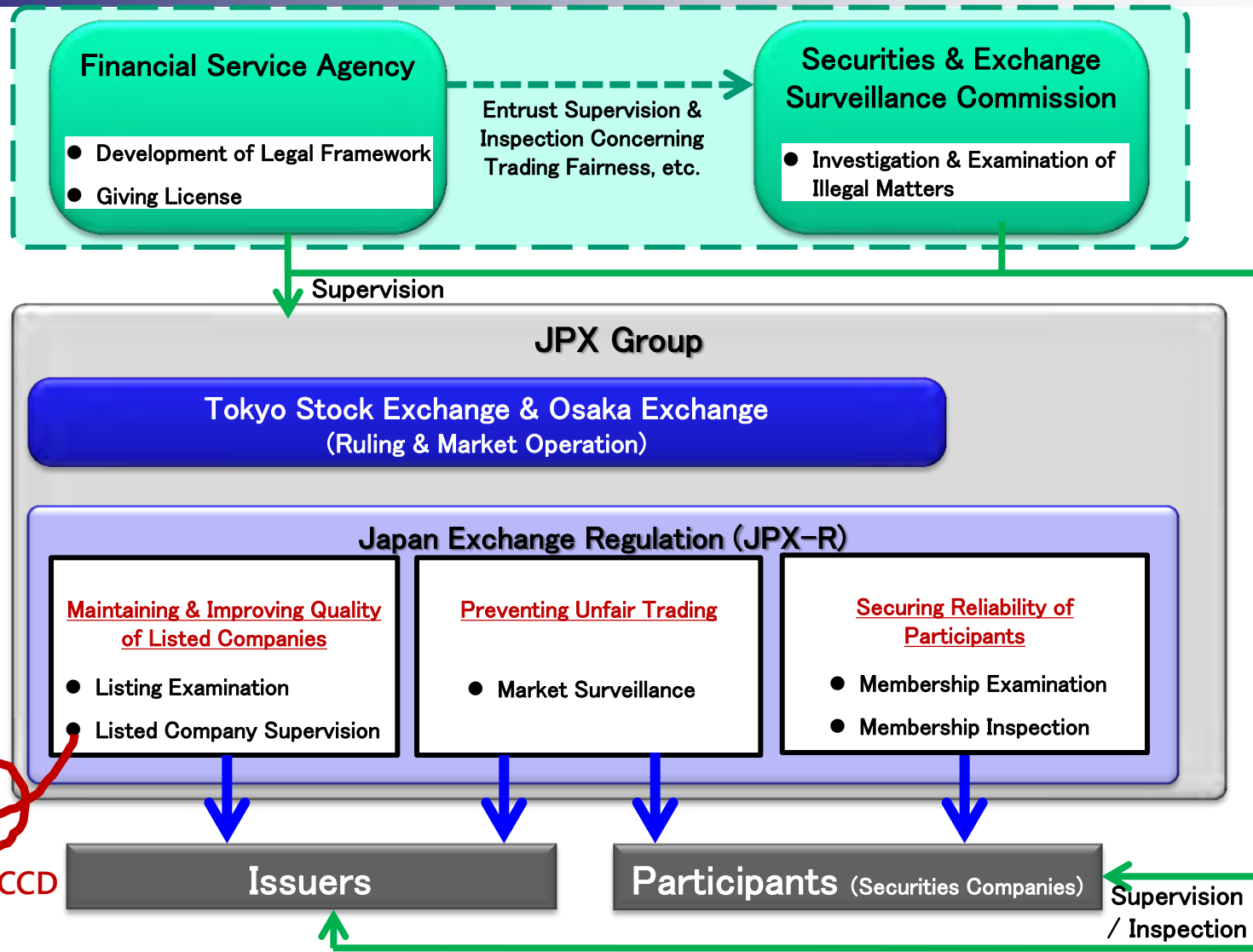


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- **Improvement Measures and Penalty Measures**
- **Examination of Information Disclosure**
- **Case Study**



Overview Of Regulation over Capital Market



Self-regulatory Operation

Task of LCCD

Regulatory Operation by Executive Authorities



Self-regulation (2)

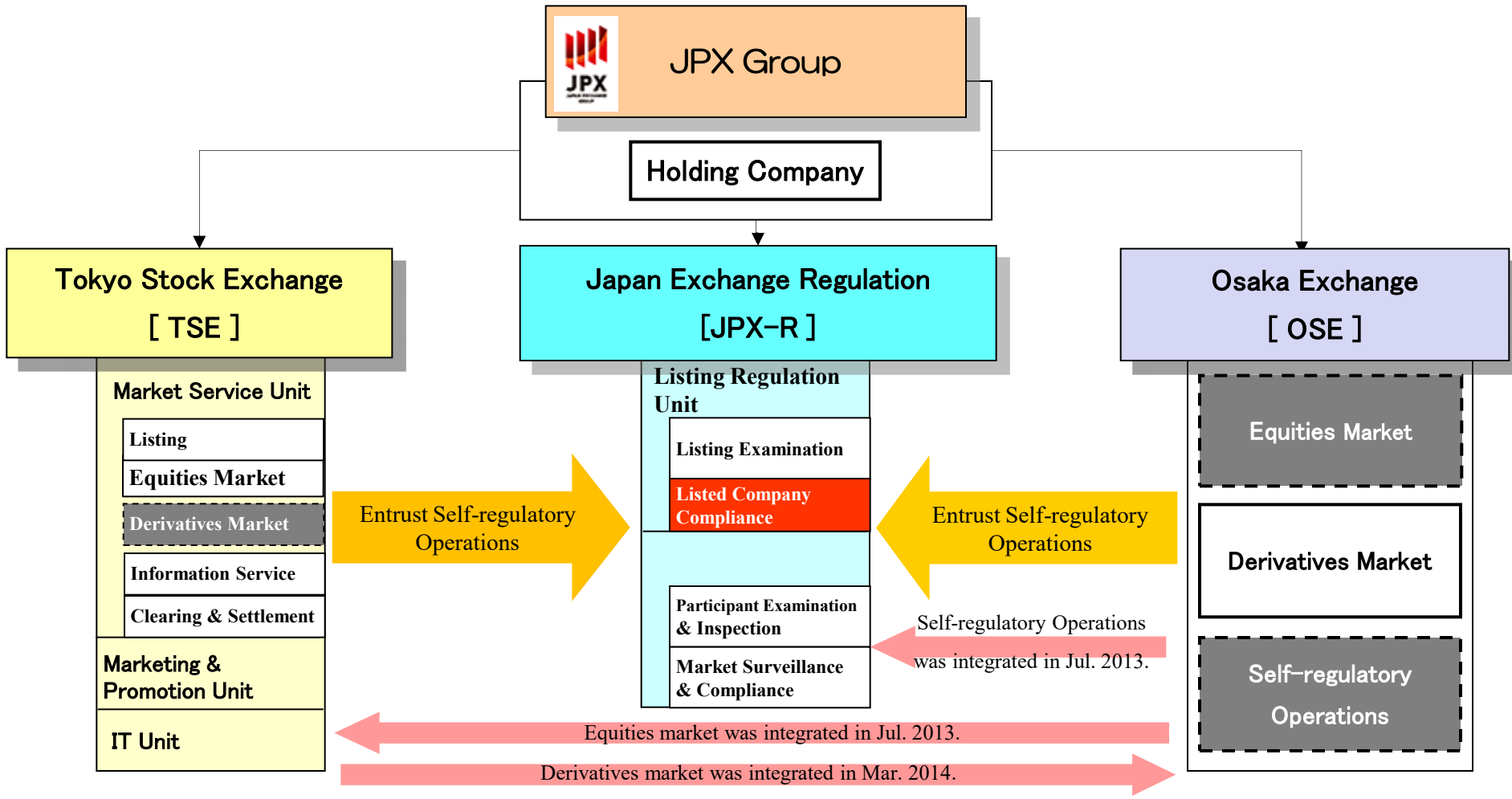
Comparison between Regulation by Executive Authorities & Self-regulation

	Regulation by Executive Authorities	Self-regulation of Stock Exchange
Purpose	<ul style="list-style-type: none"> Ensure fairness and transparency in the securities market Protect investors 	<ul style="list-style-type: none"> Ensure fairness and transparency in the securities market Protect investors Ensure confidence of trading participants or listed companies
Rule	Laws and sub-rules	Rules by Stock Exchange
Sanctions	<ul style="list-style-type: none"> Accusation⇒Criminal Penalties Administrative Penalties (Suspension or Revocation of License, Management Improvement Order, Revision Order, Surcharge Payment Order, etc.) 	<ul style="list-style-type: none"> Suspension or Revocation of License as a Participants or Listed company Improving Report, Financial Penalty,
Tools	Inspection, Surveillance, Search, Attachment, etc. (with Legal Force)	Inquiry, Hearing, Onsite Monitoring, etc. (by Contract between Stock Exchange and Participants or Listed Companies)



Listed Company Compliance Department (LCCD)

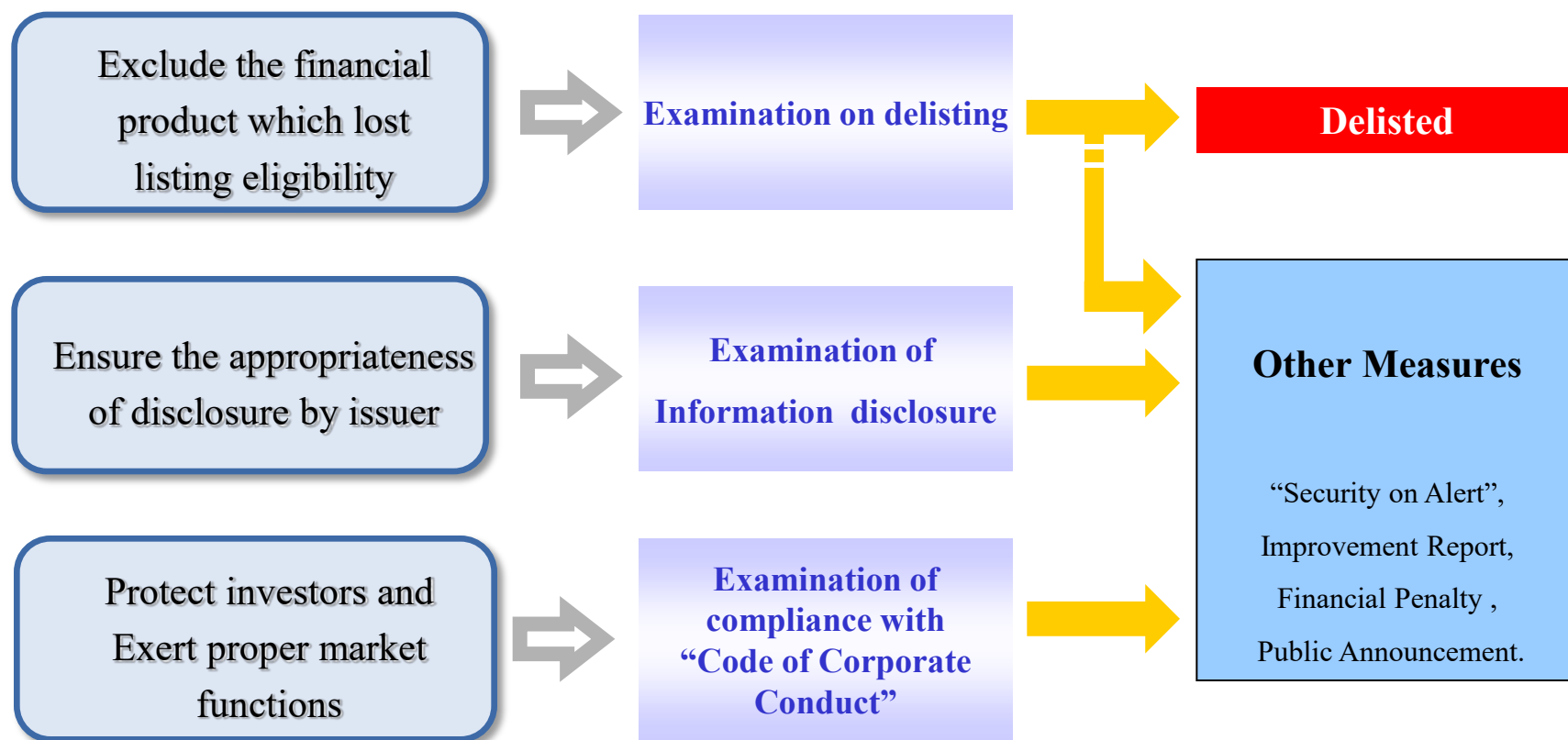
Organization



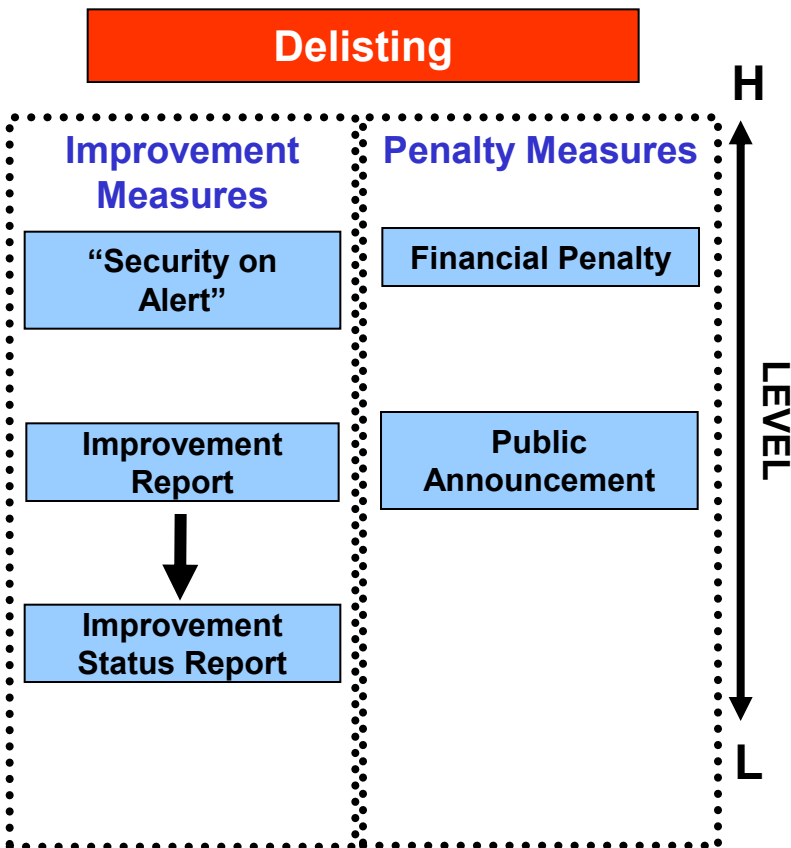


LCCD Mission & Roles

Strives to maintain and enhance the quality of listed financial products in order to ensure confidence in the financial instrument exchange market.



Types of Measures



Item	Contents
Delisting	Termination of the listing agreement between TSE and a listed company.
“Security on Alert”	Designation given to cases where the listed company has made false statements in a securities report, etc. and, in addition, improvement of the internal management system, etc. is deemed to be highly necessary.
Improvement Report	Requested when improvement is deemed to be highly necessary in cases of violations of timely disclosure obligations or the Code of Corporate Conduct. Available for public inspection.
Improvement Status Report	Report on the status of execution and operation of improvement measures which is requested 6 months after submission of an improvement report. Available for public inspection.
Financial Penalty	Taken when the confidence of shareholders/investors in the market is deemed to have been undermined in cases of the listed company violating securities listing regulations (timely disclosure rules and/or the Code of Corporate Conduct) or other rules.



Examination on Delisting



Summary of Delisting Criteria

Type	Formal Requirements - Based on figures and events	Qualitative Examination - Based on TSE's discretion
Criteria	<ul style="list-style-type: none"> ■ Numbers of shares listed ■ Distribution of shares ■ Trading volume ■ Market capitalization ■ Bankruptcy ■ Delay in filing annual/semiannual reports ■ Becoming a wholly-owned subsidiary company, etc. 	<ul style="list-style-type: none"> ■ False statements ■ Adverse opinion, etc. issued by accounting firm ■ Violation of Listing Agreement ■ Undermining public interest & investor protection ■ Inappropriate merger (backdoor listing) ■ Involvement of Anti-Social Forces, etc.
Means of Discovery	Periodical reports by listed companies, and consultation before disclosure, etc.	Disclosure, reports by listed companies, tips, and media, etc.



Actual Examination of False Statements, etc.

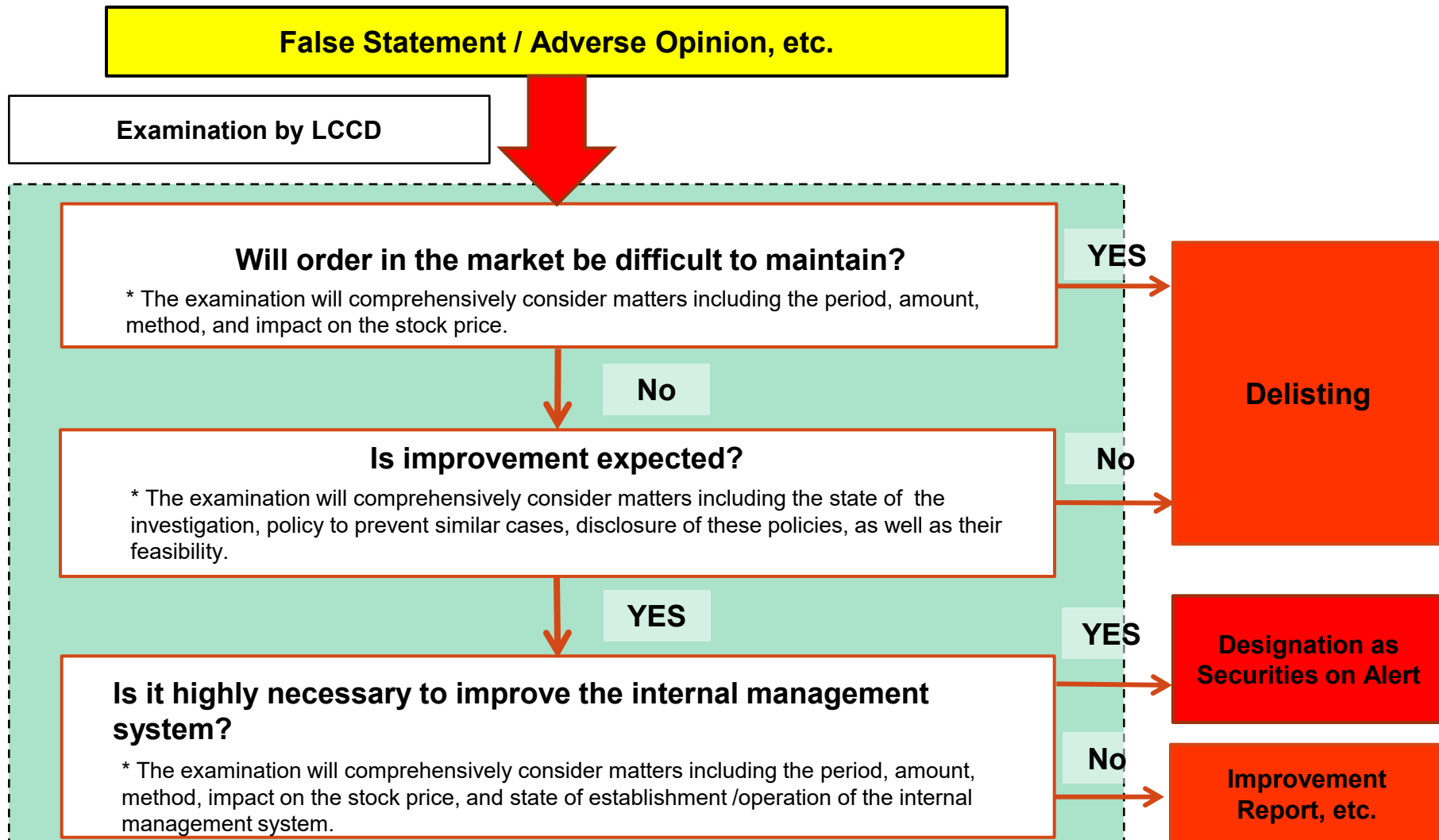
Overview of Examination of False Statements, etc.

A listed company shall be delisted if it is found to have submitted a Securities Report, etc. **which contains "false statements" and it becomes clear that it will be difficult to maintain order in the market if the company is not delisted immediately.**

- * A company is deemed to have made false statements in its Securities Report, etc., when it falls under any of the following cases:
 - when it received an order to correct its Securities Report, etc. from the Prime Minister, etc.
 - when it received an order for payment of surcharge from the Prime Minister, etc.
 - when it was indicted by the Securities and Exchange Surveillance Commission
 - when it submitted an amendment report which was found to contain material content.
- * The same shall apply to the case of "adverse opinion" or "opinions not expressed."
 - The situation where "it becomes clear that it will be difficult to maintain order in the market if the company is not delisted immediately" means such a situation where investors' confidence in the TSE market is deemed to be significantly undermined if the listing is maintained.
 - (Eg.) Cases where the listed company substantially circumvents the listing criteria by making false statements on situations, etc. at the company such as liabilities in excess of assets prior to listing, or where the listed company caused material misjudgments in investment decisions by making false statements in which the most part of its sales were fictitious.



Actual Examination of False Statements, etc.



Lists of Delisted Companies Due to False Statement/Adverse Opinion etc. (Since 2004)

■ List of delisted companies due to false statement in the security report

Date of Delisting	Company Name	Code	Market Division
Sep. 25, 2010	Senior Communication Co., Ltd.	2463	Mothers
May 01, 2009	IBE Holdings, Inc.	2347	Mothers
Feb. 21, 2009	OHT Inc.	6726	Mothers
Apr. 14, 2006	Livedoor Co., Ltd.	4753	Mothers
Nov. 15, 2005	North Co., Ltd.	6732	Mothers
Jun. 13, 2005	Kanebo Ltd.	3102	1 st section
Dec. 17, 2004	SEIBU Railway Co., Ltd.	9002	1 st section

■ List of delisted companies due to the audit firm stated “opinions are not expressed” in the audit report

Date of Delisting	Issue Name	Code	Market Division
Sep. 25, 2010	C&I Holdings Co., Ltd.	9609	2 nd section
Feb. 21, 2009	KASUGA ELECTRIC WORKS LTD.	6650	2 nd section
Sep. 20, 2008	Asia Media Co., Ltd.	2149	Mothers
Oct. 13, 2007	Framework, Inc.	3740	Mothers
Jun. 24, 2007	Internet Research Institute, Inc.	4741	Mothers

■ List of delisted companies due to the audit firm stated “adverse opinion” in the audit report

N/A



Improvement measures and Penalty measures



“Security on Alert”

Overview of Security on Alert

A company may be designated as a Security on Alert if falls under any of the following 1 to 5 and it is deemed highly necessary to improve its internal management system.

Matter	
1	- when a listed company was deemed likely to fall under delisting criteria such as damage to sound transactions with controlling shareholder, false statements, etc. violation of listing agreement, etc., or involvement of anti-social forces or other cases in light of the public interest or the protection of investors (and thus designated as a security under supervision (examination)) but later deemed not to fall under such criteria.
2	- when a listed company is found to have made false statement in securities reports, etc. or have been expressed an ‘adverse opinion ’ or ‘ opinions are not expressed ’ in audit report.
3	- when a listed company is found to have violated the timely disclosure rules.
4	- when a listed company is found to have violated the Code of Corporate Conduct.
5	- when a listed company fails to improve the execution of improvement measures and the operation of such measures following the submission of an Improvement Report.

⇒ A listed company designated as a Security on Alert is required to promptly submit a “Written Confirmation of Internal Management System” which reports the improvement progress of its internal management system after one year elapses following

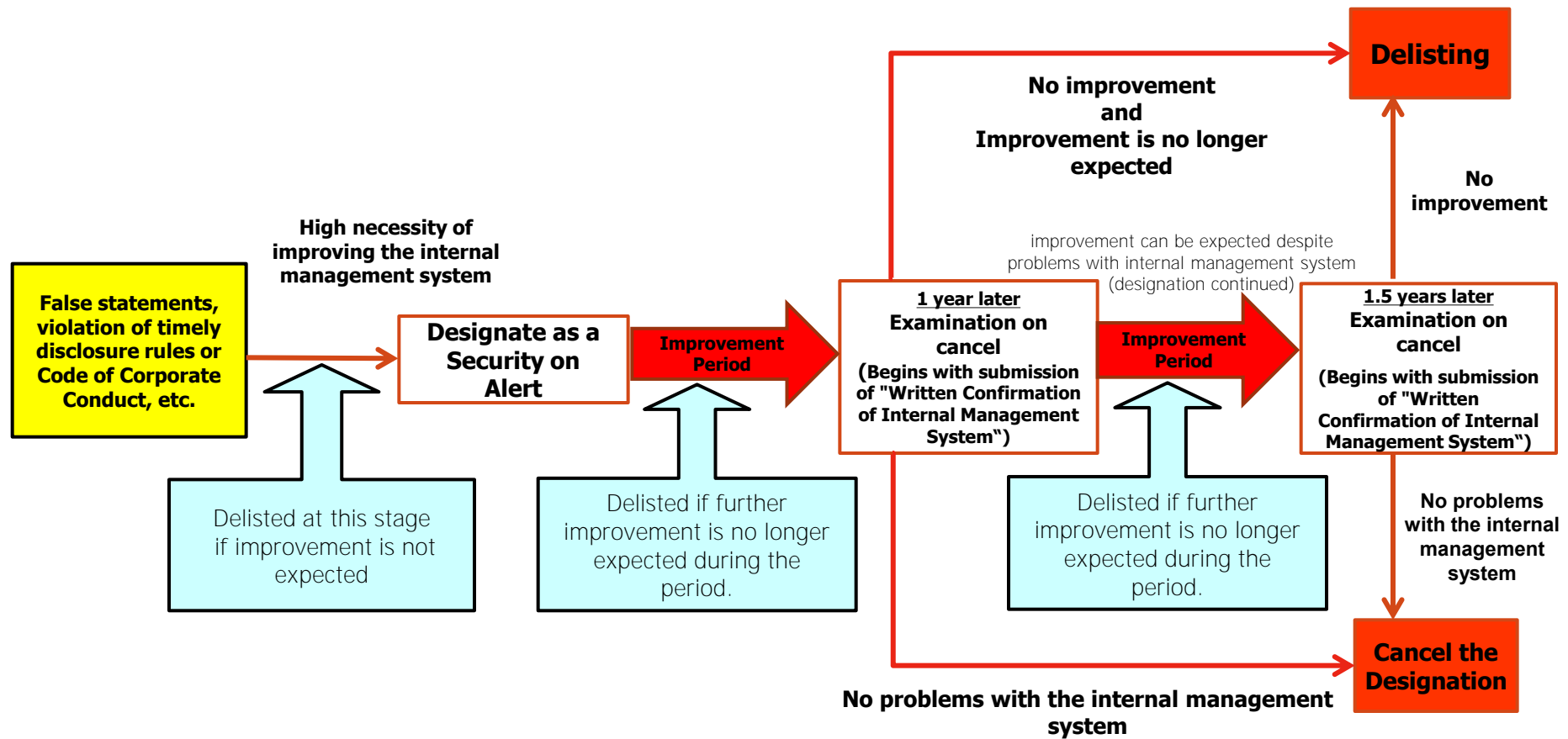


The designation shall be canceled if no problems are found with the internal management system, etc. after examination by the LCCD.



“Security on Alert”

Flow of Examination of Securities on Alert



List of Listed companies designated as “Security on Alert” (Since 2010)

Designation Date	Company Name	Code	Market Division	Cancel of Designation	Remarks
Sep. 15, 2015	TOSHIBA CORPORATION	6502	1 st section		
Apr. 01, 2015	Aisei Pharmacy Co.,Ltd.	3170	JASDAQ		
Feb. 25, 2015	SJI Inc.	2315	JASDAQ		
Jan. 29, 2015	Ishiyama Gateway Holdings Inc.	7708	JASDAQ	-	*Delisted (Aug. 1, 2015) due to public interest and for investor's protection.
Jan. 29, 2015	ENERES Co., Ltd.	6079	Mothers		
Jul. 01, 2014	JALCO Holdings Inc.	6625	JASDAQ	Sep. 25, 2015	
Mar. 11, 2014	RISO KYOIKU CO., LTD.	4714	1 st section		
Feb. 7, 2014	LCA Holdings Corporation	4798	2 nd section		
May 15, 2013	MATSUYA CO., LTD.	7452	JASDAQ		
Jun. 20, 2012	Princi-baru Corporation	3587	JASDAQ		*Delisted (Sep. 12, 2015) due to no improvement of internal management system.
Jan. 21, 2012	OLYMPUS CORPORATION	7733	1 st section	Jun. 11, 2013	
Jan. 18, 2012	KEIOZU HOLDINGS COMPANY	3731	Mothers	-	*Delisted (May. 29, 2015) due to no improvement of internal management system.
Dec. 22, 2010	DesignEXchange Co., Ltd.	4794	Mothers	-	*Delisted (May. 1, 2011) due to listed market capitalization is less than the required value
Sep. 25, 2010	Mercian Corporation	2536	1 st section	-	*Delisted (Nov. 26, 2010) due to becoming a wholly owned subsidiary of Kirin Holdings Company, Limited
May 19, 2010	Link One Co., Ltd.	2403	Mothers	-	*Delisted (Apr. 26, 2011) due to market capitalization being under JPY500 million during the period of 1 month following disclosure of a reorganization plan
Apr. 22, 2010	I'rom Holdings Co., Ltd.	2372	1 st section	Jun 22,2011	



Improvement Report and Improvement Status Report

~Improvement Measures~

Improvement Report

- The improvement report is a measure for cases less severe than those designated as Securities on Alert.
- In an improvement report, the listed company describes the background, reasons, and improvement measures regarding failure to conduct timely disclosure, etc.
- Such reports are available for public inspection.
- When the listed company does not respond to a request to submit an improvement report, the company commits a material violation of the listing agreement and will result in a **delisting**.
- In cases where TSE is unable to confirm an improvement in the status of execution and operation of improvement measures at the listed company that submitted an improvement report, TSE is able to designate its stock as **"Securities on Alert"**.

Improvement Status Report

- After 6 months from the submission of such Improvement Reports, a listed company is required to submit an improvement status report.
- LCCD normally conduct hearings and on-site examination to make sure the improvement.
- Such reports are also available for public inspection.

Financial Penalty and Public Announcement

~Penalty Measures~

Financial Penalty (Listing Agreement Violation Penalty)

- Introduced in July 2008.
- TSE may request payment of the penalty in cases where it deems that shareholder/investor confidence in the market and listed companies has been undermined in cases of a listed company deemed in violation of the securities listing regulations (timely disclosure rules and/or the Code of Corporate Conduct) or other rules.
- The penalty for a violation of the listing agreement is 20 times annual listing fee.
Ex.) TSE imposed a listing agreement violation penalty JPY 91,200,000 (≒MNT 1,500,000,000) on TOSHIBA CORPORATION (Sep.14, 2015).

Public Announcement

- TSE may make a public announcement where it deems necessary in cases of violation of timely disclosure rules and/or the Code of Corporate Conduct by a listed company.



Features of Recent “Window Dressing” Cases

- Non-core business divisions or subsidiaries that have little relationship to the main business.
- Business divisions or subsidiaries which have unusual business models or practices.
- Business divisions or subsidiaries whose ratio of amount of inventory assets to sales is large.
- Business divisions or subsidiaries at which personnel reshuffles are not conducted in an appropriate or timely manner.
- Business divisions or subsidiaries which have a particular person who wields significant management authority.



Contact

THANK YOU

**Listed Company Compliance Department
Japan Exchange Regulation**



Website: <http://www.jpx.co.jp/english/regulation/index.html>

This information has been written based on various sources that were believed to be reliable. However, Japan Exchange Group, Inc., Tokyo Stock Exchange, Inc. and/or Japan Exchange Regulation does not guarantee its accuracy or integrity. The information herein is believed to be correct at the time of printing. The purpose of this material is solely for reference, is not for sale and is not intended to solicit trading in or selling of specific securities. This material is strictly for personal use.

Corporate Governance & Disclosure

October 2015

Tokyo Stock Exchange, Inc.

Listing Department

Corporate Governance

Laws & Regulations

What is corporate governance?

- The Cadbury Report (1992)-“Corporate governance is a system by which companies are directed and controlled”.
- Japan’s Corporate Governance Code (2015)-“corporate governance” means a structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the needs and perspectives of shareholders and also customers, employees and local communities.

Basic structure of laws and regulations relating to corporate governance in Japan

<Companies Act>

- General Nature
- Incorporation
- Stocks
- Bonds
- Organization
- Accounts
- M&A
- Liquidation

<Listing Rules>

- Listing Criteria
- Timely Disclosure
- Corporate Governance Code
- Code of Corporate Conduct
- Delisting Criteria

<Financial Instruments & Exchange Act>

- Internal Control
- Insider Trading
- Disclosure
- Solicitation
- Business Regulations
- TOB rule


Increasing Accountability: The Japanese Corporate Governance Code

- ✓ Development of a CG Code is the **first action item** in the revised “Japan Revitalization Strategy” (2014 version).
- ✓ The FSA and the TSE established **the Council of Experts** to deliberate the outline of code.
- ✓ “**Comply or explain**” basis

Developed over several months by a council of experts from finance, industry, academia and think tanks, using CG codes from these countries as a reference:




Key Issues Addressed




Board Structure

- At least 2 outside directors
- 1/3 depending on size, etc.




Knowledge and Skills

- Provide for director training
- At least one expert in finance/ accounting as statutory auditors



Capital Policy

- Ample analysis/explanation for takeover defenses, offerings, MBOs, etc.




AGM Scheduling

- Ensure ample information, time for deliberation



Cross-Shareholdings

- Provide detailed analysis/ explanation for major holdings



Shareholder Dialogue

- Actively pursue dialogue
- Disclose earnings plan, capital policy, etc.

Aug - Dec 2014
8 meetings by panel

Dec 2014 - Jan 2015
Draft report /
public comment

Feb - Mar 2015
Final report
(released on Mar. 5)

Feb - May 2015
Compilation into
exchange rules

Jun 2015
**Implementation of
Code / Exchange rules**

Aug. Sep. Oct. Nov. Dec. Jan. Feb. Mar. Apr. May Jun.

Japanese CG Code: Overview

I. Respect for shareholder rights and ensuring fair treatment

- ✓ Provide necessary information for AGMs in a timely fashion
- ✓ Provide information in a format usable for foreign investors
- ✓ Address capital strategy and cross-shareholdings

II. Cooperation with stakeholders

- ✓ Address social/environmental sustainability
- ✓ Promote workplace diversity and develop a robust whistleblower system

III. Timely, relevant disclosure and ensuring transparency

- ✓ Publish company philosophy, strategy, and corporate governance approach
- ✓ Disclose strategy and process for determining compensation, appointment, and the reasons for such for management, directors and auditors

IV. Defining board responsibilities

- ✓ Develop company vision, create specific long-term strategy with management
- ✓ Monitor and evaluate management, disclosure and conflicts of interest
- ✓ Define auditor responsibility, promote higher independence and proactivity

V. Encourage dialogue with shareholders

- ✓ Directors should actively seek out dialogue with shareholders
- ✓ Companies should develop and communicate long-term revenue/capital goals and explain clearly to shareholders how they plan to achieve them.

Stronger Governance Through Companies Act Revision

- ✓ Amendment approved by the Japanese Diet in June, 2014
- ✓ Implemented on **May 1, 2015**.

Purpose

- Strengthen **corporate governance** through outside directors
- Protect **minority shareholders**

Key Changes

- Appointment of at least one outside director (comply-or-explain)
- Tighter definition of “outside director”
- New governance structure to facilitate move to committee-style boards

	Outside Director		Independent Director		
Current Definitions in Companies Act	Amendment	(Ref.) TSE rule	US*	UK**	
Executive officer/employee	✗	✗	✗	✗	✗
Executive officer/employee of its subsidiaries	✗	✗	✗	✗	✗
Executive officer/employee of parent /sister companies	○ »	✗	✗	✗	✗
Family of executive officer/employee	○ »	✗	✗	✗	✗
Major business affiliate	○	○	✗	✗	✗

* the NYSE Listing Manual, Nasdaq listing standards

**UK combined code of corporate governance

Company Act Revision: New Governance Structure to Promote Independence



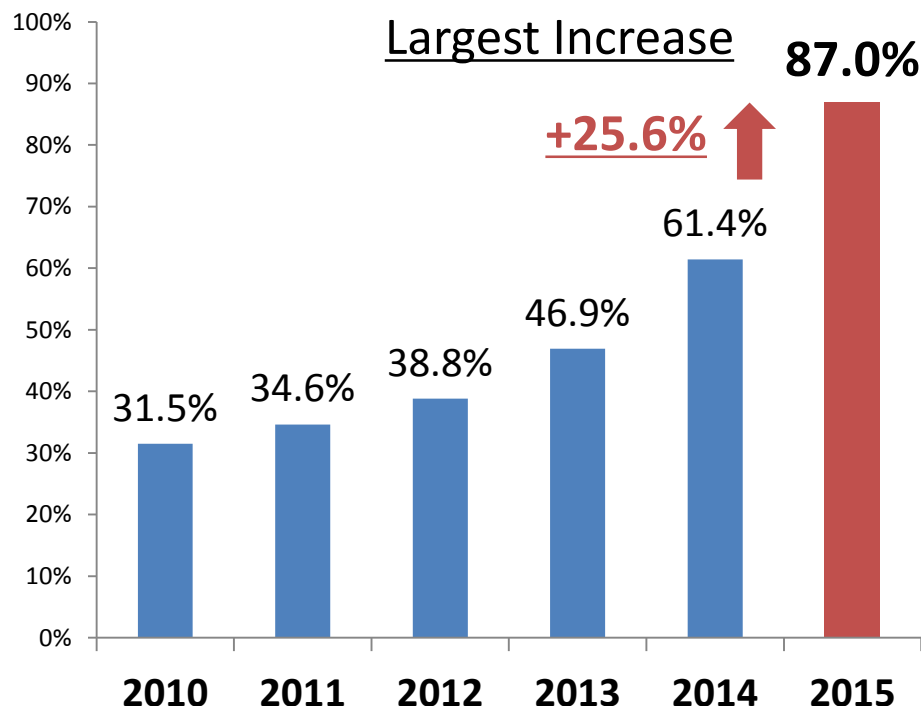
- ✓ The new amendment establishes a new “Audit/Supervisory Committee Model” to encourage appointment of outside directors. **At least 2 outside directors** must be appointed under this model.
- ✓ Members of the new Audit/Supervisory Committee **have voting rights** in board meetings, while statutory auditors under the existing structure do not.

	CG structure	%	Monitoring Person	Voting Right	Notes
A	Company with Committees	2%	Outside Director	YES	Over half of the directors of each committee must be outside directors.
B	Company with Audit/Supervisory Committee	-	Outside Director	YES	The committee consists of three or more directors, <u>the majority of which must be outside directors.</u>
C	Company with Board of Statutory Auditors	98%	Statutory Auditors	NO	Over half of the S-auditors must be outside S-auditors.

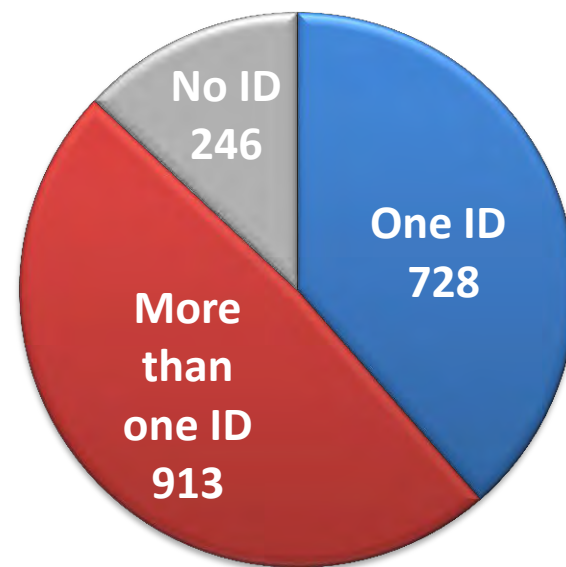
- ✓ Members of the Audit/Supervisory Committee **have a tenure of two years** and their dismissal requires a **two-thirds majority vote** by shareholders, whereas other directors have a tenure of one year and their dismissal requires only a majority vote.

More Companies Are Appointing Independent Directors

1st Section Companies with Independent Directors



Independent Directors at 1st Section Companies



Average: 1.8 Independent Directors
(Average board size = 8.9 directors)

What's the result?

- ✓ Optimistic reaction from both inside and outside Japan

“At long last, Japanese firms seem to be coming under proper outside scrutiny”

- The Economist

“I think this will be epoch-making in the context of Japan.”

- Nicholas Benes, Board Director Training Institute

“ We believe that solid development in corporate governance is on the horizon. This should improve the likelihood of mid- to long-term returns for investors in Japanese equities.”

- Kazuhiro Toyoda, Schroders Investment Management

- ✓ The Asian Corporate Governance Association now ranks Japan as 3rd in Asia, up from 4th two years ago.

ACGA Corporate Governance Ranking/Scores:

Rank	Country	2010	2012	2014	Change
1	Hong Kong	65	66	65	-1
1	Singapore	67	69	64	-5
3	Japan	57	55	60	5
4	Thailand	55	58	58	-
4	Malaysia	52	55	58	3

Disclosure

Investment and Disclosure

Investors' self-responsibility

- Investors make investment upon their own decision and responsibility
⇒ Investors take risk and return resulting from the investments
- An environment where the investors can make reasonable decisions has to be provided as a precondition of the self-responsibility.

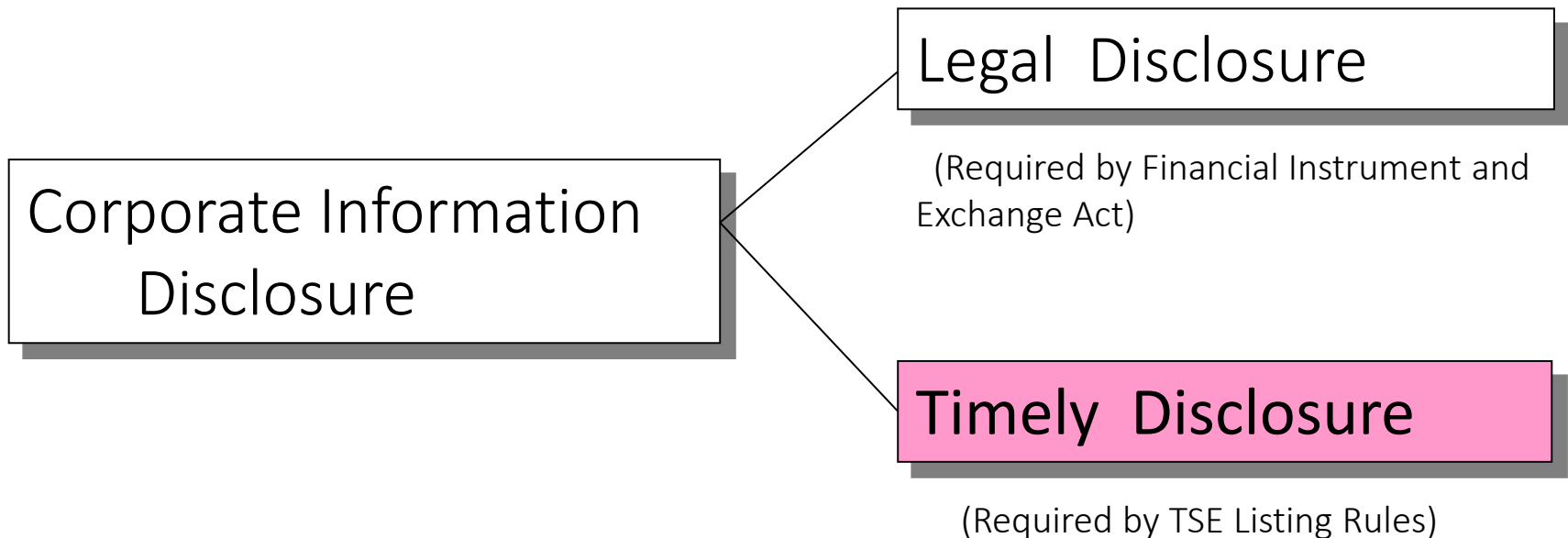


Disclosure

Information on the securities and issuer has to be disclosed in a precise, fair, timely manner.

Disclosure

Companies listed on TSE are required to disclose its information by laws (mainly by Financial Instrument and Exchange Act) and the listing rules.



Disclosure

Disclosure

Legal Disclosure (Required by Financial Instrument and Exchange Act)

- securities registration statement
- annual securities report
- quarterly securities reports etc

Correctness
Completeness

Timely Disclosure (Required by TSE Listing Rules)

- Facts that are decided by the listed company
- Facts that occurred at the listed company
- Information on subsidiaries
- Earnings report/Quarterly reports
- adjustments to earnings forecasts or figures etc

Flash report
Publicity

- Required by Companies Act (Business report, etc)
- Voluntary disclosure (Annual Report, CSR Report, etc)

Outline of Legal Disclosure (1)

- **Disclosure for the Primary Market**

- Disclose when an issuer issues and offers securities.
- Give an opportunity to make a decision necessary for purchasing securities based on the investors' self-responsibility.
- Securities Registration Statement
 - Disclose precisely (i) the contents of the securities to be issued and (ii) businesses and financial conditions of the issuer (and the business group of the issuer).
 - Subject to public inspection at the finance bureau. Copies are also stored at the issuer's office and the stock exchanges for public inspection. Disclosed electronically via EDINET system.
 - Cannot make solicitation or deliver the securities without filing of securities registration statement.
- Prospectus
 - Prospectus stating similar information in SRS has to be delivered to the investors.
 - Prospectus must be delivered before purchase of the securities.
 - May deliver electronically upon consent by the customer.

Outline of Legal Disclosure (2)

- **Ongoing Disclosure**

- required after public offering of the securities.
- Secure fair, smooth trading and protect investors in the secondary market
- disclose the businesses and financial conditions of the issuer (or the business group of the issuer).
- Annual Securities Report
 - To be filed within 3 months (6 month in case of a foreign company) after ending of fiscal year
 - Most detailed ongoing disclosure
- Quarterly Report
 - To be filed within 45 days after ending of 1st, 2nd and 3rd quarter.
- Extraordinary Report
 - Disclose the matters that may materially affect investment decision without delay
- Others
 - Internal control report, report of purchasing treasury stocks, report of parent companies, etc.

Outline of Timely Disclosure (1)

1. Principles of timely disclosure rule

- Information that may materially affect investment decision has to be disclosed in a timely manner.
- The Listing Rules provide minimum standards for timely disclosure.

2. Timing of disclosure

- Immediately after the decision or recognition of facts

3. Prior Explanation to TSE

- Prior to disclosure, listed company are required to explain about the information to TSE.

4. The method of timely disclosure

- Electronic filing system: “TDnet”(Timely Disclosure NETWORK)

5. Response to uncertain information

- If uncertain information is spread or broadcasted, TSE may require relevant listed company to disclose accurate information.

6. Update of disclosed information

7. Designation of corporate information handling officer

Outline of Timely Disclosure (2)

Information required to be disclosed

1. Management Decisions

e.g. Merger, Equity Finance, Bankruptcy...

2. Events affecting corporate situation

e.g. Disaster, Default of Debt...

3. Information on subsidiaries

4. Financial Information

e.g. Earnings Release, Changes of forecast on dividends...

5. Others

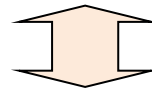
e.g. Information on unlisted Controlling Shareholder, etc.

Outline of Timely Disclosure (3)

Timely Disclosure and Insider Trading

Regulation on Insider Trading (Financial Instruments and Exchange Act)

- An insider of a listed company must not sell/purchase relevant securities after material information arises until the information is disclosed.



Timely Disclosure (Listing Rules)

- A listed company can prevent insider trading by disclosing material information immediately.
- An exchange maintains fairness and creditability of the market by requiring the listed companies to disclose such information and preventing insider trading.
- The range of information subject to Timely Disclosure is wider than that of insider trading regulations because Timely Disclosure is designed in view of dissemination of information contributing to investors' decision making.

Thank you.



A Brief Explanation of Market Surveillance at Japan Exchange Regulation

**Market Surveillance and Compliance Department
Japan Exchange Regulation
October 2, 2015**



Contents

- I. Target of Our Surveillance
- II. Structure of Market Surveillance
- III. Market Surveillance activities
- IV. Preventive Measure



I . Target of Our Surveillance



I . Target of Our Surveillance

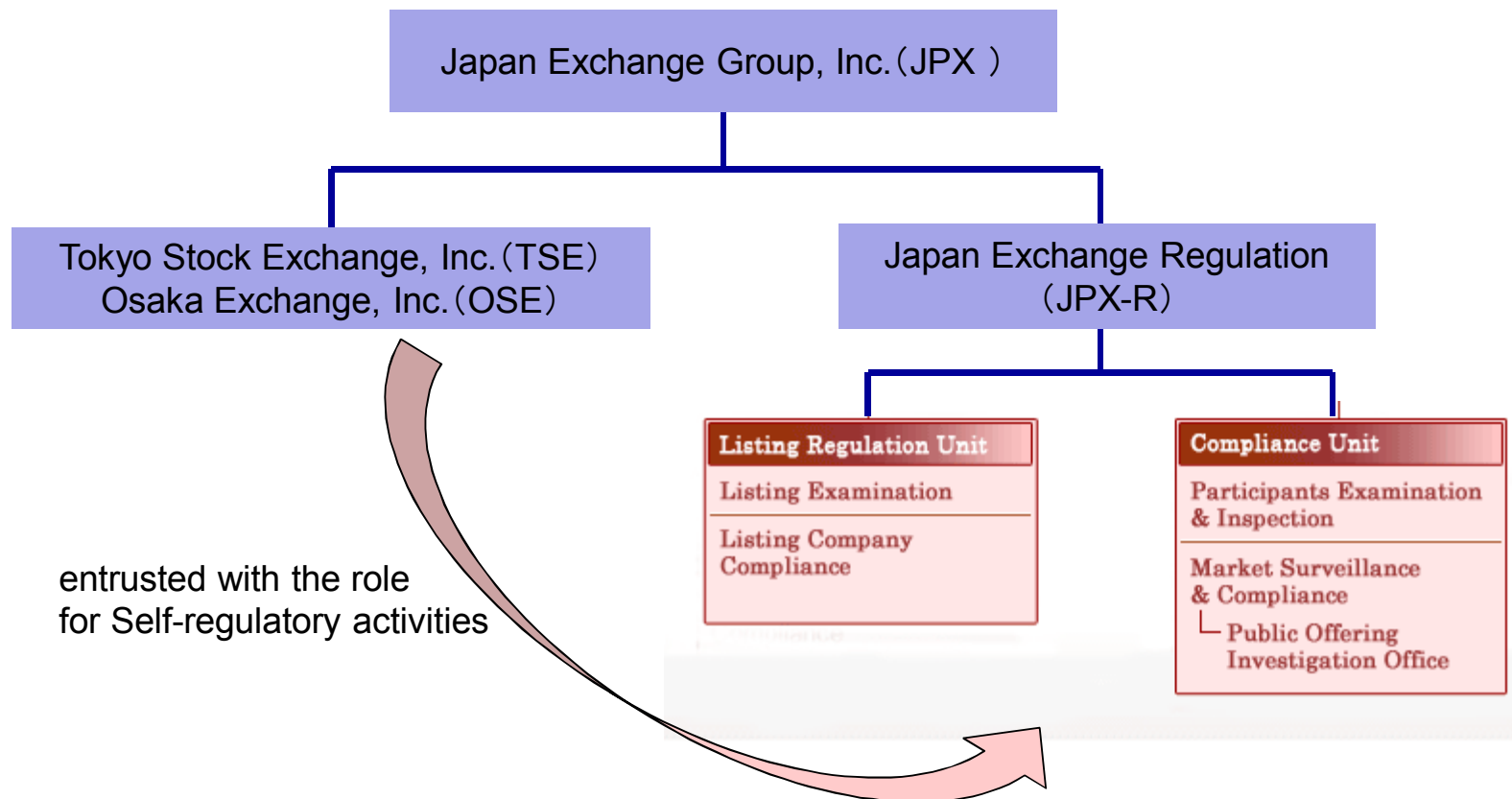
- ✓ The stock Exchanges in Japan have a duty to investigate unfair trading(in Article 84)

- ✓ Unfair trading are defined by Financial Instruments and Exchange Act(Chapter VI)
 - Insider Trading(in Article 166,167)
 - Market Manipulation(in Article 157-159)



I. Target of Our Surveillance

[Reference] Structure of JPX Group





I . Target of Our Surveillance

[Reference] Types of Unfair Trading ①

Insider Trading refers to transactions where someone with a connection to a listed company uses information which they acquired through their official job or based on their position, such as a not-yet-released financial statement, etc with the potential to have a large impact on investors, to conduct an illegal sale or purchase of a stock.

When this kind of trade occurs, general investors who do not have access to this information are at an unfair disadvantage. This may result not only in unexpected losses, but may also cause investors to lose faith in the overall reliability of the market.



I . Target of Our Surveillance

[Reference] Types of Unfair Trading ②

Market Manipulation is similar to insider trading, exploit important company information that has yet to be released to the public to influence the market.

For example, this includes any effort to make personal gains by deliberately altering the market to form prices in an unnatural way. This is done in a manner such that it mistakenly appears to others as if it were following the natural laws of supply and demand.

This action is referred to as market manipulation and, like insider trading, it is an unfair type of price forming action which may have an unexpected negative impact on investors.



I. Target of Our Surveillance

[Reference] Definition of “Material Facts”

Classification	Examples of Material Fact	Numerical Standard
(1) Decisions	<ul style="list-style-type: none"> - Offering of shares for subscription - Acquisition of treasury shares - Stock split - Business alliance - Merger - Commercialization of new products / new technologies 	Total amount of the amount paid-in under the offering is 100 million yen or more None (all are material facts) Ratio of increase is 10% or more
(2) Occurrences of events	<ul style="list-style-type: none"> - Damage arising in the course of business - Release of a debt by creditor 	<ul style="list-style-type: none"> - Damage amount is 3% or more of net assets - Forgiven amount is 10% or more of the total debt
(3) Financial results or projections	Significant revision of business results' projections <ul style="list-style-type: none"> - Sales - Ordinary profit - Current term net profits 	<ul style="list-style-type: none"> - Variation of 10% or more - Variation of 30% or more, and the amount of the variation is 5% or more of net assets - Variation of 30% or more, and the amount of the variation is 2.5% or more of net assets
(4) Basket clause	In addition to (1) to (3), material facts relating to the management, business, or property of a Listed Company, etc. which may have a significant influence on the investment decision of investors.	
(5)~(8) Material facts with respect to a subsidiary	Similar to (1)~(4)	

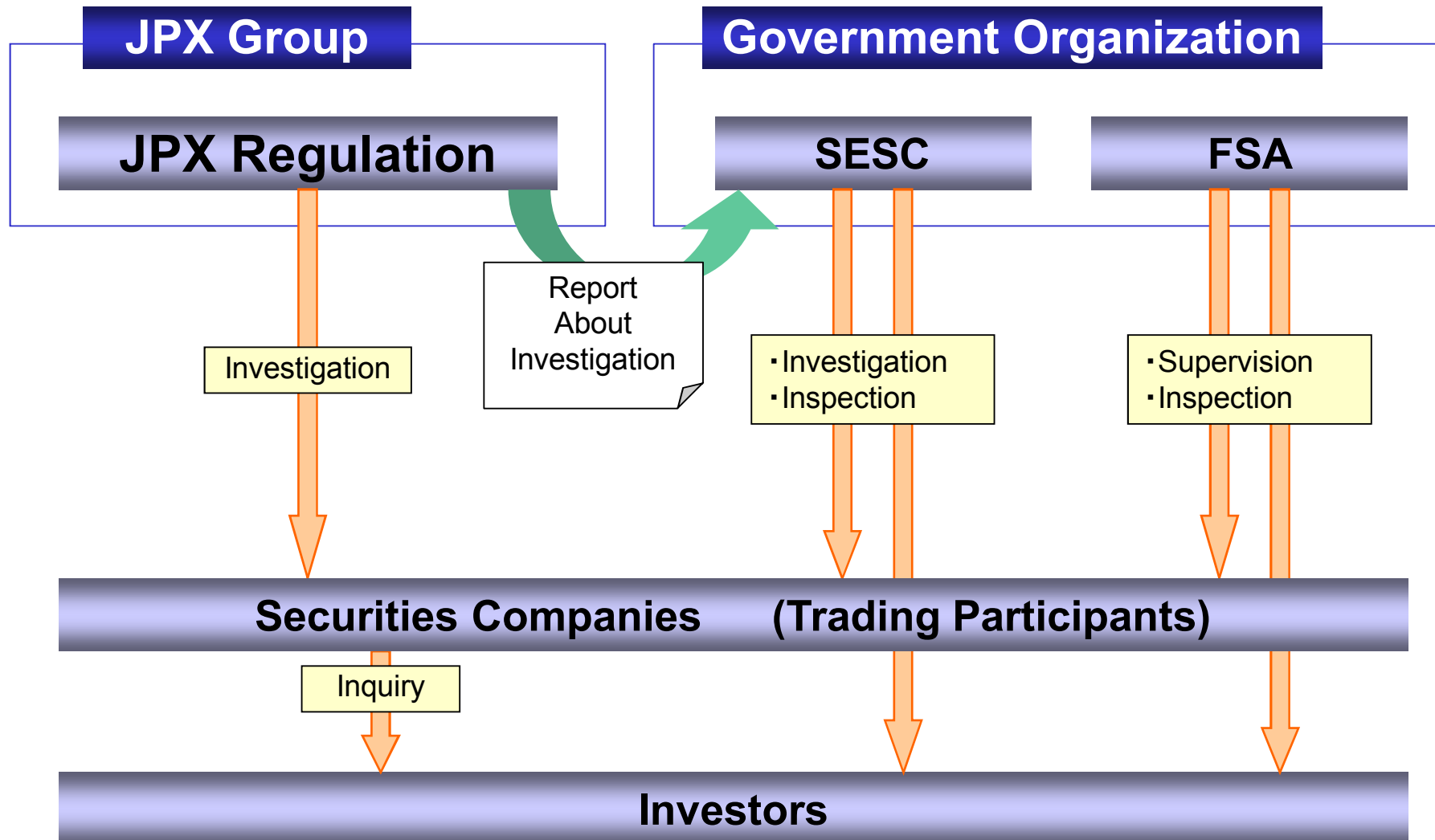


II. Structure of Market Surveillance



II. Structure of Market Surveillance

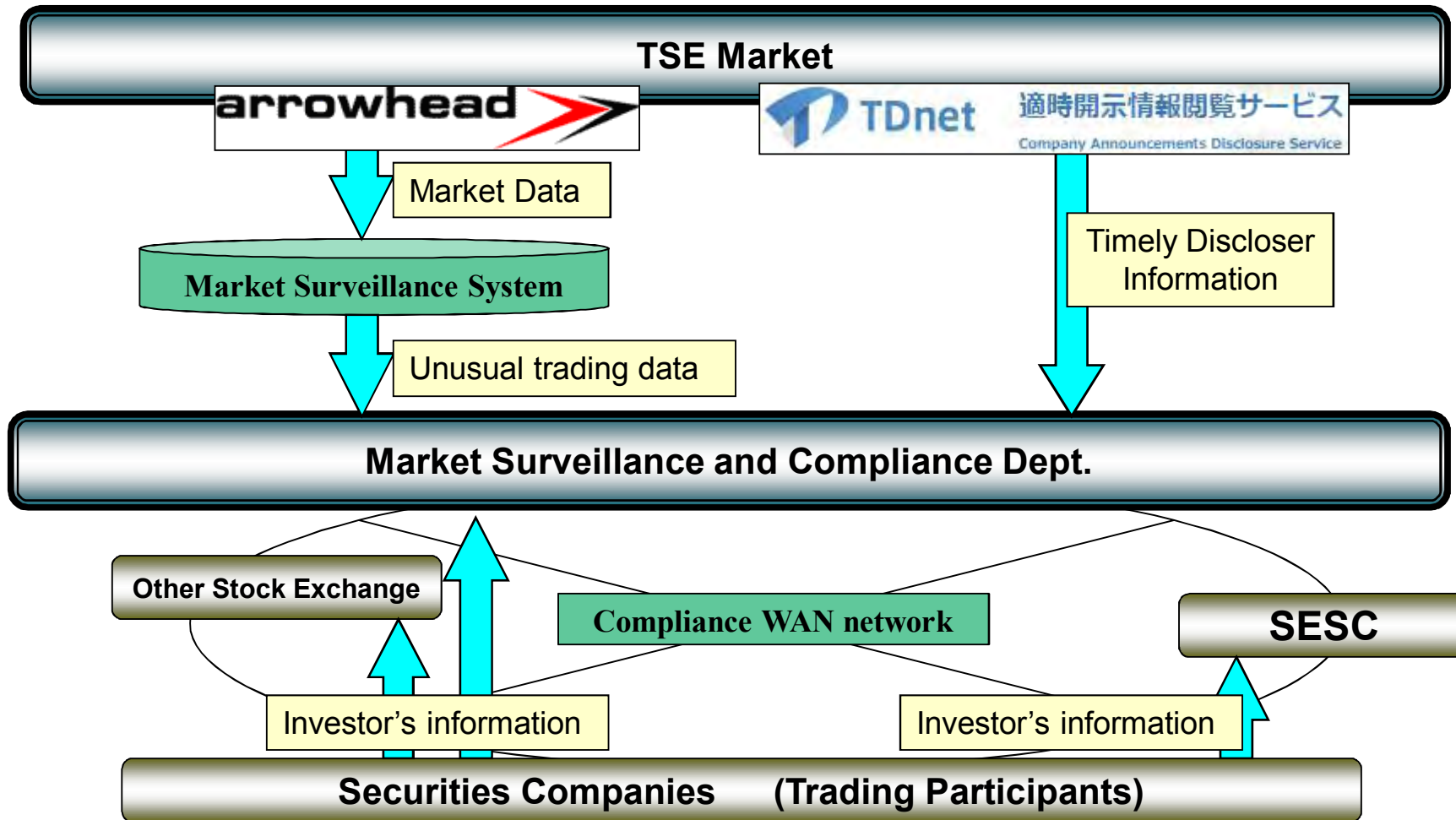
1. Organization of Market Surveillance





II. Structure of Market Surveillance

2. System and Network of Market Surveillance



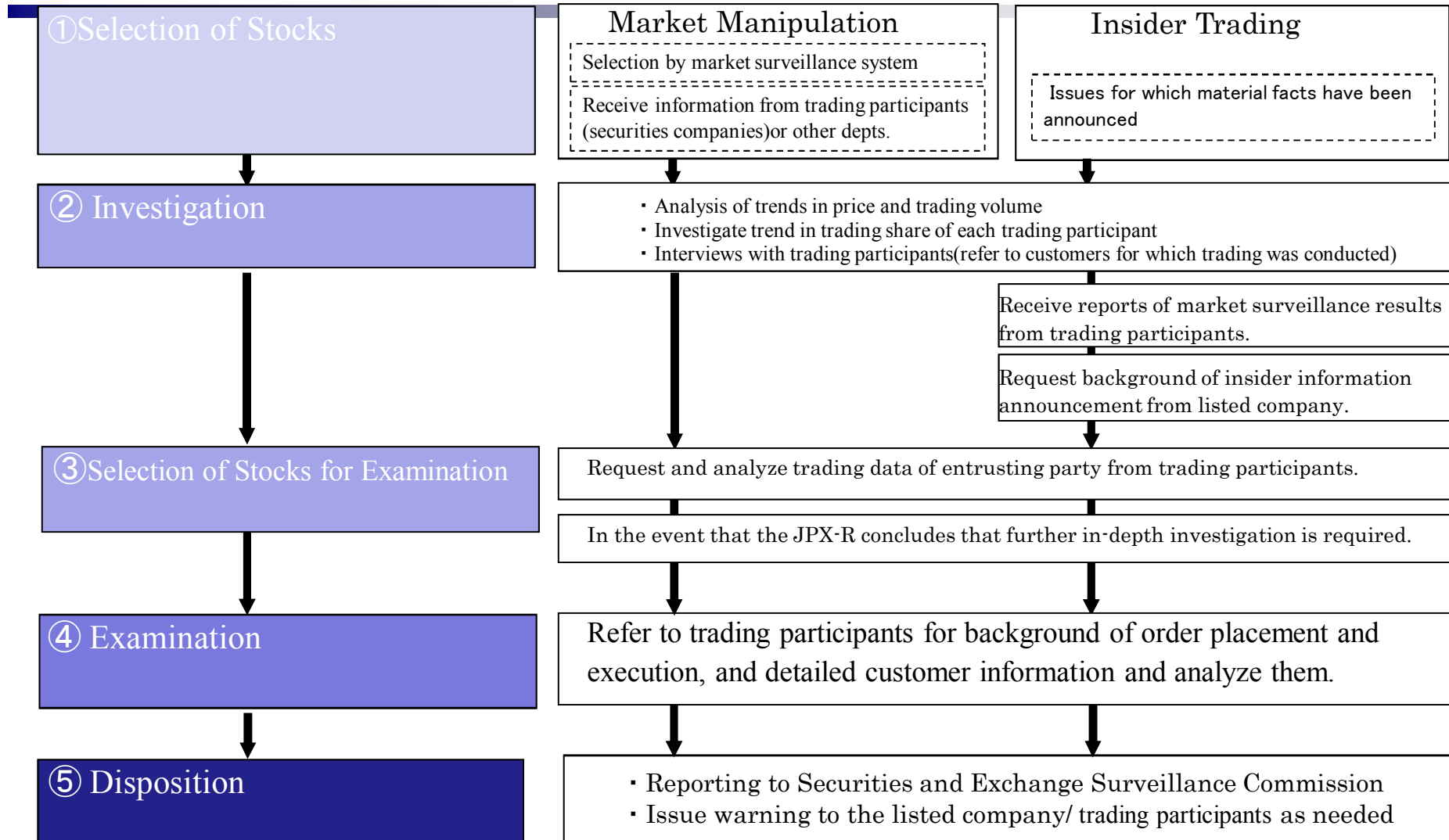


III. Process of Market Surveillance



III. Process of Market Surveillance

1. Flow of Market surveillance





III. Process of Market Surveillance

2. Number of Examinations and Investigations

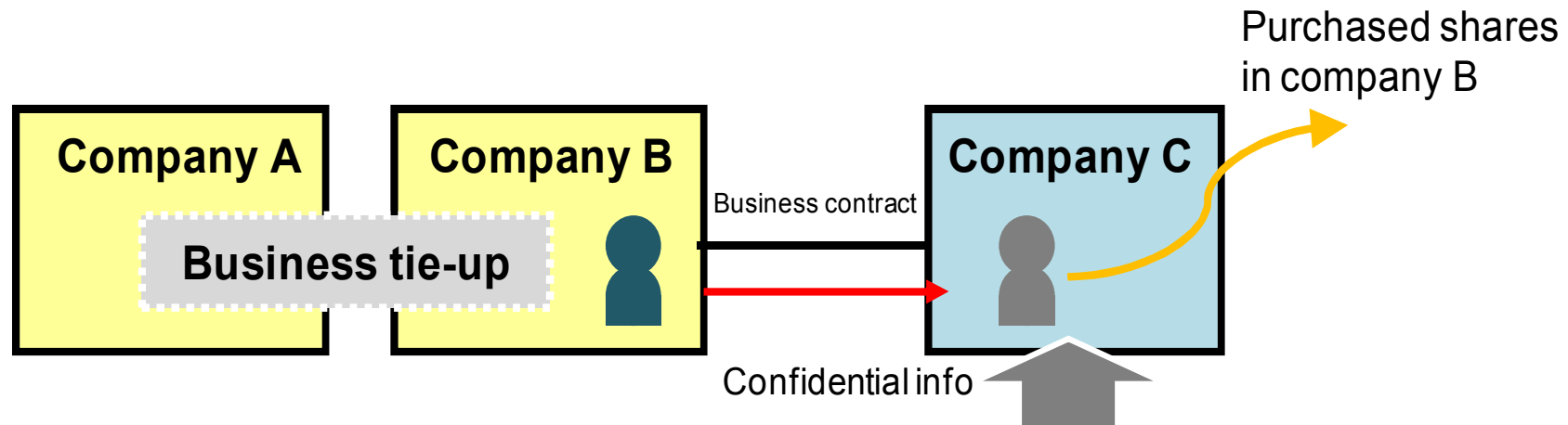
	FY 2012		FY 2013		FY 2014	
	Investigation	Examinations	Investigation	Examinations	Investigation	Examinations
Insider Trading	1,206	112	1,726	177	1,985	134
Market Manipulation	29	16	568	16	1,143	31
Others	1,002	3	1010	1	359	1
Total	2,237	131	3,304	194	3,487	166




III. Process of Market Surveillance

3.Example of Insider Trading Case

- An employee at Company C learned of material non-public information on business tie-up between Company A and B.
- The employee purchased shares in Company B prior to public announcement of the business tie-up.



Administrative Monetary Penalty
JPY0.68mil

 denied insider trading charges.



III. Process of Market Surveillance

4. Example of Market Manipulation Case

■ Contract:

- TOPIX Futures (Expiry : 2013.09)

■ Date:

- 2013.07.29 – 2013.07.31 (3 days)
- 2013.09.09 – 2013.09.11 (3 days)

■ Details:

- A prop desk trader entered a small buy order to Best Bid (or Ask) price and entered a large sell order to Best Ask (or Bid) price.
- Acquired JPY5.435 mil (approx US\$50K) in profit.
- Traded volume (buy and sell) : 4,032 units
- Order volume (buy and sell) : 88,443 units



III. Process of Market Surveillance

4. Example of Market Manipulation Case

1. Entered small buy order A

Trader	Vol (S)	Price	Vol (B)	Trader
	154	1234.0		
	96	1233.5		
	76	1233.0		
	14	1232.5		
		1232.0	51	10
		1231.5	68	
		1231.0	89	
		1230.5	126	

2. Entered large sell order B

Trader	Vol (S)	Price	Vol (B)	Trader
	151	1234.0		
	96	1233.5		
	78	1233.0		
100	157	1232.5		
		1232.0	49	10
		1231.5	67	
		1231.0	90	
		1230.5	126	

3. Small buy order A filled

Trader	Vol (S)	Price	Vol (B)	Trader
	151	1234.0		
	96	1233.5		
	78	1233.0		
100	159	1232.5		
		1232.0	1	
		1231.5	66	
		1231.0	90	
		1230.5	126	

4. Deleted large order B

Trader	Vol (S)	Price	Vol (B)	Trader
	151	1234.0		
	94	1233.5		
	85	1233.0		
400	81	1232.5		
	29	1232.0		
		1231.5	40	
		1231.0	78	
		1230.5	129	



IV. Preventive Measure



IV. Preventive Measure

1. Explanation

- **Explanation (After Investigation or Examination)**
 - ✓ If the possibility of illegal trading in the future arises, staff members of the Market Surveillance and Compliance Department explain the situation to persons in charge of market surveillance at trading participants.



IV. Preventive Measure

2. Investor Education(1)



(Compliance Learning Center)

- Contents
 - ✓ Seminar
 - ✓ E-Learning Service
 - ✓ Publication

IV. Preventive Measure

3. Investor Education(2)

- Seminar – How to prevent Insider Trading
 - ✓ COMLEC held seminar to prevent Insider trading for listed companies.





IV. Preventive Measure

3. Investor Education(3)

- E-learning – about Insider Trading
 - ✓ COMLEC provide e-learning service for staffs of listed companies, staffs of securities companies, and investor.



Insider trading is a fraudulent transaction

Insider trading was detected

It was reported in newspapers and on television

The incident had tremendous effects on parties concerned including his/her family members and his/her company

Let's begin by gaining proper understanding of insider trading regulations.

STOP Insider Trading

Let's learn about "insider trading regulations" in detail from the next chapter!

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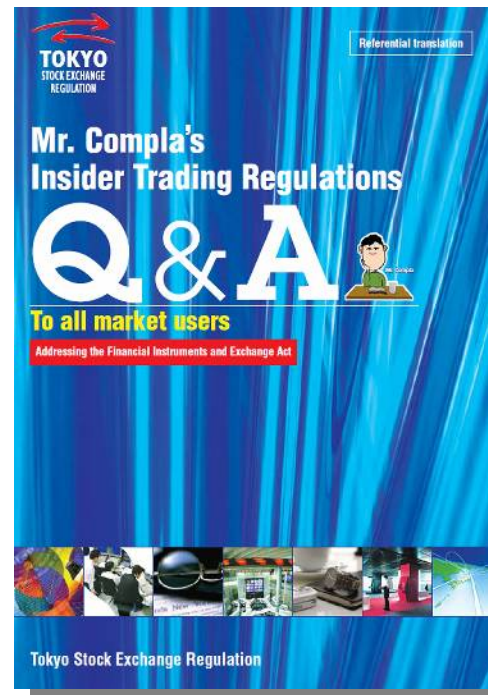
Replay Stop/Start On/Off



IV. Preventive Measure

3. Investor Education(4)

- Publication
 - ✓ “Insider Trading Regulations Q&A”
 - Explains insider trading regulation for staffs of listed companies in plain terms.
 - Total circulation had exceeded a million (2010)





Thank you for your kind attention!!

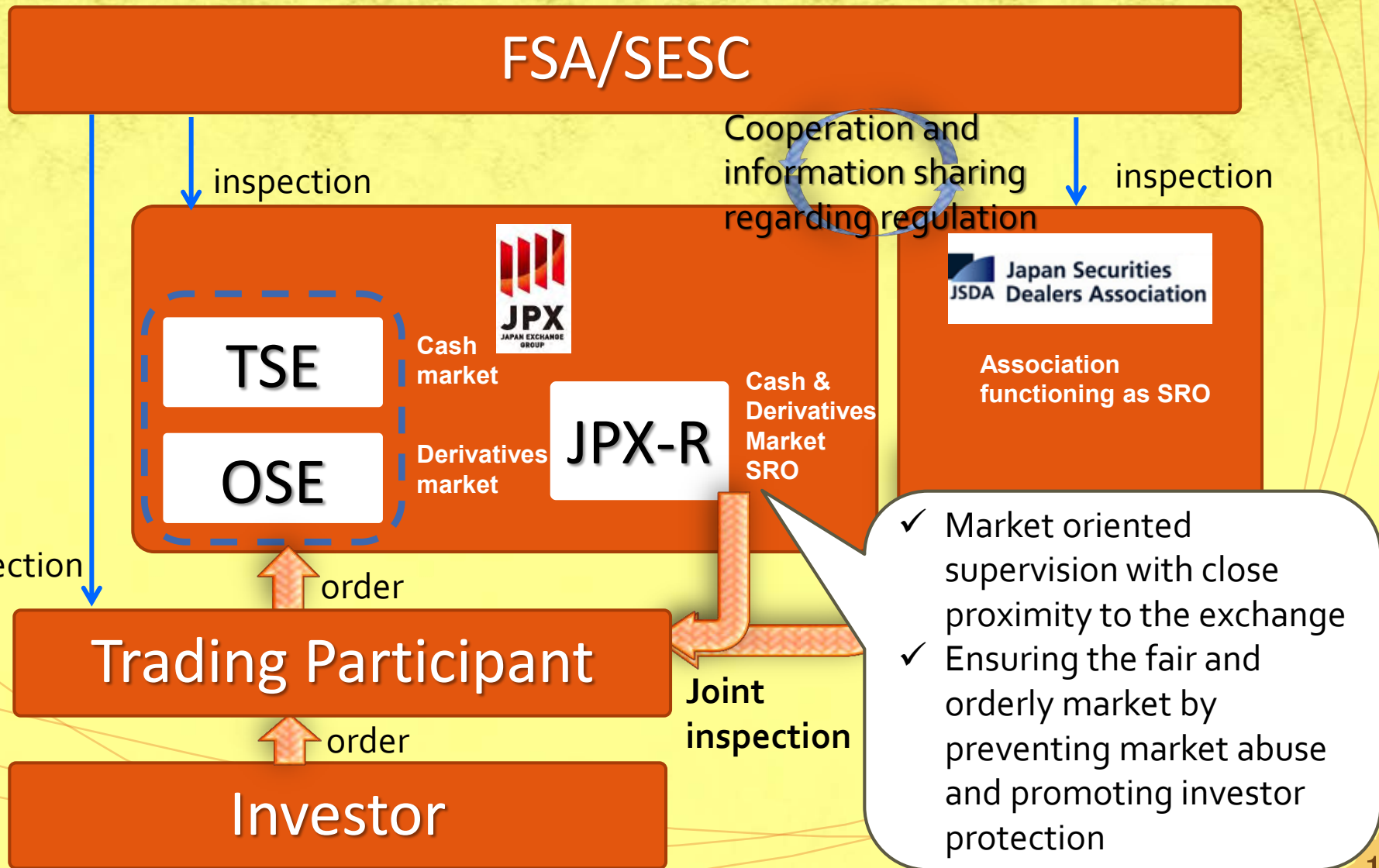
Inspection on Trading Participants

October 2, 2015

Participants Examination & Inspection
Japan Exchange Regulation



1. Framework of the supervision of Trading Participants



2.JPXR - Self-Regulatory Body of JPX

JPXR

“Quality Control Center” of the Exchange

Listing Examination

Examine eligibility of companies or financial instruments seeking to list

Listed Company Compliance

Check information disclosure and corporate actions of listed companies

Market Surveillance

Monitor and investigate possible market manipulation and insider trading

Participant Examination and Inspection

Ensure the reliability of exchange trading participants

3. Difference of Inspection & Market Surveillance

	Participant Examination and Inspection	Market Surveillance
Purpose	Secure qualification and credibility of trading participants	Secure fairness of trading on the TSE and OSE market
Object of examination	Trading participants	Trading on (and outside, when necessary) the TSE and OSE market
Outline of examination	Inspect trading participants' compliance with laws and regulations, and their business and financial condition	Investigate existence of unfair trading, such as insider trading or market manipulation, on the TSE and OSE market

4. Structure of the department

Inspection director

General Administration and Planning Group

- Plans inspections
- Conducts examinations of trading qualifications etc.
- Decides the conducts of the disciplinary action

Information Analysis Group

- Gathers and analyzes inspection information
- Evaluates inspection results etc.
- Responds to inquires from trading participants
- Training to trading participants

Inspection Group

- Conducts On-site inspections etc.

5. Overview of Inspection

●Objective

In order to ensure market fairness and reliability, the JPXR investigates compliance with laws and TSE and OSE rules, condition of business and property of trading participants, take necessary measures based on the results.

●Type of Inspection

Regular Inspection	The JPXR take into consideration the results of last inspections and the number of days elapsed since the last inspection etc. and carries out general inspections sequentially from trading participants is deemed highly necessary to inspection.
Follow-up Inspection	Follow-up Inspection is carried out within one year after the previous inspection as needed to confirm how well the trading participant has made improvements.
Special Inspection	Inspections of trading participants are conducted with a focus on specific items based on a variety of information.

●Inspection methods

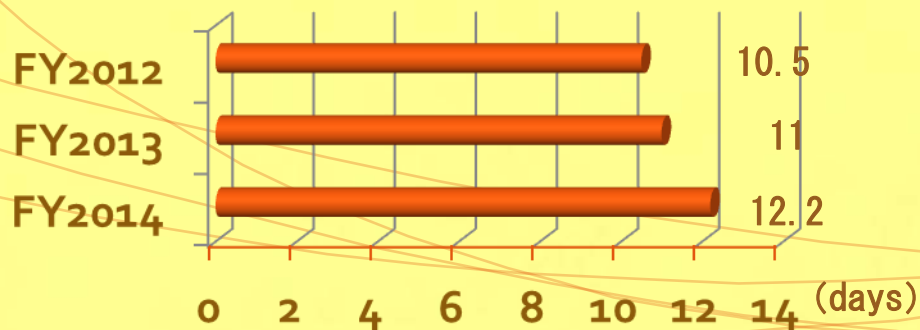
On-site Inspection	The JPXR selects several offices from among trading participants' headquarters and branch offices, and conducts on-site inspections at these offices. Majority of inspections are conducted using this method.
Document Inspection	If the JPXR decides that the documents submitted by a trading participant are sufficient, inspections are carried out based on the documents without an on-site inspection.

6. Statistics on Inspection

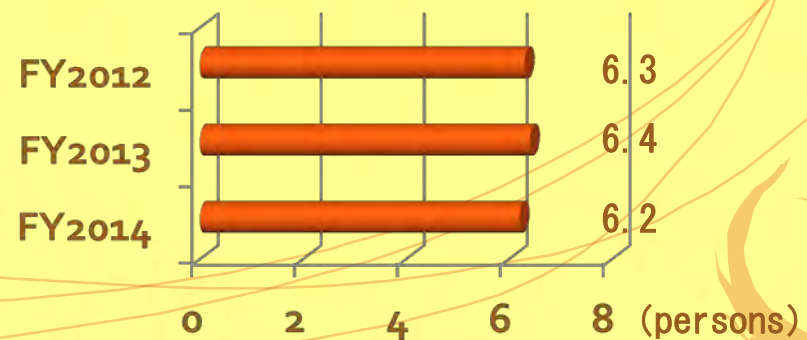
- The number of on-site inspection conducted

Type of inspection	Number of companies		
	FY2012	FY2013	FY2014
Regular Inspection	30	28	29
Follow-up Inspection	1	1	0
Special Inspection	0	2	1
Total	31	31	30

○ Average number of days spent for an on-site inspection per trading participants



○ Average number of inspectors engaged in an on-site inspection per trading participants



7. Inspection Steps

Selection



Pre-inspection



On-site inspection



Analysis



Measures

- Select a trading participant to be inspected considering following : latest inspection result, results of SESC inspection, interval, financial condition, information from the outside, etc.
- Request to submit documents related to examination for the trading participant in order to analyze the documents and prioritize items for inspection in advance.
- Based on the investigation of record books and documents, understand transactions ,customers or sales staff suspected of violating laws, etc.
- Conduct the hearing for compliance officer, etc. , and confirm business flow and in-house compliance management.
- Determine the contents of the measures pertaining to the violation of laws, TSE or OSE rules , etc.
- JPXR imposes disciplinary action (suspension or restriction of trading, imposition of financial penalties, etc.) or caution, if the violation of laws, TSE or OSE rules, etc. is observed.

8. Deficiency found in recent Inspection (in FY 2014)

Deficiencies		Number of cases	Of these, cases in which warnings or requests were issued
1	Deficiency related to margin trading	13	10
2	Deficiency related to short-selling	8	1
3	Deficiency in the management system for preventing erroneous order placement	7	5
4	Deficiency in the management system for preventing unfair transactions	6	1
5	Deficiency in the management of corporate information	5	4
6	Deficiency in the calculation of net capital regulation ratio	4	1
7	Deficiency in the management of margin of derivatives trading	3	2
8	Deficiency in books and documents	3	0
9	Deficiency related to regulatory measures for trading, etc.	2	1
10	Deficiency related to segregating customer assets from proprietary assets	2	1
11	Deficiency in reporting to JPX	2	0
12	Deficiency related to best execution obligation	2	0
13	Deficiency related to net settlement transactions	1	1
14	Others	4	3
Total		62	30

9. Disciplinary Actions and Cautions

(reference : Number in FY 2014)

Violation cases			Deficiencies of internal control systems	
Disciplinary actions	Revocation of trading qualification	0	Recommendation	0
	Suspension or restriction of trading	0		
	Imposition of financial penalties	0		
	Censure	0		
Cautionary notices	Warning by the Governor in charge	0	Request	1 2
	Warning by the director of Participants Examination and Inspection Department	3		
	Warning by inspection staff	1 5		

10. Enforcement

If a trading participant violates laws, TSE or OSE regulation etc., JPXR can determine disciplinary actions such as Revocation of trading qualification, Suspension or restriction of trading, etc. for the trading participant.

- JPXR may initiate appropriate disciplinary process with the result of inspection or market surveillance by JPXR or other organizations when a participant.
 - violates the FIEL or the TSE or OSE rules , etc.
 - obtains the exchange's trading qualification unfairly or dishonestly
 - rejects to report or makes false report , etc.
- After through deliberation by the Discipline Committee, JPXR will decide on the content of the disciplinary action.
 - 7 ~11 members from representatives of trading participants and non-trading participants
 - More than half the members shall be from non-participant such as lawyers, etc.
 - Approval of more than half of attended members is necessary.
- Type of Disciplinary Actions
 - Censure (warnings)
 - Fine up to JPY 500 million
 - Limiting or suspending transaction
 - Revocation of trading qualification

11. Enforcement steps

- Violation of laws and/ or regulations
- Acquisition of trading qualification by false means
- Insolvency, breach of contracts
- Failure to pay or deposit of funds or securities
- Refusal of inspection, report, submission of information, etc.
- Presentation of case subject to disciplinary actions
- Deliberation on disciplinary actions
- Decision on disciplinary actions
- The trading participant can lodge a objection for TSE and/ or OSE, within 10 days from the notification the disciplinary actions.

Occurrence of event subject to disciplinary actions



Trading Participant Hearing



Discipline Committee



Board of Directors



Disciplinary actions taken by the TSE

Disciplinary actions taken by the OSE



Trading Participant

12. Recent disciplinary actions

(reference : Disciplinary actions)

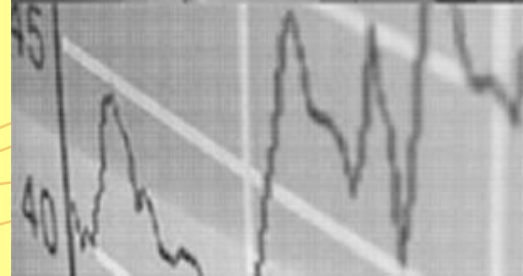
Date	Trading Participant	Violation	Disciplinary Action
7-Aug-2012	SMBC Nikko Securities Inc.	Business operation which lacks the necessary and appropriate measures to prevent unfair trading with respect to the management of corporate information, as well as inappropriate solicitation which includes acts in violation of laws and regulations	Fine of JPY 80 million
29-Aug-2012	livestar Securities Co., Ltd.	The administration of the electronic data processing system pertaining to financial instruments business, etc. was deemed to be inadequate.	Fine of JPY 3 million
18-Sep-2012	TAKAGI SECURITIES CO., LTD.	Conditions deemed lacking in necessary and appropriate measures for prevention of unfair trading in relation to management of corporate information.	Fine of JPY 5 million
31-Oct-2012	Nomura Securities Co., Ltd.	Not having measures necessary and proper for preventing unfair trading related to management of corporate information, and soliciting customers with the provision of corporate information.	Fine of JPY 200 million

12. Recent disciplinary actions

(reference : Disciplinary actions)

Date	Trading Participant	Violation	Disciplinary Action
21-Feb-2013	SANKO SECURITIES Co., Ltd.	Act of conducting purchases, etc. of listed securities with the aim of causing fluctuations in prices of such listed securities.	Fine of JPY 12 million
27-Feb-2014	SMBC Nikko Securities Inc.	Business operation which lacks the necessary and appropriate measures to prevent unfair trading with respect to the management of corporate information.	Fine of JPY 10 million
24-Sep-2014	Musashi Securities Co., Ltd.	Act of conducting a series of Sales and Purchase therefor that would cause fluctuations in prices of Listed Financial Instruments, etc. in a Financial Instruments Exchange Market for the purpose of inducing sales and purchase of Market Transactions of Derivatives	Fine of JPY 80 million
24-Sep-2014	Bansei Securities Co.,Ltd.	Violation of just and equitable principles of transactions	Censure

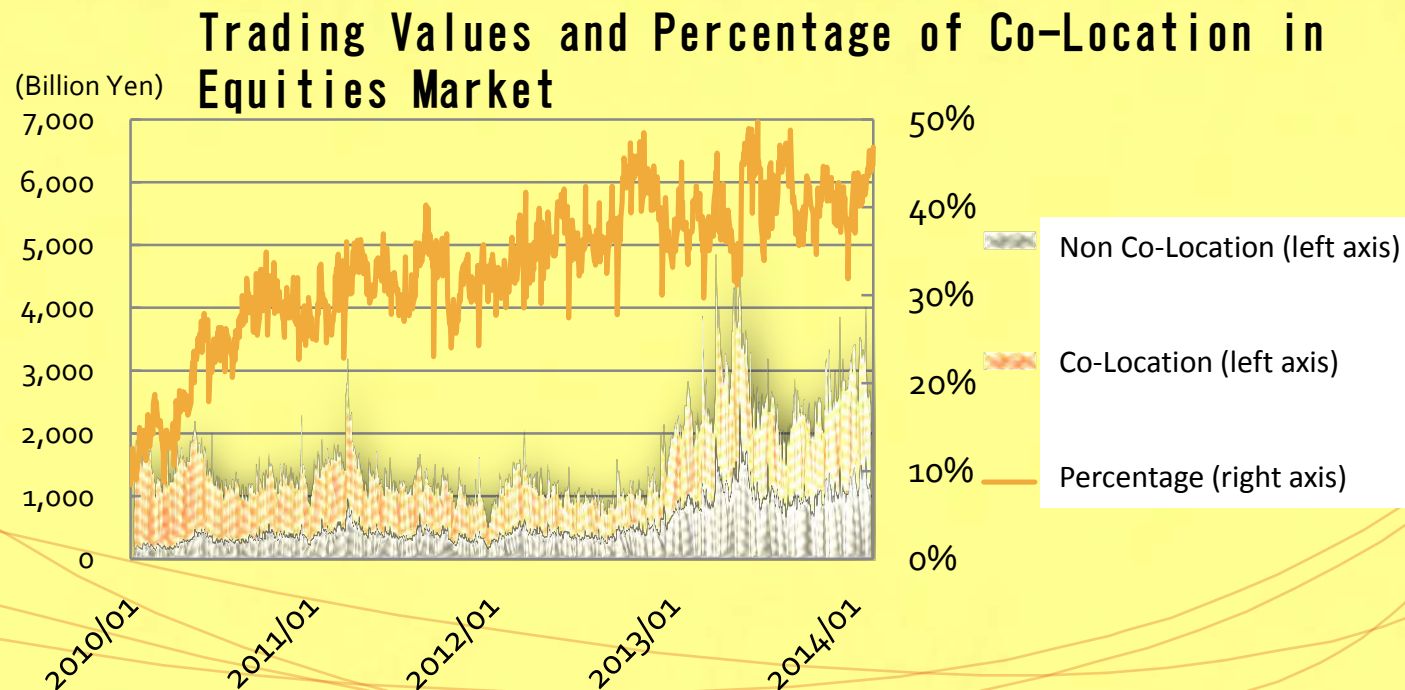
Current Topics



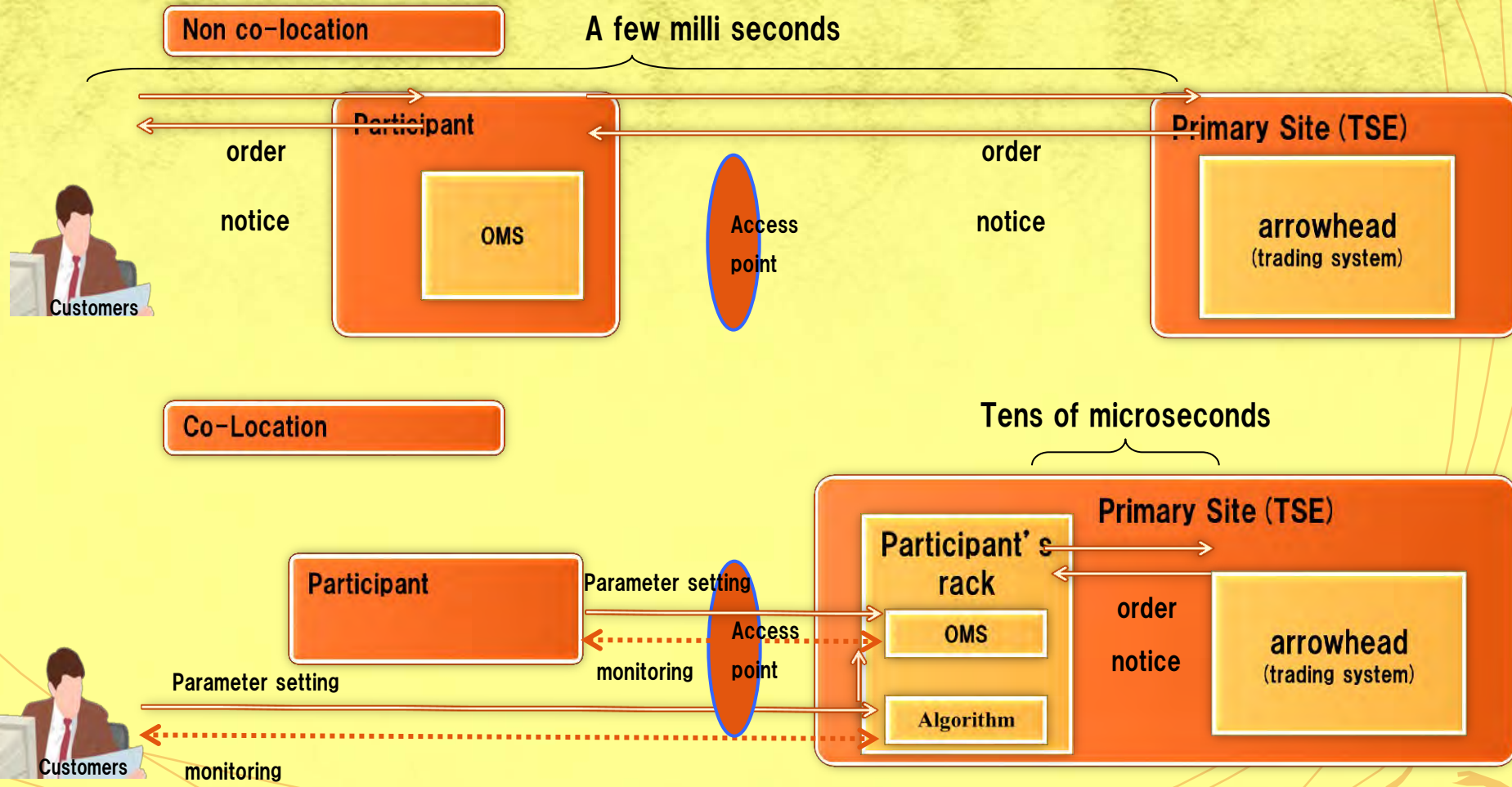
Order management

● Order Management

- ❑ Prevention of order misplacement from fat-finger is highly important for the orderly market operations.
- ❑ JPX-R inspects order limits on trading volume/value set in trading participant order placement systems.
- ❑ In light of the emerging HFT trading, JPX-R inspects controls over placement of large amounts of small orders and management for order placement systems.



Typical order flow using co-location



Management of co-location risks

■ Risk of Co-Location

- ✓ The possibility of runaway of the algorithm
- ✓ The Possibility that can not manage customer' order.

■ How Trading participants manage their risk

- ✓ Pre-trade filter
 - quantity and value of one order
 - the net position of a day
 - the gross trading volume of a day
 - the number of orders in a certain period of time
- ✓ When the trade filter is set in customers algorithm
 - MOU with customers to prevent unauthorized system changes
 - Monitoring the change status of customer systems on a regular basis
- ✓ Install Kill Switch to stop orders promptly when abnormal orders are detected.

● Actions by JPXR

- Review Trading participants' order filtering and how it is managed.
- Review Trading participants' order management systems and their process when then make system changes.

Activities to promote compliance



COMLEC

Established for the purpose of compliance assistance to trading participants.

- **Information sharing with trading participants to comply with laws, regulations and rules**
 - The Information Analysis Group answers questions from trading participants about rules and regulations regarding securities trading.
- **Publication**
 - Compliance Case Study Handbook 2014
- **Seminar**
 - Seminar for in-house examination staff
 - Compliance seminar for securities companies

Thank you.

Disclaimer

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Self Regulatory Function of JSDA

October 5, 2015

Hajime Mitsumori
Deputy Chief Officer for Self-Regulation HQ
& Senior General Manager for
Self-regulatory Planning Division
Japan Securities Dealers Association

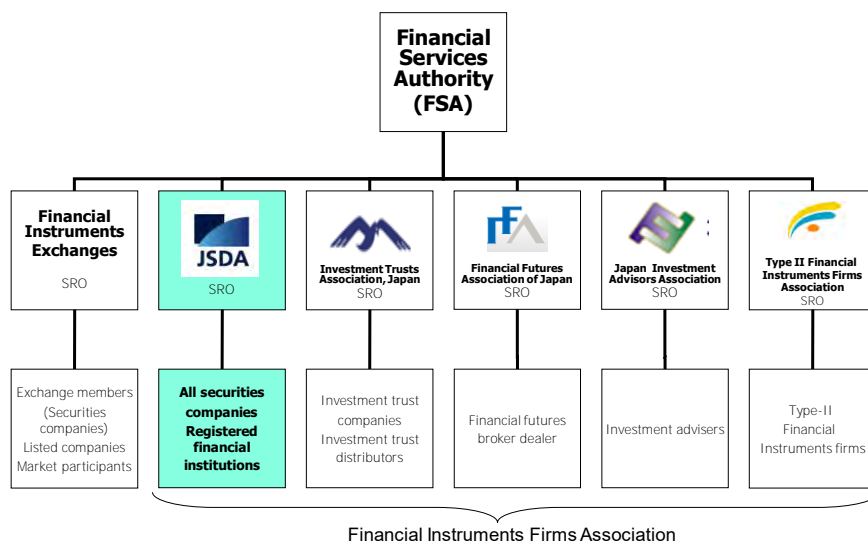
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Self Regulatory Function of JSDA

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I. Self Regulatory Organization under the Financial Instruments and Exchange Act (FIEA)



[Scope of Self-Regulations for Each Financial Instruments Firms Association] (Outline)

➤ Japan Securities Dealers Association (JSDA)

- ◆ Securities related Business
- ◆ OTC Derivatives Transactions (excluding Financial Futures Transactions)

➤ Investment Trust Association, Japan (JITA)

- ◆ Investment Management Business (Investment Trust Business, etc.)

➤ Financial Futures Association of Japan (FFAJ)

- ◆ Financial Futures Transactions

➤ **Japan Investment Advisers Association (JSIAA)**

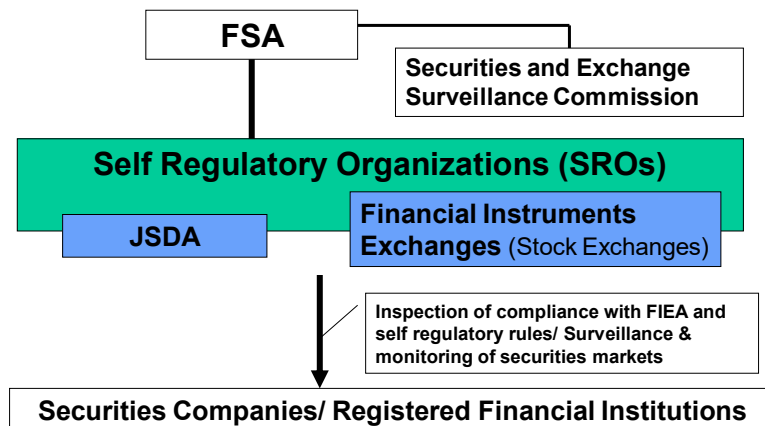
- ◆ Investment Counseling Business
- ◆ Discretionary Investment Business

➤ **Type II Financial Instruments Firms Association**

- ◆ Fund Business

※The above 5 associations hold periodically meetings to exchange views (“Meeting for Communication and Deliberation among Financial Instruments Business Associations”)

[Structure for Application of Self-Regulations to Securities Companies and Registered Financial Institutions]



II. JSDA under Financial Instruments and Exchange Act (FIEA)



➤ Authorization of Establishment (Article 67-2)

A Financial Instruments Business Operator that intends to establish an Authorized Association shall obtain authorization from the Prime Minister (FSA). JSDA has obtained such authorization.

➤ JSDA's Purpose under FIEA (Article 67)

“aims to ensure fair and smooth sale and purchase or other transactions of Securities and Derivative Transactions, etc. and to contribute to the sound development of Financial Instruments Businesses and the protection of investors.”

➤ JSDA's Member Firms (Article 68, Para.1)

Member Firms of an Authorized Association (JSDA) shall be limited to Financial Instruments Business Operators and Registered Financial Institutions (latter within the scope of conducting the business of registered financial institutions).

⇒ Prescribed by Article 5 of JSDA's Articles of Association.

➤ Eligibility for JSDA's Members (Article 68, Para.2&5)

An Authorized Association (JSDA) shall stipulate in its articles of association that any Financial Instruments Business Operator is eligible for membership as a Member Firm, provided, however, that an Authorized Association may stipulate in its articles of association that the Authorized Association may refuse the admission as a Member Firm if an applicant has been expelled from membership of, or has had qualification for trading rescinded by, an Authorized Association (JSDA) or a Financial Instruments Exchange, on account of having violated laws and regulations.

⇒ Prescribed by Article 11 and 23 of JSDA's Articles of Association.

※ FSA shall supervise directly the business of a Financial Instruments Business Operator that has not joined JSDA, while considering JSDA's Articles of Association and rules. (Article 56-4, Para.1)

[Self Regulatory Operations Required of JSDA under FIEA]

Self Regulatory Operations	Outline
① Rule-making (Item 10, Paragraph 1 of Article 67-8)	<ul style="list-style-type: none"> Establishment and making awareness of self-regulatory rules applicable to member firms
② Inspection and Monitoring of members' compliance with laws and regulations (Item 14, Paragraph 1 of Article 67-8)	<ul style="list-style-type: none"> Inspection and monitoring of members' business activities and internal control system
③ Disciplinary Actions (Article 68-2)	<ul style="list-style-type: none"> Taking any of such actions as reprimand, fines, suspension or limitation of membership, expulsion, etc. against member firms violating laws and self regulatory rules
④ Improving the aptitude of members' officers and employees (Item 9, Paragraph 1 of Article 67-8)	<ul style="list-style-type: none"> Holding qualification examination for securities sales representatives and for employees responsible for internal administration
⑤ Settlements of complaints and mediations between investors and member firms (Item 11, Paragraph 1 of Article 67-8)	<ul style="list-style-type: none"> Resolving complaints from investors concerning member firms' operations. Conducting mediation for resolving disputes between member firms and investors

[*Functions Required under FIEA*]

➤ Article 68

An Authorized Association shall stipulate the following items in its articles of association;

- ◆ It shall endeavor to prevent fraudulent acts, market manipulation or collection of unreasonable fees or expenses by Member Firms, as well as to promote the fair and equitable principles of transactions. (Para.3)
- ◆ It shall endeavor to ensure confidence of investors, by having Member Firms establish their internal rules and control systems for the purpose of observance of the laws and regulations and the Authorized Association's articles of association and other regulations. (Para.4)

⇒ Consequently, JSDA prescribes these items in its Articles of Association, and prepares, if necessary, the model internal rules, etc. and requests member firms to be equipped with such rules.

III. Types of JSDA's Self Regulatory Rules



- Articles of Association
- Self Regulatory Rules
- Unified Business Practice Rules
 - ⇒ Rules prescribing the unified process in the securities industry regarding rights and obligations in connection with securities transactions among member firms.
- Dispute Settlement Rules
 - ⇒ Rules prescribing actions and procedures for JSDA to resolve disputes between member firm and customer or among member firms.
- Association Management Rules
 - ⇒ Rules prescribing management procedures of various deliberating groups within JSDA.
- Resolutions of the Board of Governors

IV. Outline of Self Regulatory Rules



In order to ensure the smooth running of financial instrument markets, JSDA formulates various kinds of self regulatory rules applicable to association members, thereby striving to make the financial instrument business fair and efficient (number of rules: approximately 50).

Self regulatory rules are roughly classified as follows;

- Investment Solicitation, Customer Management and Internal Management
- Employees and Sales Representatives
- Advertising
- Personal Information Protection
- Stocks
- Bonds
- Foreign Products and Transactions
- Code of Ethics

➤ **Rules Concerning Investment Solicitation, Customer Management and Internal Management by Association Member**

- Solicitation for Investments and Management of Customers, etc., by Association Members
- Establishment of Confidential Corporate Information Management System by Association Members
- Change, etc. of Assessment Rates for Substitute Securities Related to Margin Transactions
- Establishment of Trade Compliance Screening System for the Prevention of Unfair Trading
- Proper Handling of Pre-Hearing by Association Members
- Establishment of Order Management System by Association Members
- Acceptance of Deposit, etc. of Securities
- Appropriate Implementation of Separated Management of Customer Assets by Regular Members
- Internal Administrators, etc. of Association Members
- Application for Confirmation, Examination, Confirmation, etc. of Incidents
- Unification of Accounting for Securities Business Related
- Handling of Documents Delivery, etc. through Electromagnetic Methods
- Financial Instruments Intermediary Service Providers
- Protection, etc. of Customers from Fraudulent Withdrawal Using Counterfeit or Stolen Card
- Planning, etc. of Business Continuity Management in case of Emergency by Regular Members
- Elimination of Relationship with Antisocial Forces

➤ **Rules Concerning Employees and Sales Representatives**

- Employees of Association Members
- Sales and Purchase, etc. of Specified Securities , etc. of Listed Companies, etc. by Employees of Association Members
- Qualification and Registration, etc. of Sales Representatives of Association Members
- Qualification Examination for Sales Representatives

➤ **Rules Concerning Advertising**

- Representation of Advertising, etc. and Offer of Premiums
- Handling of Analyst Reports

➤ **Rules and Guideline Concerning Personal Information Protection**

- Guideline for Protection of Personal Information
- Securement of Proper Handling of Personal Information by Association Members
- Complaint Processing Operation Related to Handling of Personal Information

➤ **Rules Concerning Stocks**

- Over-The Counter Securities
- Green Sheet Issues and Phoenix Issues
- Sale and Purchase, etc. of Listed Share Certificates, etc. Conducted Outside of Financial Instruments Exchange Market
- Transactions Subject to Closing Price and Associated Proprietary Transactions
- Handling of Cumulative Stock Investment and Mini Investment in Stocks
- Handling of Borrowing and Lending Transactions for Share Certificates, etc.
- Underwriting, etc. of Securities
- Distribution to Customers Related to Underwriting, etc. of Public Offering, etc. of Share Certificates, etc.
- Handling of Allocation of New Share Certificates to Third Party, etc.

➤ **Rules Concerning Bonds**

- Publication of Over-The Counter Trading Reference Prices, etc. and Trading Prices of Bonds
- Publication, etc. of Over-The Counter Quotation of Corporate Bonds for Retail Customers
- Solicitation, etc. of Sale and Purchase, etc. of Domestic CPs, etc., and Private Placement Corporate Bonds
- Handling of Sale and Purchase of Bonds with Options
- Handling of Conditional Sale and Purchase of Bonds, etc.
- Handling of Sale and Purchase of Bonds, etc. with Delayed Settlement
- Handling of Short Selling, and Borrowing and Lending Transactions of Bonds

➤ **Rules Concerning Foreign Products and Transactions**

- Sale and Purchase of Foreign Securities
- Special Provisions of the Rules Concerning Sale and Purchase of Foreign Securities regarding Overseas Issued Securities Solicited to Small Number of Investors
- Foreign Securities Futures Transactions, etc.

➤ **Rules Concerning Securitized Products**

- Distributions, etc. of Securitized Products

➤ **Rules Concerning Derivatives Transactions**

- CFD Transactions

➤ **Rules Concerning Code of Ethics**

- Maintenance of and Compliance with Ethical Code by Association Members

➤ **Rules Concerning Solicitation for Investments and Management of Customers, etc., by Association Members**

- ◆ Principle of Suitability, Management of Customer Card, Solicitation Commencement Criteria, Transaction Commencement Criteria
- ◆ Adequate Explanations to Customers, Collection of Written Confirmations
- ◆ Prevention of Insider Trading
- ◆ Prevention of misunderstanding the instruments offered by Special Members (Registered Financial Institutions) as bank deposits, etc.
- ◆ Prudent solicitation and sale toward elderly customers (see p34)

➤ **Rules Concerning Internal Administrators, etc. of Association Members**

- ◆ Qualification, disposition, responsibilities, etc. of officer/employee that manages legal compliance with FIEA, by Association Members
- ◆ Internal Administration Supervisor
(responsible for the compliance of the company as a whole)
- ◆ Internal Administration Assistant Supervisor
- ◆ Sales Manager
(leader in charge of compliance at sales outlet level)
- ◆ Internal Administrator
(employee in charge of compliance at sales outlet level)

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➤ **Rules Concerning Establishment of Trade Compliance Screening System for the Prevention of Unfair Trading**

- ◆ Regular Members to establish sale and purchase management system to prevent customers' unfair trading of listed stocks, etc.
- ◆ Establish internal rules
- ◆ Proper understanding of customers' trend of sale and purchase and reason for trading as well as an examination of sale and purchases
- ◆ Prepare/save internal records

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➤ Rules Concerning Employees of Association Members

- ◆ Inquiry of past disciplinary action taken by Association at the time of employees recruiting
- ◆ Prohibited acts by employees
(Examples of prohibited acts)
 - ✓ Leakage of confidentiality obtained through occupation
 - ✓ Advertisement not being checked by examiner of advertisement
 - ✓ Derivatives transactions made by employee as own investment
 - ✓ Securities Transactions conducted jointly with customer
- ◆ Report of breach of laws and rules
- ◆ Disciplinary action due to the conduct of inappropriate acts

➤ Rules Concerning Over-The-Counter Securities

- ◆ Solicitation of investments and sale and purchase of non-listed stocks
- ◆ Association Members must not solicit customers for sales of non-listed stocks, except for the cases below.
<Exceptional Cases>
 - ✓ Green Sheet issues, Phoenix issues
 - ✓ Non-listed stocks, etc. issued by listed companies
 - ✓ Private Placement for professional investors

➤ **Rules Concerning Underwriting, etc. of Securities**

- ◆ Regulations concerning underwriting of securities that Regular Members conduct in Japan
- ◆ Ensure independence of underwriting examination
- ◆ Underwriting examination items
- ◆ Verify use of funds and request issuers to disclose this information, request also issuers to disclose the dividend payout and dividend policy

➤ **Rules Concerning Publication of Over-The-Counter Trading Reference Prices, etc. and Trading Price of Bonds**

- ◆ Over-the Counter Transactions
- ◆ Publicize “Reference Prices for Transactions” (every business day)
- ◆ Publicize “Monthly Trading Volumes”, etc.
- ◆ Ensure fair trading (trading by proper price, display of price information to retail investors)

➤ Rules Concerning Sale and Purchase of Foreign Securities

- ◆ Self Regulatory Rules for sale and purchase, and public offerings and secondary offering of foreign securities
- ◆ Requirements for foreign securities for which investment solicitation of retail customers is possible
- ◆ Delivery of explicative notes and notice for Foreign Securities

V. Implementation of Inspections and Monitoring Surveys



JSDA conducts inspections regarding compliance with laws and self regulatory rules in such areas of Association Members' businesses as sales activities and status of the internal administration system.

In addition to that, JSDA conducts monitoring surveys regarding the business management of Regular Members and their segregated administration of customers' assets.

(1) Overview of inspections of Association members

The inspections are conducted by JSDA's inspectors visiting headquarters and branches of the Member Firms. The number of the inspectors and the duration differs according to the size of the firms.

	FY Mar. 2012	FY Mar. 2013	FY Mar. 2014
Regular Member (Securities Company)	87	87	84
In which joint inspection with Stock Exchange	(30)	(28)	(31)
In which inspection conducted solely by JSDA	(57)	(59)	(53)
Special Member (Registered Financial Inst.)	53	53	48

Notes: 1. 251 Regular Members and 213 Special Members as of September 1, 2015

2. For Regular Members which are participants of stock exchanges, the inspection shall be conducted jointly by JSDA and stock exchanges.

(2) Monitoring surveys regarding the status of management of Regular Members and their segregated administration of customers' assets

- ◆ Business management of Regular Members
 - ⇒ Grasped mainly through capital adequacy ratio
- ◆ Segregated administration of customers' assets
 - ⇒ Regular Members are required to administrate separately the funds and securities deposited by customers from their proprietary assets. JSDA verifies the status of this administration.

JSDA requires Regular Members to report their asset segregation status every month, and monitors those reports to check status.

VI. Imposing Self Regulatory Disciplinary Action



JSDA takes strict disciplinary action against Association Members and their officers and employees for violations of laws, self regulatory rules, etc., to prevent their recurrence and as a deterrent

Types of disciplinary action taken by JSDA

- ◆ Association Members
 - Expulsion
 - Suspension or restriction of membership (for max. 6 months)
 - Levy of negligence fine (with upper limit of 500 mil. yen regarding the portion of disciplinary action)
 - Reprimand
- ◆ Officers and employees of Association Members
 - Treatment as performer of inappropriate acts
 - Revocation of Sales Representative Qualification
 - Suspension of Sales Representative Qualification (for max. 2 years)
 - In addition to the above, as administrative sanction;
 - Revocation of Registration as Sales Representative, Suspension of Duty of Sales Representative (for max. 2 years)

VII. Carrying Out Sales Representative Registration Process and Qualification



JSDA carries out the registration process for Sales Representatives under mandate by Prime Minister (FSA).

Moreover, pursuant to the Self Regulatory Rule, JSDA implements the Sales Representative Qualification examination and the training seminar for renewal of Sales Representative Qualification.

(1) Registration process of Sales Representatives

An Association Member must have the names, birthdays, etc. of officers and employees to whom it intends to assign the duty of Sales Representative recorded in the register provided by JSDA pursuant to the FIEA and the relevant Self Regulatory Rule.

To ensure only those who have a certain knowledge of securities become Sales Representatives and engage in sales activity, JSDA implements a Sales Representatives examination and limits registration eligibility to those that pass this examination and obtain qualification (that-is-to-say, those who are not qualified are not eligible for registration).

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(2) Types of Sales Representative Qualification (Qualification for those belong to Securities Companies)

Type 1 Sales Representative Qualification: Qualified to handle entire range of duties of Sales Representative

Type 2 Sales Representative Qualification: Qualified to handle the duties of Sales Representatives regarding cash market securities transactions (unable to handle securities with share options, margin transactions and derivatives transactions)

(3) Outline of Examination for Sales Representatives (Same for Type 1 and Type 2)

- Eligibility for Examination: Officers, employees and persons expected to be employed of Association Members
- Method of Examination: CBT (taking exam on computer at the examination venue)
- Question format: Yes or No type questions and 1 correct choice among 5 choices
- Textbook: "Sales Representative Manual" produced by JSDA

Ref.: As Sales Representative Examinations are open to the public, anyone can take it

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(4) Training Course for Renewal of Sales Representative

Qualification

After registration, a Sale Representative is required to take the “Training Course for Renewal of Sales Representative Qualification” every 5 years, thereby verifying his/her basic knowledge as an SR at least every 5 years.

This training course is also conducted by the CBT method.

Ref.: Regarding Internal Administrators Qualification Examination

Passing the Examination for Internal Administrator Qualification is required to engage in the duties of the aforementioned “Internal Administrator” and “Sales Manager”. This Examination is also implemented by JSDA.

VIII. Complaints/Consultation and Mediation of Securities Transactions, etc.

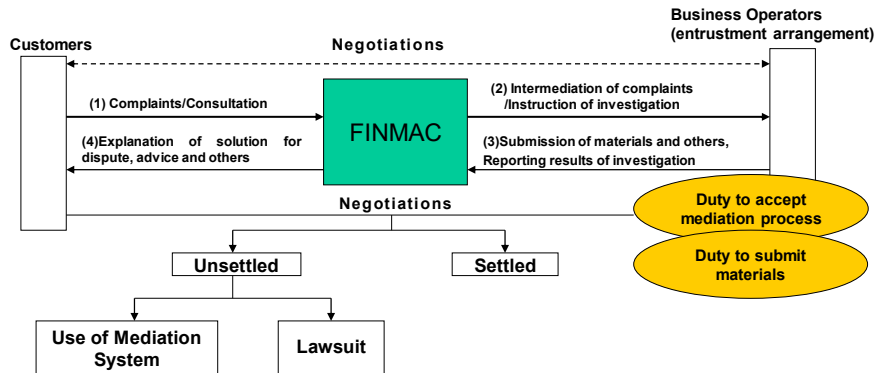


FIEA requires JSDA to handle customers’ complaints and requests for consultation regarding Association Members, as well as to provide a “mediation” service to resolve disputes over securities transactions between customers and Association Members.

These tasks of handling complaints /consultations and mediation are assigned to, and conducted by the Financial Instruments Mediation Assistance Center (FINMAC), which is an NPO.

(1) Complaints and Consultation

- Consulting staff of FINMAC responds to requests for consultation and to inquiries from customers in connection with financial instruments or trading methods.
- After receiving the complaints concerning a specific securities transaction or the related solicitation or procedures, FINMAC acts as an intermediary between the counterparty Association Member and assists in the resolution of the dispute.



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(2) Mediation

- If FINMAC does not succeed in resolving a dispute through discussions and the customer is not satisfied with the result, it will introduce lawsuits, arbitration or mediation as necessary.
- In the Mediation system, a neutral and independent "Mediator (lawyer)" is appointed by FINMAC to act as an intermediary. The Customer reapplies for this service to FINMAC, which appoints a Mediator and takes the necessary procedures to resolve the dispute with the counterparty Association Member.

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IX. Additional Reference: Investment Solicitation Rules for Elderly Customers



New rules for sales by solicitation towards elderly customers are fully implemented from March, 2014

Background

- Situation where there are an increasing number of elderly customers.
- Increasing number of complaints from elderly customers (in particular, from their families).

Purpose

- Implementing cautious solicitation of and sales to elderly customers, thereby enabling them to fully understand and conduct transactions.
- Thereby mitigating as much as possible complaints and troubles

Outline of Rules

- Association Members should establish internal rules prescribing the solicitation of and sales to elderly customers, and must strive to conduct solicitation and sales in compliance with those internal rules.
 - ⇒ Customers over 75 years old shall be defined as “Elderly Customers”.
 - ⇒ When soliciting the purchase of complex securities by elderly customers over 75 years old, prior permission from an officer of the Association Member is required.

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- ⇒ When soliciting the purchase of complex securities from customers over 80 years old, the order should not be taken on the same day.
- ⇒ The order should be taken on or after the following day. The person who receives such an order shall be an officer of the Association Member and not sales staff.
- ⇒ After receiving an order, and when the order is executed, the details of the executed transaction shall be communicated to the elderly customer.

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Thank you for your attention !!

Japan Securities Dealers Association Rules for IPOs

October 5, 2015

Self-regulation HQ, Equity Market Div.
Japan Securities Dealers Association

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Attachments



Reference 1: Japan Securities Dealers Association, "Rules Concerning Underwriting, Etc. of Securities" (Underwriting Rules)

Reference 2: Japan Securities Dealers Association, "Detailed Rules Relating to the Rules Concerning Underwriting, Etc. of Securities" (Detailed Underwriting Rules)

Reference 3: Japan Securities Dealers Association, "Rules Concerning Distribution to Customers Related to Underwriting, Etc. of Public Offering, Etc. of Share Certificates, Etc." (Distribution Rules)

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1. Underwriting rules

Introduction

- The rules for initial public offerings of shares (IPOs) are mainly established by a stock exchanges.
 - Listing requirements
 - Listing review

- The JSDA has established rules concerning the underwriting of shares by brokerages and the associated distribution of such shares.
 - Initial public offerings (IPOs) are governed by these rules.
 - In its rules, JSDA prescribes the basic principles that should be observed. The specifics of how each company ensures that underwriting and distribution are handled appropriately in actual practice are established in each company's own internal rules and manuals, which they enforce themselves.

- Appropriate underwriting decisions (Underwriting Rules Article 3)
 - Ensure necessary and sufficient period of time for the underwriting review
 - Based on the substance of the underwriting review
 - Underwriting decision must be made based on the overall judgment and responsibility
- Rigorous underwriting review (Underwriting Rules Article 12)
 - The underwriting review department carries out a rigorous underwriting review of the underwriting review categories listed in Article 16 of the Underwriting Rules (for an IPO)
 - The materials necessary for the underwriting review are received from the issuer
 - Exchange of questions and answers with the issuer, both in person and in writing
 - Sound out the auditor
 - Receive comfort letter from the auditor
 - Utilize securities analyst research findings

cf. "Cabinet Office Ordinance on the Financial Instruments Business", Article 123-1-5

- Develop underwriting review framework (1)
 - Ensuring the independence of the underwriting review (Underwriting Rules Article 5)
 - ✓ Establish an underwriting review department
 - ✓ Officers and personnel responsible for the underwriting review may not be involved in underwriting
(with certain exceptions)
 - Establish internal rules for underwriting reviews (Underwriting Rules Article 6-1)
 - ✓ Underwriting review categories
 - ✓ Information necessary for an appropriate review
 - ✓ Information necessary to form an opinion while ensuring the independence of the underwriting review
 - Establish internal manual for underwriting review (Underwriting Rules Article 6-2)
 - ✓ Underwriting review procedures

Underwriting review (2)



- Develop underwriting review framework (2)
 - Create underwriting review records and retain for 5 years (Underwriting Rules Article 7)
 - ✓ Materials and information collected in the underwriting review
 - ✓ Records of the analysis and evaluation of these materials and information
 - ✓ Materials and information that served as the basis of the underwriting decision
 - ✓ Records of the process of forming the underwriting decision
 - Regular internal inspections/audits of underwriting (Underwriting Rules Article 8)
 - ✓ Are the internal rules being observed?
 - ✓ Is the internal manual being properly followed?

Underwriting review (3)



- Develop underwriting review framework (2)
 - Create underwriting review records and retain for 5 years (Underwriting Rules Article 7)
 - ✓ Materials and information collected in the underwriting review
 - ✓ Records of the analysis and evaluation of these materials and information
 - ✓ Materials and information that served as the basis of the underwriting decision
 - ✓ Records of the process of forming the underwriting decision
 - Regular internal inspections/audits of underwriting (Underwriting Rules Article 8)
 - ✓ Are the internal rules being observed?
 - ✓ Is the internal manual being properly followed?

Underwriting review (4)



- Items for underwriting review (for equity IPOs)
(Underwriting Rules Article 16-1(1) and Detailed Underwriting Rules Article 9-1))
 - Eligibility for public offering
 - Soundness and independence of corporate management
 - Business continuity regime
 - Corporate governance and internal control regime
 - Financial condition and business performance
 - Business performance outlook
 - Intended use of proceeds
 - Proper disclosure of company information
- ★ The above represent the minimum as far as the items for underwriting review specified by the rules. It may be necessary to review other items as needed.

Underwriting review (5)



- After launch, and up to the payment date (Underwriting Rules Article 4)
 - Strive to get accurate information about how the issuer is doing.
 - Sound out the issuer as necessary
- Immediately following IPO (Underwriting Rules Article 15)
 - When the issuer discloses material facts immediately after the IPO
 - ✓ Check whether the circumstances arose before the IPO
 - ✓ Check whether the issuer was misleading in the information provided during the underwriting review
 - ✓ Verify whether the disclosures at the time of the IPO were appropriate
 - ✓ If it is determined that there is a substantial disparity between what was disclosed at the time of the IPO and the issuers business situation at the time of the underwriting review, offer the issuer the opportunity to fully explain the reasons for this to the investors

Request for disclosure of the use of funds



- Ask the issuer to disclose the following information in press releases at the time of the launch and/or in the securities registration statement (Underwriting Rules Article 20-1, Article 23)
 - Intended use of proceeds
 - Impact on the issuer's future earnings attributable to the funds raised

* Because the issuer is not a member of the JSDA, the rules of the JSDA do not apply to the issuer.
Therefore, these rules take a form in which the brokerages, which are members of the JSDA, are obligated to request disclosure by the issuer.

Choosing pricing method at time of the initial listing



- Tokyo Stock Exchange, "Enforcement Rules for Securities Listing Regulations"

(Procedure for public offering before listing)

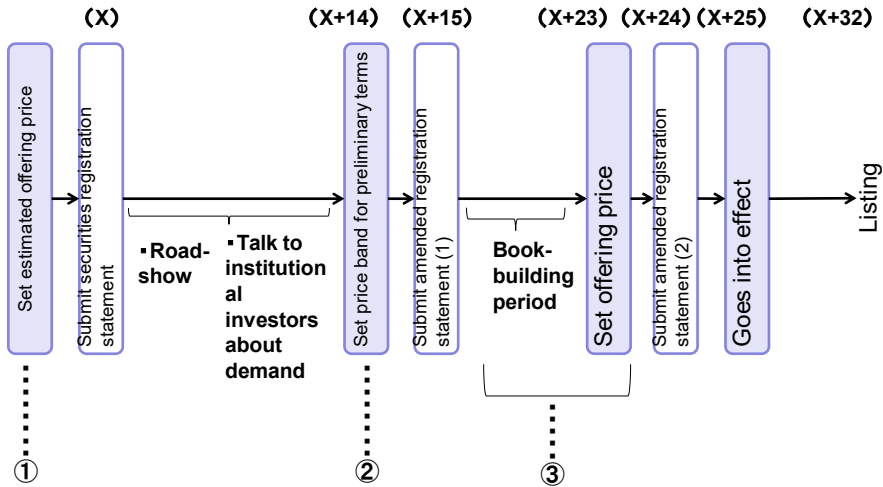
Rule 233. In cases where an initial listing applicant conducts a public offering before listing, the initial listing applicant and the lead underwriter shall follow either of the procedures listed below.

- (1) Book-building
- (2) Public offering through competitive bidding

(Determination of offering price)

Rule 234. After comprehensively considering factors including the possible danger arising from a fluctuation in share prices in the time up to the listing day and the expected demand for the securities, the initial listing applicant and the lead underwriter shall determine the offering price based on the circumstances that apply in accordance with the method used for the offering, as shown below.

- (1) When book-building is used:
 - The state of investor demand, as gauged through the book-building
- (2) When there is a public offering through competitive bidding:
 - The weighted average winning bid price in the public offering through competitive bidding (referring to a price obtained by calculating the weighted average by the method in which the aggregate of the amounts obtained by multiplying the winning prices by the winning numbers of shares is divided by the total number of shares associated with the winning bids), and other results of the competitive bidding process.
- 2 (Omitted)



Gauge investor demand based on the preliminary terms indicated by institutional investors who excel in price discovery
 ⇒ Set price more in line with the market trend

JSDA rules for pricing public offerings (1)

- Set proper offering terms by respecting prevailing market conditions. Must not underwrite on terms that are seriously inappropriate with respect to quantity, price, or some other element (Underwriting Rules Article 24).
 cf. "Cabinet Office Ordinance on the Financial Instruments Business", Article 123-1-4
- When setting the offering price through book-building, it is done in consultation with the issuer, based on the investor demand gauged through book-building and taking into general consideration the risk of market fluctuations in the time period leading up to the payment date (Underwriting Rules Article 25).

- When setting the offering price at the time of the IPO, after the suitability of the price is verified by a department or committee that has no close business relationship with the issuer or investors, the records of this verification must be retained for five years (Underwriting Rules Article 26).
- A brokerage that underwrites IPOs must establish internal rules specifying what is necessary in order to set preliminary terms and prices and to properly conduct book-building. It must also prepare an internal manual that specifies the procedures for this (Underwriting Rules Article 27).
- An underwriter must conduct regular inspections/audits to assess the state of compliance with its internal rules and to see if the internal manual is being properly followed (Underwriting Rules Article 28).

- When setting the preliminary terms of an IPO through book-building, it is done in consultation with the issuer, taking into general consideration the following matters (Detailed Underwriting Rules Article 14-1(1)).
 - The nature of the issuer's business, its financial condition, and its business results
 - The opinions of persons who have professional expertise and experience in investing
 - Other materials and opinions that can serve as a reference when determining the preliminary terms
- Formulate a basic policy for gauging demand. Book-building is carried out based on this basic policy (Detailed Underwriting Rules Article 14-1(2)).
- Book-building may not include submissions that are clearly expected to correspond with those listed below (Detailed Underwriting Rules Article 14-1(2)).
 - Submissions that are not based on actual investor demand
 - Overly large submissions aimed at securing an allotment
 - Multiple submissions based on the demand from a single investor
- Book-building records are retained for six months (Detailed Underwriting Rules Article 14-1(3)).

2. Distribution rules

Basic principles for distributions

- Basic principles for the distribution of shares by a brokerage (Distribution Rules Article 2-1)
 - Fairness
 - Must not be tilted towards certain investors without good reason

JSDA rules concerning the distribution of shares



- *Oyabike* (the practice of selling shares to parties designated by the issuer) is prohibited, in principle (Distribution Rules Article 2-2).
- At the time of the IPO, the recipients of at least 10% of the volume of shares that is to be distributed to individual customers is determined by lottery (Distribution Rules Article 3).
- At the time of the IPO, if the distribution to individual customers is decided by a means other than by lottery, the following points must be considered (Distribution Rules Article 4).
 - There must not be an excessive distribution for a certain investor and the distribution must not be unfair
 - The difference between the distribution using this means and the average per customer quantity using the lottery method must not be significant
 - Distributions must not be made repeatedly to the same customer

JSDA rules concerning the distribution of shares



- Providing information about the distribution recipients to the issuer (Distribution Rules Articles 5 to 8).
 - Names and distribution quantities for certain institutional investors that became recipients
 - Does not include information about individual investors.
 - Information provided after distribution is completed
 - Attach a commitment in writing that the issuer will not leak the information that it receives.
- Information about the status of the distribution is reported to JSDA, and JSDA releases it (Distribution Rules Article 13).
 - On a quarterly basis, distribution situation in terms of recipient characteristics and distribution quantities
→<http://www.jsda.or.jp/shiryo/toukei/kabu-haibun/index.html>
 - On a monthly basis, distributions to individual customers by IPO issue (including quantities for distributions by lottery and distributions by other means)
→<http://www.jsda.or.jp/shiryo/toukei/shinkikoukai/index.html>

- Formulate basic policy and make it known to investors (Distribution Rules Article 9).
 - How lotteries are conducted
 - Measures to prevent excessive distributions to certain investors and unfair distributions
 - Relationship between book-building and distribution
 - Other policy matters
- Draw up internal rules (Distribution Rules Article 10).
 - The aforementioned basic policy
 - Customers who are prohibited from receiving distributions
 - Legal and regulatory compliance
 - Distribution of "hot issues"
 - Distributions when the environment deteriorates
 - Other matters

- The chief internal control officer (person in charge of compliance) is responsible for carrying out regular internal inspections to see if distributions are properly conducted in accordance with the internal rules (Distribution Rules Article 11).
- The following records are retained for 5 years (Distribution Rules Article 12).
 - Distribution records
 - Lottery records
 - Records of the findings of aforementioned inspections
 - Purpose is to ensure that audits/inspections by outside parties are carried out properly
 - The brokerage must respond to requests for these records and submit to audits as requested by the JSDA

The Role of an Underwriter in an IPO

5 October 2015

Daiwa Institute of Research

Agenda

1. Introduction of the Stock Exchange and the IPO	2
2. Practice of the Initial Public Offering	6
3. Due Diligence	9
4. Documentation	17
5. Equity Story	21
6. IPO Prices	25
7. Offerings	32

Introduction of the Stock Exchange and the IPO

A stock exchange and its role



What is a stock exchange?

1. Place where investors buy/sell stocks and other securities
2. Place where companies raise funds efficiently
3. Only certified securities companies allowed to offer brokerage services
4. Pillar of economy and capital markets
5. Company created by special act

The role of a stock exchange

1. Sets trading procedures
2. Monitors share price movements, securities companies' activities
3. Monitors information disclosure of listed companies
4. Assesses listing applicants
5. Provides information on stock prices to the public



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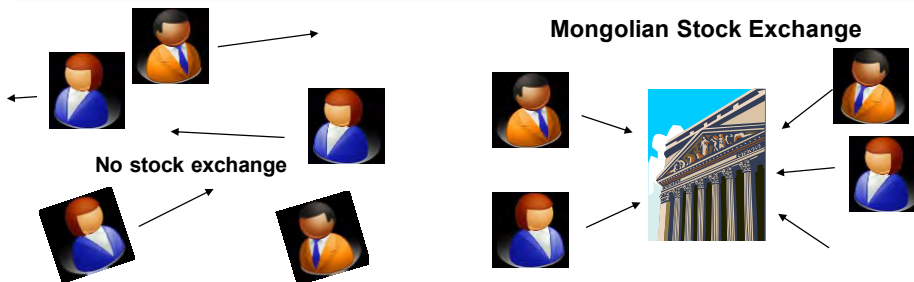
Why do we need a stock exchange?

Companies issuing stocks

- Without a stock exchange, it would be difficult for companies to find lots of investors who want to buy stocks when they issue new shares.

Investors trading in stocks

- Without a stock exchange, it would be difficult for investors to find people who want to trade in stocks and also difficult for favorable quotes to be achieved.
- Hence, a stock exchange is able to support both companies and investors.



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What is an Initial Public Offering?

- A company lists for the first time on a stock exchange and conducts a public offering

Advantages of Listing

Advantages for companies

- Access new funding
- Build market awareness
- Incentive employees

Advantages for investors

- Deliver value to existing investors
- Personal prestige
- Give opportunity to new investors for investing in Mongolian companies

Key Considerations in Deciding to List

Meeting and passing the listing criteria

- Quantitative requirements
- Qualitative requirements

Disadvantages of listing

- Cost - initial and ongoing
- Pressure for performance
- Disclosure of information

- In this lecture, I'd like to present an **overview of the timeline of preparing for an initial public and other important issues relating to such preparation.**

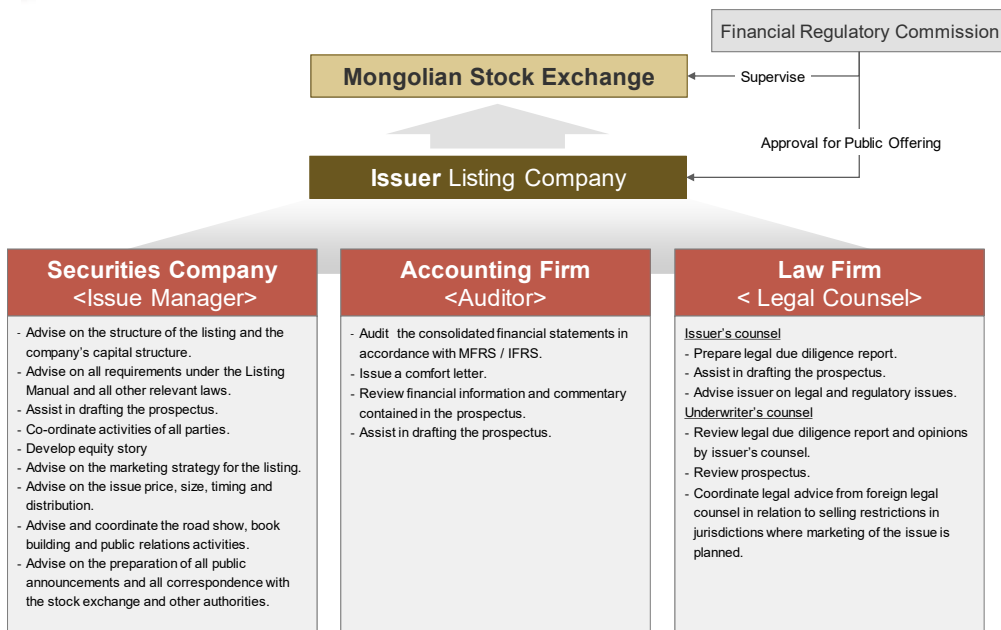
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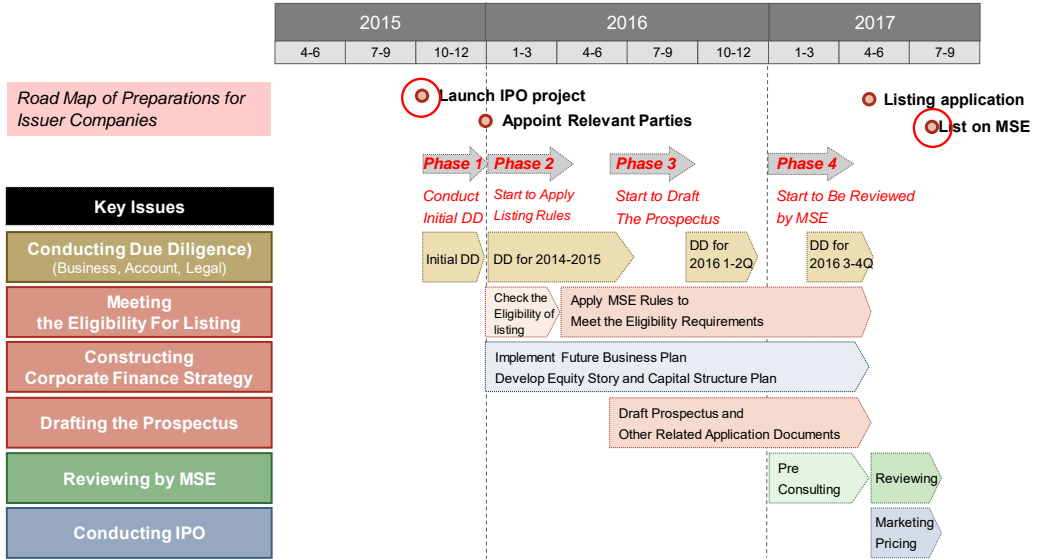
Practice of the Initial Public Offering

Key Parties Involved in the Initial Public Offering Process

- Appoint a team of advisors having deep experience and a strong grasp of regulatory trends



A Sample Timeline of Preparations for an IPO on MSE



Due Diligence

Reason of conducting the due diligence (1)

- Drafting prospectus

- Due diligence list from next slide is adjusted to the contents of prospectus and the project team will draft the prospectus based on the due diligence so an initial listing applicant's responses may directly reflect in description of the prospectus.
- The prospectus will be used to one of the listing application document and offering circular of the IPO.

Table of contents of the prospectus

The contents may be amended after discussing with MSE, FRC and other relevant organization.

Part I.	OFFERING SUMMARY
Part II.	INFORMATION ON THE PUBLIC OFFERING
Part III.	ISSUER INFORMATION
Part IV.	INFORMATION ON THE ISSUER'S MANAGEMENT AND SHAREHOLDERS
Part V.	RELATED PARTY TRANSACTIONS
Part VI.	FINANCIAL INFORMATION
Part VII.	MONGOLIA: COUNTRY INFORMATION
Part VIII.	THE MONGOLIAN SECURITIES MARKET
Part IX.	OTHER INFORMATION

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Table of contents of the due diligence list (1)

- After completion of the due diligence list by an applicant, investment bank will report to the applicant about the result of the due diligence, in terms of drafting the prospectus and meeting listing requirement.
- Based on the result of the due diligence, investment bank will make a plan of detail schedule for meeting listing requirement and drafting prospectus.

<u>Items</u>	<u>Descriptions</u>	<u>Date</u>
1.	GENERAL	
2.	CORPORATE STRUCTURE / LEGAL STATUS	
3.	HISTORY AND DEVELOPMENT	
4.	INDUSTRY OVERVIEW	
5.	RISK FACTORS	
6.	BUSINESS STRATEGY	
7.	BUSINESS OPERATIONS AND MANAGEMENT	
8.	MARKETING	
9.	LICENSES AND REGULATIONS	
10.	RISK MANAGEMENT AND OTHER COMPLIANCE MATTERS	
11.	EMPLOYEES / DIRECTORS	

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Table of contents of the due diligence list (2)

Items	Descriptions	Date
12.	ACCOUNTS AND FINANCIAL	
13.	FINANCE	
14.	AGREEMENT AND CONTRACTS	
15.	INTELLECTUAL PROPERTY	
16.	RESEARCH AND DEVELOPMENT	
17.	TAXATION	
18.	PROPERTY	
19.	LEGAL AND LITIGATION	
20.	INFORMATION TECHNOLOGY	
21.	RELATED PARTY TRANSACTIONS	
22.	MAJOR SHAREHOLDERS	
23.	OTHERS	
24.	ANTI-MONEY LAUNDERING	
25.	ECONOMIC SANCTIONS	
26.	ANTI-BRIBERY	
27.	COMLIANCE AND INVEASTIGATIONS	
28.	ENVIRONMENTAL MATTERS	

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Reason of conducting the due diligence (2)

- Meeting qualitative listing requirement

- An initial listing applicant must, in a prospectus and other filings, provide to the exchange and investors evidence of its suitability to become a listed company.
- The points below address some of the things that are normally required of companies in order for them to list on a stock exchange.

The requirements may be amended after discussing with MSE, FRC and other relevant organization.

Corporate continuity and profitability

- A listed company must have the ability to continue to operate its business (continuity) and have a revenue base to generate stable profit (profitability).

Soundness of corporate management

- Soundness-related requirements are used to assess the possibility that the profits of the business are not flowing inappropriately to related parties, thereby causing loss to investors.

Effectiveness of corporate governance and internal control

- A listed company must have effective corporate governance and internal control.

Disclosure

- After listing, companies are required to disclose to investors in a timely and appropriate manner financial and other information that could impact investment decisions.

Other

- In addition to the above criteria, the examination also covers other issues important to the protection of investors and the public good.

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Example of qualitative listing requirements (1)

- Corporate Continuity and Profitability, Soundness of Corporate Management

1 Corporate Continuity and Profitability

- **Continuity**
 - For example, the exchange assesses whether there are issues that could negatively impact relationships with customers and whether or not important contracts and permits are expected to remain in place after listing.
- **Profitability**
 - Specifically, the exchange assesses the company's revenue base on the basis of its past earnings, and based on that assessment, evaluates the reasonableness of its post-listing business plans, etc.

2 Soundness of Corporate Management

- **Soundness**
 - Specifically, the exchange examines the necessity of such transactions as well as the reasonableness of the price at which they are transacted. For example, when a company engages in unnecessary transactions in order to benefit a company owned by a relative or uses the goods or services of a company owned by a relative when those could be obtained more cheaply from another supplier, profits that properly belong to shareholders are being diverted to related parties.

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Example of qualitative listing requirements (2)

- Effectiveness of Corporate Governance and Internal Control, Disclosure

3 Effectiveness of Corporate Governance and Internal Control

- **Corporate Governance**
 - With regard to corporate governance, the exchange assesses whether decision making by the board of directors is conducted appropriately. The exchange looks at the roles played by each of the directors, and whether a system of checks is in place. The effectiveness of the audit committee is also examined.
- **Internal Control**
 - With regard to internal control, to ascertain that the company will be able to operate fairly and continuously as a listed company, the exchange assesses whether the company has sufficient and effective internal control mechanisms to prevent dishonest behavior and errors by employees and to avoid unforeseen losses; e.g., whether appropriate internal policies have been created and are being enforced, and whether there is an active regime in place for regular internal audits.

4 Disclosure – (1)

- **Periodic financial reports**
 - The exchange determines whether the company is able to file periodic financial reports at the required times during the year, as well as correctly prepare disclosure documents required by law and file them with the relevant authorities by the deadlines specified in law.

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Example of qualitative listing requirements (3)

- Disclosure and Other

4 Disclosure - (2)

- **Disclosure for a timely and appropriate manner**
 - Corporate information that could significantly influence investment decisions includes information about the company's financial condition and performance as well as information about executives and major shareholders. The company must disclose and explain such information to investors, and must have mechanisms in place to do so in a timely and appropriate manner.
- **Insider trading**
 - Furthermore, as insider trading by company insiders not only damages investors' trust in the company but also harms their faith in the stock market as a whole, the company must take steps to prevent insider trading.

5 Other

- **The protection of investors and the public good**
 - For example, if the company is involved in any disputes or conflicts that could have a significant impact on the management or performance of the company, the exchange assesses whether they have the potential to cause loss to investors in the future.

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Documentation

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Preparing the financial statements

- Financial statements to be prepared by management and audited by independent accountants

1 Preparation and fair presentation of financial statements by management

- **Company's management shall be responsible for the financial statements.**
 - Company's management is responsible for the preparation and fair presentation of the financial statements in accordance with the accounting principles generally accepted in Mongolia, and for the effective implementation of the internal control as the management determines is necessary to enable the preparation of the financial statements that are free from material misstatements, whether due to fraud or error.
 - After the offering, the Company shall continue to be responsible for the financial statements for the subsequent quarters/years, all of which should be fairly presented in the continuous disclosures.

2 Proper auditing of the financial statements

- **Proper audits conducted by independent accountants would give reasonable assurance to the prospective investors.**
 - Auditor's responsibility is to express an opinion on the financial statements based on their audits. The auditing standards would require that they comply with ethical requirements and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
 - The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

3 Establishment of internal control infrastructure

- **Internal control should be properly established and thoroughly implemented by management.**
 - Internal control is the process designed to ensure reliable financial reporting, effective and efficient business operations, and compliance with applicable laws and regulations.
 - Periodic review on the internal control functioning would be essential to monitor the variety of the risks involved within the group.

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Description of key documents

- Underwriting or purchase agreement, legal opinion, comfort letter, etc.

1 Underwriting agreement or purchase agreement

- **An underwriting agreement or purchase agreement shall be duly executed between the Company and the lead manager and binding on both parties.**
 - In accordance with the agreement, the lead manager shall agree, jointly and severally, to subscribe for and purchase from the Company the entire amount of the securities at the issue price at the closing.
 - Basic terms to be covered in the agreement would be as follows.
 - *Representations and Warranties of the Company*
 - *Underwriting/Purchase, Sale and Delivery*
 - *Covenants of the Company and the Lead Manager*
 - *Conditions to Lead Manager's Obligations*
 - *Indemnification*
 - *Termination of Agreement*
 - *Governing Law and Jurisdiction*

2 Execution document – legal opinion

- **A legal opinion would be the important condition precedent to ensure the contents of the Prospectus as well as to duly close the offering.**
 - A legal opinion would be produced by the external legal counsel to confirm the descriptions of the Prospectus in material respects and the legality and enforceability of the offering before it closes.
 - All of the documents relating to the offering shall be examined by the external legal counsel and the opinion would be provided with respect to the clearance and completeness of the offering.

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Description of key documents (cont'd)

- Underwriting or purchase agreement, legal opinion, comfort letter, etc.

3 Execution document – comfort letter

- A comfort letter would be the letter of the assurance on the financial figures to be furnished by auditor.
 - A comfort letter is a document prepared by an external auditor assuring the financial soundness or backing of the Company. The comfort letter would be issued by an accountant declaring no indication of false or misleading information in the financial statements of the Prospectus, those of which would follow the generally accepted accounting principles in Mongolia.
 - The comfort letter also states that, while a full audit has not been done, a review has revealed nothing inaccurate or misleading and that the auditor is comfortable that a full audit would not uncover anything unusual that would negatively affect the offering.
 - Comfort letters are typically signed prior to the pricing or closing date for an IPO or other public offering, as a part of the due diligence process. Subsequently, a "bring-down" letter is used to re-verify, as of a later date (i.e., closing date), that the original comfort letter is still valid.

4 Execution document – issuer certificate, etc

- An issuer certificate would be the letter of the confirmation on the Company's status at the closing.
 - The Company would issue a certificate stating that all the representations and warranties of the Company as provided in the subscription/purchase agreement be certified and also that no material adverse event has occurred, both on the closing date.
 - Other certificates (i.e., certificate of articles of incorporation, certificate of incumbency,) and/or certified copies (i.e., resolutions of meeting of board of directors, resolutions of shareholders' meeting) would be necessary to certify the contents of the Prospectus, as the case may be.

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Equity Story

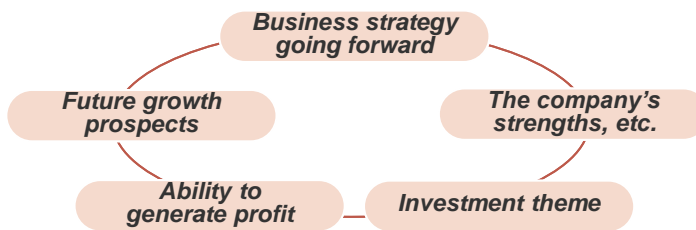
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Constructing the equity story

Constructing the equity story

- **A compelling equity story is an essential part of the marketing of an initial public offering.**
 - A highly compelling equity story is essential in order to entice investors to subscribe for shares.
 - The equity story is combined with other information into a presentation that is delivered to a number of investors.
 - It is important to effectively convey to investors the strengths and growth story of the company in order to achieve a good IPO price and achieve capital raising objectives.
- Using the company's financial information, business strategy, earnings outlook, business environment outlook, etc., the company and the issue manager form a persuasive case to convince investors to buy the stock.

Key factors of equity story



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Planning the capital structure

Capital structure

- **Consideration of opportunities to conduct a pre-IPO allocation of shares to a strategic partner**
 - By forming a capital and business alliance involving an allocation of shares to a strategic partner prior to the IPO, would make the equity story more concrete and help to maximize the valuation achieved at listing.
- **Consideration of post-listing shareholder structure and offering structure**
 - In consideration of the amount of capital to be raised and the desired shareholder structure, determine the proportion of the offering shares to be supplied by new issuance and selling shareholders.
- **Consideration of dividend policy**
 - Determine the dividend policy in consideration of the company's current growth stage and future earnings prospects. (Normally, a growth-stage company should return little or no capital to investors.)

- 1 **Target equity ratio**
- 2 **Estimate of future risk assets**
- 3 **Estimate of future retained earnings**

The amount of capital to be raised in the IPO and any follow-on offerings should be determined so that a balance is achieved between obtaining required investment capital and achieving capital efficiency (ROE).

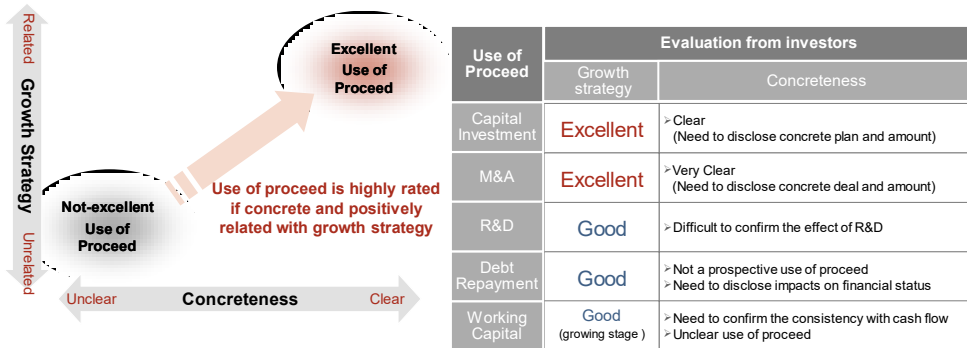
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Use of proceed and growth strategy

- In equity finance, use of proceed should be concrete and directly related with the growth strategy in order to persuade investors that the proceed leads to the future growth of issuer's corporate value
- Generally, "Capital Investment" and "M&A" would be recognized as appreciated use of proceed because investors easily associate the invested proceed with the growth strategy

General criteria for use of proceed



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IPO Prices

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Determining the Selling Price of a Listed Company's Stock

- Everything is determined entirely by market value.

The selling price of a listed company's stock

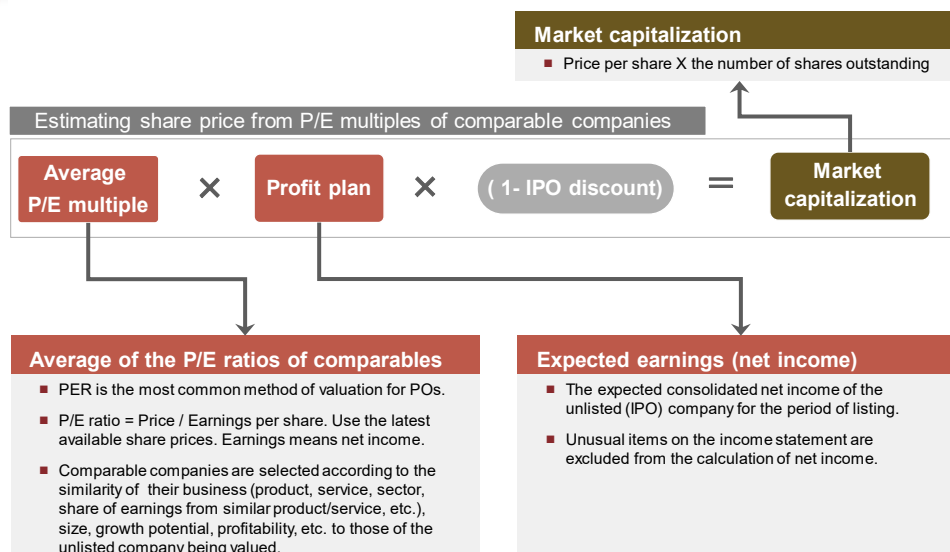
- Par value is used as a basis when thinking about issue prices and dividends.
- However, par value is meaningless with regard to the formation of share prices in the capital market. **Everything is determined entirely by market value.**

	Unlisted public company	Listed public company
Determination of selling price	Par Value × (1 + Premium) <i>Reflects past performance</i>	Net Income × PER Book Value × PBR <i>Reflects future growth expectations</i>
Determiner of selling price	Management of Listing Company	Investors
Evaluation of dividend payout level	Dividend Rate (Dividend ÷ Par Value)	Dividend Yield (Dividend ÷ Share Price)

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Valuation Using Price-to-Earnings Multiples



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Example: Determining the IPO Price of ABC Corporation

PER of comparables				EPS of ABC Corporation	
Company	PER (times)	Market cap. (US\$m)	Estimated Net income (US\$m)	Estimated Net income	FY2013 Estimated: US\$18m
D	17.0	170	10	Shares Outstanding	8 million shares (before IPO)
E	11.0	165	15	Issuing new Shares	2 million shares
F	-20.0	100	-5	Earning per share (EPS)	FY2013 Estimated: US\$1.8 (after IPO)
G	14.0	168	12		
H	19.0	152	8		
I	12.0	240	20		
Average**		14.6			

* Target net income for FY2013.
** Because F's PER is negative, it is excluded from the average.

Process of calculating mean PER

- As explained on the previous page, a number of listed comparable companies are selected on the basis of business and financial similarities to the IPO company. Due to the current insufficient number of listed companies in Mongolia, comparable stocks would be sought in other Asian markets.
- The price-to-earnings ratio is calculated for each comparable company, extreme values (negative values, very large values) are excluded, and the mean or median value is calculated.

Average P/E multiple	×	EPS	×	(1 - IPO discount)	=	Estimated IPO price
14.6 times	×	US\$1.8	×	(1 - 30%)	=	US\$18.4
Estimated IPO price	×	New shares issued	=	Amount raised		
US\$18.4	×	2m shares ※	=	US\$37m	※ Assuming a capital increase of 25 percent compared to the number of shares outstanding.	
Estimated IPO price	×	Shares outstanding	=	Market capitalization		
US\$18.4	×	10m shares	=	US\$184m		

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Comparison of the pricing methods in Japan

- Auction method and Book building method

- Currently in Japan, auction and book building methods are coexisting as a pricing method. However, after 1997, only book building method has actually been applied in the pricing.

	Auction method	Book building method
Overview	<ul style="list-style-type: none"> An auction is conducted in portion of the shares to be offered <u>without</u> an upper limit, and the weighted average of the successful bids becomes the public offer price for the remaining public offering tranche of the offering 	<ul style="list-style-type: none"> Based on feedback from pre-marketing to institutional investors, investment banks determine an indicative price range. Within the indicative price range, level of demand in each price is then calculated and an offering price is determined taking into account the market conditions and the level of demand for the offering
Auction Price/ Indicative Price	<ul style="list-style-type: none"> Lower limit ✓ 85% of the price calculated by comparable analysis Upper limit ✓ No limit 	<ul style="list-style-type: none"> Reference price → Calculated by investment bank based on issuers' business, financial records and financial status compared with the comparable companies, considering market condition Indicative price range → Determined based on feedback from pre-marketing to institutional investors
Pricing Process	<ul style="list-style-type: none"> Auction: Shares are allocated to bidders starting with the highest bid Public Offer: Weighted average of the successful bids from the auction 	<ul style="list-style-type: none"> Pricing for public offering based on the result of book building and market condition by investment banks' decision
Factors impacting pricing	<ul style="list-style-type: none"> Demand/Supply from individual investors Discretion of investment bank (based on weighted average of the successful bids from the auction) 	<ul style="list-style-type: none"> Demand/Supply from Institutional investors, valuation from institutional investors Discretion of investment banks (based on weighted average of the successful bids from the auction)
Allocation	<ul style="list-style-type: none"> Auction → Allocation to bidders as the amount bid by each successful bidder Public Offer → Investment banks underwrite the public offering tranche and sell shares to investors → Balloting is used for the allocation If demand is larger than the shares to be offered 	<ul style="list-style-type: none"> Public Offer → Investment banks underwrite the public offering tranche and sell shares to investors → Balloting is used for the allocation If demand is larger than the shares to be offered in the portion of individual investors
Finance Period	<ul style="list-style-type: none"> Around 1 month since listing approval 	<ul style="list-style-type: none"> Around 1 month since listing approval

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Comparison of the pricing methods in Japan

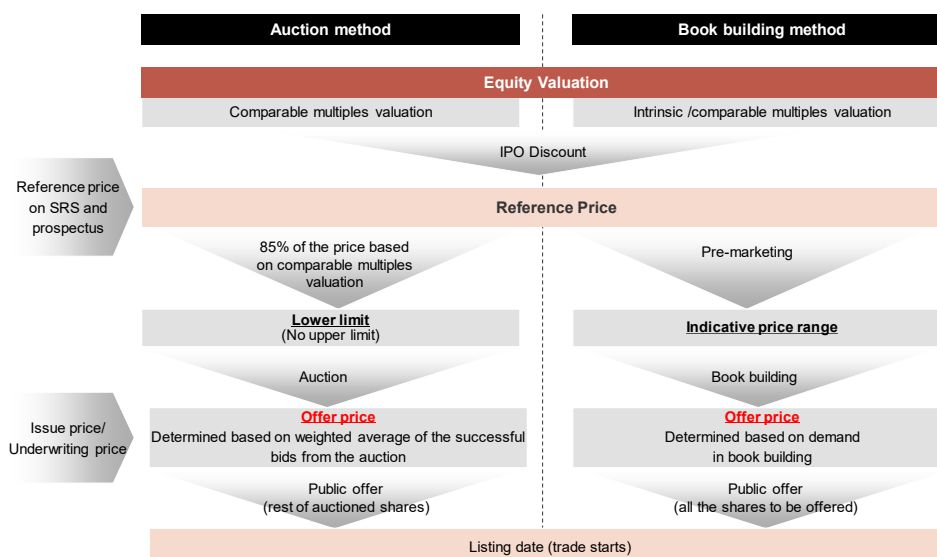
- Pros and Cons of Auction and Book building

	Auction method	Book building method
Pricing	<ul style="list-style-type: none"> ➤ Pricing process is clear because this pricing method is based on market principle and <u>reflects various players' viewpoints</u> ➤ <u>In popular deals, many investors are going to bid higher price</u> expecting to be allocated many shares, and therefore, the offer price is speculatively determined (higher offer price) ➤ Valuation capability of investment bank does not perform well on auction method ➤ Auction has upper limit on bidding shares, and as a result, demand from institutional investors is often excluded 	<ul style="list-style-type: none"> ➤ Pricing process is unclear compared with auction method, because <u>investment banks have stronger discretion on pricing</u> ➤ Investment banks ensure the clarity of pricing process by structuring checking mechanism for validity and by disclosing pricing process on prospectus. ➤ Leveraging underwriting capabilities, Investment banks determine the offer price considering not only <u>primary market condition but also secondary market</u>. ➤ Hearing from price leaders, investment banks determine the offer price through book building process
Allocation	<ul style="list-style-type: none"> ➤ Investment banks have no discretion on allocation, and shares are allocated to bidders starting with the highest bid, which provides <u>fair investment opportunities</u> ➤ Upper limit on bidding shares 	<ul style="list-style-type: none"> ➤ Allocation process is unclear compared with auction method, because investment banks have stronger discretion on allocation ➤ Investment banks ensure the clarity of allocation by disclosing allocation rules, keeping allocation record and allocating a portion for balloting ➤ <u>Investment banks are able to allocate shares for institutional investors</u>, considering investors characteristics and quality of demand.
Underwriting Risks	<ul style="list-style-type: none"> ➤ High underwriting risks because of low discretionary on pricing 	<ul style="list-style-type: none"> ➤ Although this method also has market volatility risk, book building process mitigates underwriting risk
General	<ul style="list-style-type: none"> ➤ Not a general method of pricing in developed countries including Japan. 	<ul style="list-style-type: none"> ➤ Global standard of pricing, adopted in developed countries

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Comparison of the flow of pricing

- Auction method and Book building method



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Offerings

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Domestic Offering and Global Offering - Overview of Domestic Offering and Global Offering

	Domestic Offering	Global Offering (Reg.S and 144A)	
Overview			
Workload	Registration/ Contracts/ Other materials	<ul style="list-style-type: none"> SRS, Prospectus Road show materials (Japanese) 	<ul style="list-style-type: none"> SRS, Prospectus Extraordinary report, English Prospectus Road show materials (Japanese, English)
	Due Diligence (DD)	<ul style="list-style-type: none"> DD based on the rule of Japan Securities Dealers Association 	<ul style="list-style-type: none"> DD based on the rule of Japan Securities Dealers Association DD based on overseas laws
	Preparation	<ul style="list-style-type: none"> 1-2 months 	<ul style="list-style-type: none"> 2-3 months
Road show target	<ul style="list-style-type: none"> Domestic Institutional Investors (including Japanese offices of overseas investors) 	<ul style="list-style-type: none"> Domestic Institutional Investors Overseas Institutional Investors 	
Book building period	<ul style="list-style-type: none"> 5-7 business days 	<ul style="list-style-type: none"> 7-10 business days 	
Other considerations	<ul style="list-style-type: none"> No solicitation for the overseas investors (but not excludes the investment from overseas investors) 	<ul style="list-style-type: none"> Need to assign law firms (Japanese law and U.S. law) Rule10b-5 Rule12g3-2(b) 	

Role's description

- Global Coordinator**
 - Coordinating the overall deal execution
 - e.g. appropriately balancing between domestic and overseas tranche
- Bookrunner**
 - Targeting investors and marketing with effective equity stories
 - Ability to successfully place the offering with domestic and overseas sales capabilities
 - Research capabilities and sales network's consistent sales effort post-offering

Domestic Offering and Global Offering

- Difference of target investors

- Global offering is an offering scheme in which shares are actively offered to the overseas investors in addition to the domestic investors.

Difference of target Investors



Domestic Investors		Overseas Investors	
Retail Investors	Institutional Investors	Euro (outside of U.S.)	U.S.
<ul style="list-style-type: none"> Include all domestic investors (individual and corporation) except institutional investors Track records show high demand from this investor group Compared with the offering in U.S and Europe, retail investors account for the larger part in Japanese offering 	<ul style="list-style-type: none"> Institutional investors are investors like below Banks, Trust bank, Life insurance, Non life insurance, Investment trust, Investment advisor etc Trust bank, investment advisor, annuity funds from life insurance are primary players among institutional investors 	<ul style="list-style-type: none"> Institutional investors, accounting for over 50% of overseas investors which invest into Japanese stocks In terms of jurisdictions, U.K is the largest, and Asian players (HK, Singapore) are accounting for larger the shares recently Primary sources are annuity, insurance funds 	<ul style="list-style-type: none"> Institutional investors, accounting for just below 50% of overseas investors which invest into Japanese stocks Some players manage the huge amount of funds but selective as for Japanese stocks Primary sources are annuity, insurance funds, and investment trust
Offer to the Public (Disclosure based on Financial Instruments and Exchange Law)		Private Placement (based on each country's regulation)	Private Placement (Rule 144A) or Offer to the Public*

* In case registered under the Securities Act

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Rationale for the Global Offering

1 Maximize demand

- In addition to the domestic investors, involving overseas investors which manage the large amount of fund could maximize the demand in the offerings

2 Consideration for existing overseas investors

- Provide opportunities for the existing overseas investors to participate in the offering, and, through the overseas road show, convey the equity story and growth strategies

3 Improve name recognition (attract new shareholders)

- Because many overseas investors have Growth Investment Strategy as their investment policies, being recognized by these investors is essential for issuers' future growth
- Approaching to these investors by conveying equity story motivates them to participate in the primary offerings or to invest in the secondary market.

Maximize enterprise value and stabilize aftermarket

- By maximize demand in the primary offerings, investors with unfilled demand might invest in the secondary market
- Successfully communicating equity stories for the existing shareholders prevents a falling stock price and stabilizes aftermarket
- By involving overseas investors in growing phase, maximize corporate value

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Investor Relations

Daiwa Securities Group Inc.
October 6, 2015

1. ABOUT INVESTOR RELATIONS

What is Investor Relations (IR) & Why do we need IR?

- ◆ IR is a communication between a company and investors, and it is necessary to form proper stock price of the company

Definition of IR

Investor Relations is the communication of information and insight between a company and the investment community. This process enables a full appreciation of the company's business activities, strategy and prospects and allows the market to make an informed judgment about the fair value and appropriate ownership of a company.

(Source: HP of Investor Relations Society)

Goal of IR

- ✓ Build trust between shareholders and/or investors
- ✓ Form proper stock price
- ✓ Acquire long-term investors
- ✓ Notify management strategy and management philosophy
- ✓ Promote understanding of the company and business
- ✓ Improve the recognition of the company

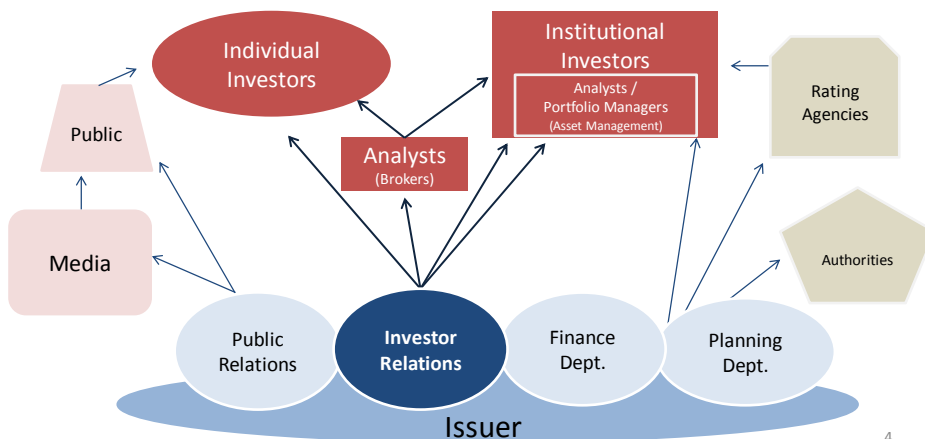
(Source: IR Basic Book of Japan Investor Relations Association)

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Role of IR (external)

- ◆ IR communicate mainly with institutional investors and individual investors including shareholders.

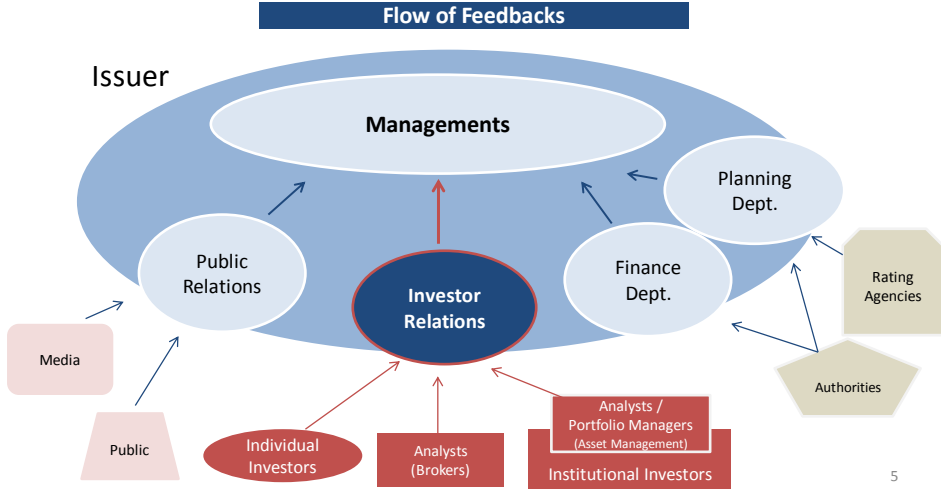
Flow of IR Information (external)



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Role of IR (internal)

◆ Comments or opinions of institutional investors and individual investors including shareholders are shared with managements



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2. IR OF DAIWA SECURITIES GROUP INC.

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Basic IR Policies

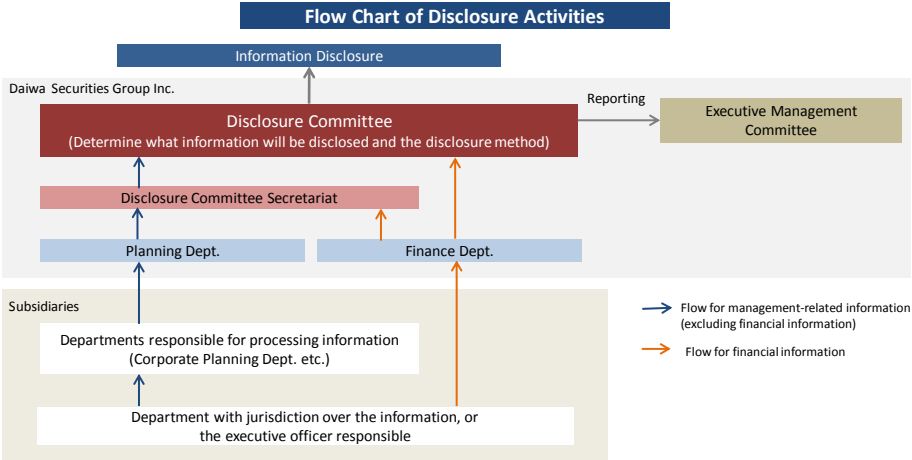
◆ Daiwa Securities Group Inc. has basically 3 main policies regarding IR activities

Timely	Providing information accurately on requested timing by investors
Fairly	Disclosing impartially to all investors and avoid informing only to particular investors
Continuously	Continuing IR activities regardless of favorable or unfavorable business conditions

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Disclosure System of Daiwa

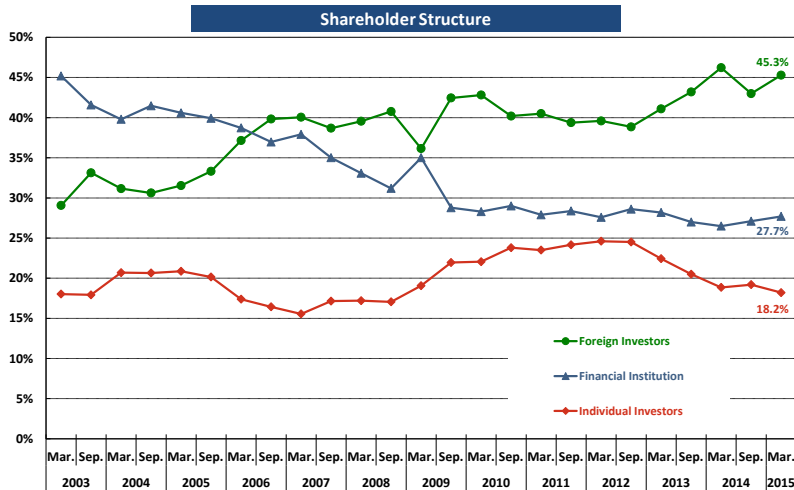
◆ Disclosure Committee, a sub-committee of the Executive Management Committee, makes final decisions regarding the disclosure of information



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Shareholder Structure of Daiwa

- ◆ Foreign investors' share is 45.3%, financial institution's share is 27.7% and individual investors' share is 18.2%



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Basic IR Activities

- ◆ IR manage events, publish documents, and operate shareholder reward program etc.

Planning Events

- ✓ Announcement of earnings results (quarterly)
- ✓ Group Strategies Meetings (CEO presentation to institutional investors and media, semi annually)
- ✓ IR Meetings with Analysts, Fund Managers and Institutional Investors (domestic and overseas through out the year except for quiet periods)
- ✓ IR seminar for individual investors

Publishing Documents

- ✓ Annual Report (Business & financial reports for shareholders, both on Japanese and US standards)
- ✓ Business Report (Simplified reports for individual shareholders)
- ✓ Presentation materials for earnings results
- ✓ Presentation materials for management strategies meetings

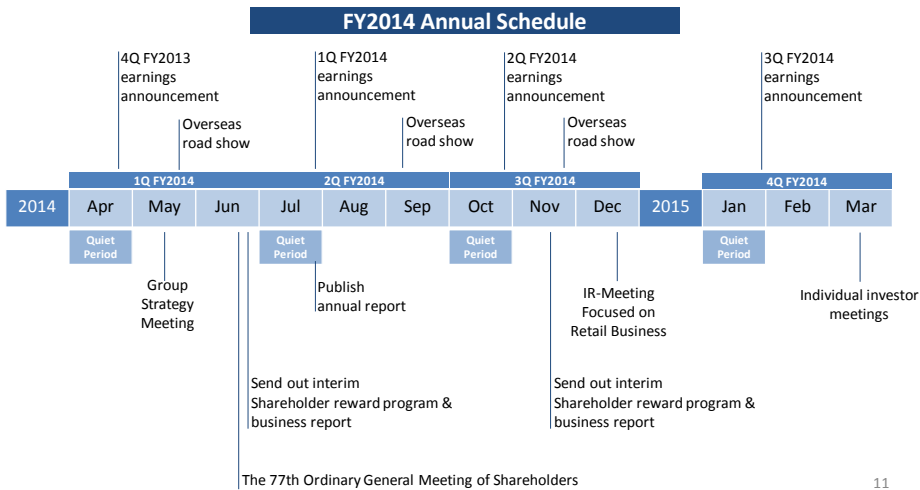
Other Operations

- ✓ Operating shareholder reward program
- ✓ Managing web site of Daiwa Securities Group (IR section)
- ✓ Corresponding to inquiries from shareholders and investors, etc.

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IR Calendar

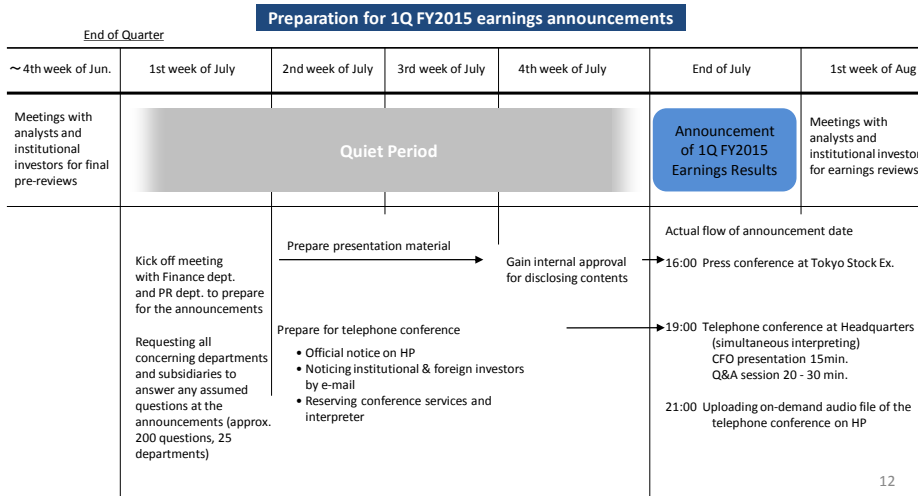
◆ There are many events throughout the year.



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Preparation for Earnings Announcement

◆ Begin preparation for earnings announcement about a month before the announcement day cooperating with other departments

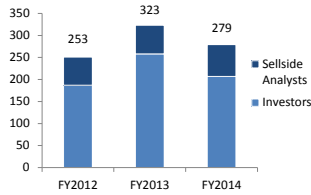


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Institutional Investors and Analysts

- ◆ Hold around 300 meetings with institutional investors and analysts throughout the year
- ◆ Main questions at the meetings include growth stories, earnings and corporate governance

Meetings With Institutional Investors and Analysts



Group Strategy Meeting



Popular Questions at Meetings

- Management strategy for growth
- Capital and dividend policy
- Earnings forecast and results
- Corporate Governance

Daiwa Investment Conference

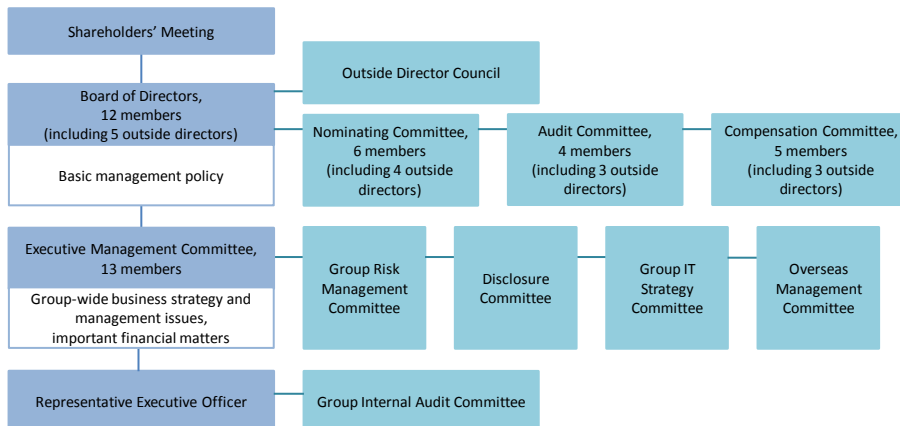


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Corporate Governance System

- ◆ Committee system of Corporate Governance with 3 committees

Corporate Governance System at Daiwa Securities Group



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Individual Investors

- ◆ Hold meetings at branches of Daiwa Securities Ltd. throughout Japan for individual investors
- ◆ Also hold internet live seminar for investors who cannot attend the meetings at branches

Meetings at Branches of Daiwa Securities Ltd.



Popular Questions at Meetings

- Management strategy for growth
- Economy
- Dividend
- Shareholder Return Program

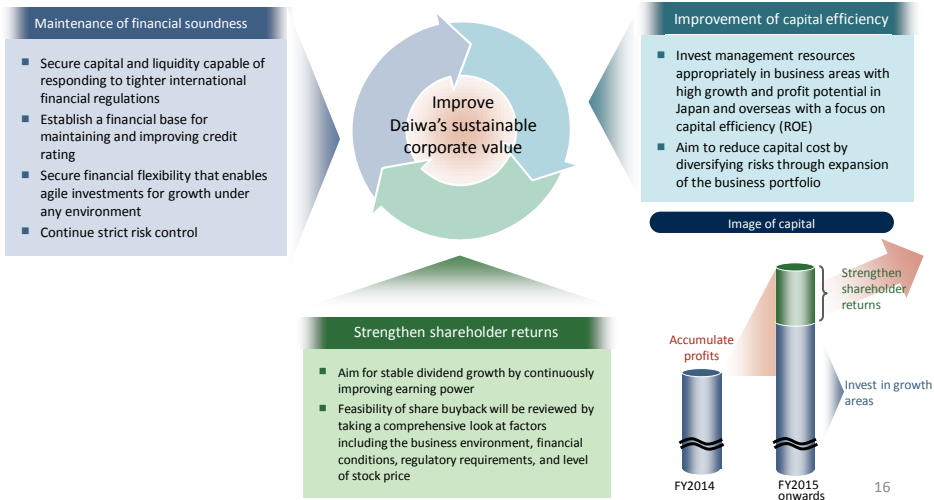
Internet Live Seminar



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Capital Policy Aimed at the Sustainable Improvement of Corporate Value

- ◆ Aim for sustainable improvement of corporate value by working to achieve the optimum balance between the maintenance of financial soundness, the improvement of capital efficiency, and the strengthening of shareholder returns



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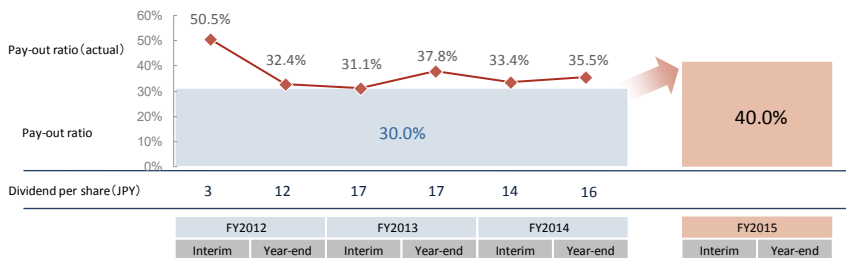
Dividend Payment Policy

- ◆ Pay dividends semiannually at a pay-out ratio of approximately 40% based on the consolidated financial performance

Dividend Payment Policy

Daiwa Securities Group Inc. (the "Company") aims to continuously raise shareholders' value including a profit-sharing. The Company will basically pay dividends semiannually at a pay-out ratio of approximately 40% based on the consolidated financial performance. The Company will also consider increasing returns to its shareholders in various ways including share buybacks when it has sufficient accumulated capital to pursue further growth.

*The new dividend payment policy will take effect from the fiscal year ending on March 31, 2016 (from interim dividend for FY2015, which will be paid in December 2015)



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Shareholder Return Program

- ◆ Provide gifts to shareholders as of end of March and September

Shareholder Return Program

Holding shares: 1,000-2,999	Holding shares: 3,000-4,999
Select one item from Catalogue A (around ¥2,000 per item)	Select two items from Catalogue A (around ¥2,000 per item)
Holding shares: 5,000-9,999	Holding shares: more than 10,000
Select one item from Catalogue B (around ¥5,000 per item)	Select two items from Catalogue B (around ¥5,000 per item)

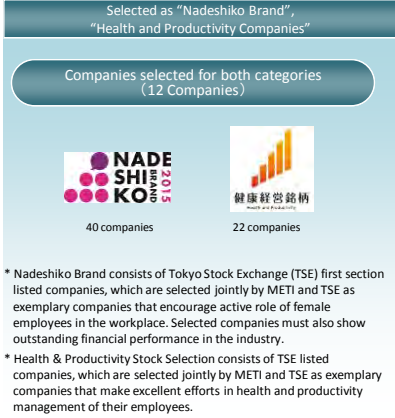
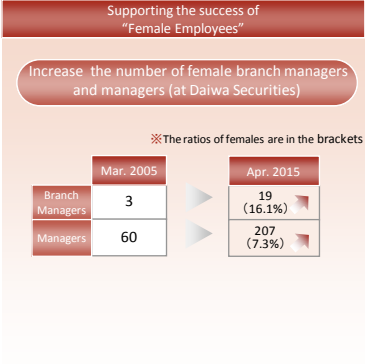
Examples of reward items



18

Human Resources Strategy

◆ Human resource is the most important management resource for the Group

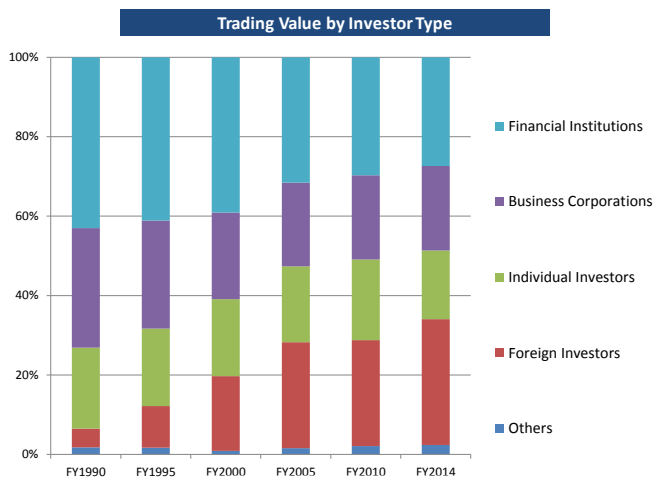


Source: Ministry of Economy, Trade and Industry (METI) 19

3. APPENDIX

Trading Value by Investor Type

- ◆ Presence of foreign investors is expanding



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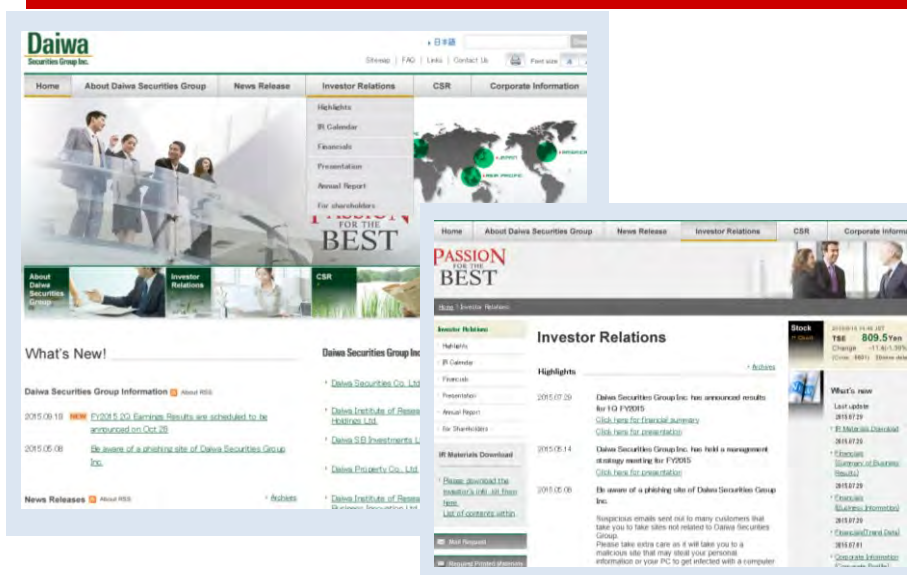
Published documents

- ◆ Annual report consists of company's profile, messages from managements, and corporate governance etc.
- ◆ Publish and send business report semi-annually to shareholders



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Web Site



Daiwa Securities Group Inc.
Investor Relations

E-mail: ir-section@daiwa.co.jp

URL: <http://www.daiwa-grp.jp/english/ir/index.cfm>

**Project for Capacity Building of Capital Market in Mongolia
(Training Course in Tokyo)
- Listing Standard & Underwriters -**

October 5, 2015

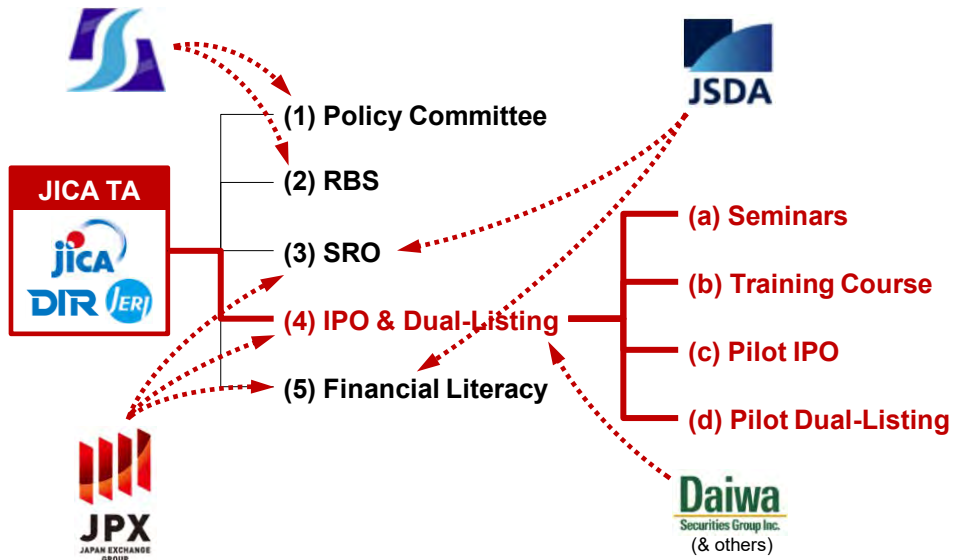
Daiwa Institute of Research
Japan Economic Research Institute

Contents

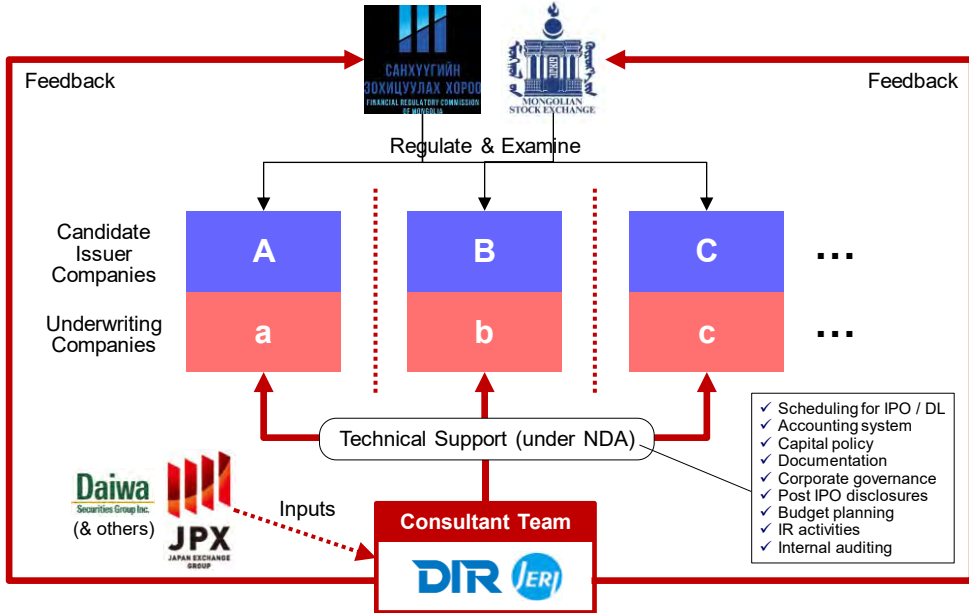
1. Introduction
2. Listing Standard & Examination: Cross National Comparison
3. Evaluating Underwriters

1. Introduction

Support Under JICA TA: Consulting Framework



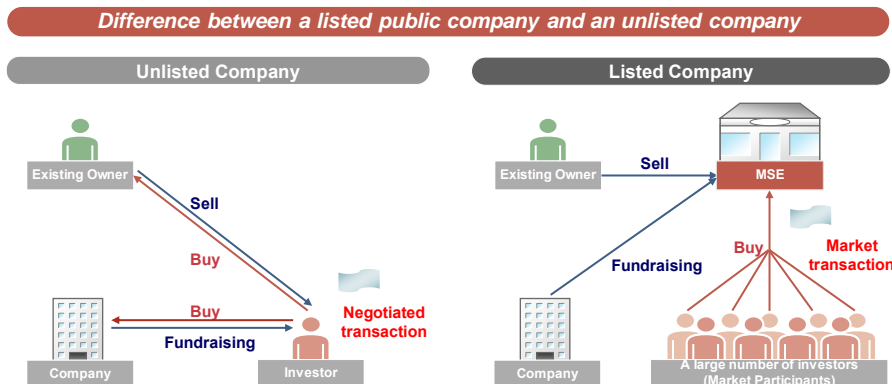
(4)-(c),(d) Pilot IPO & Dual-Listing



5

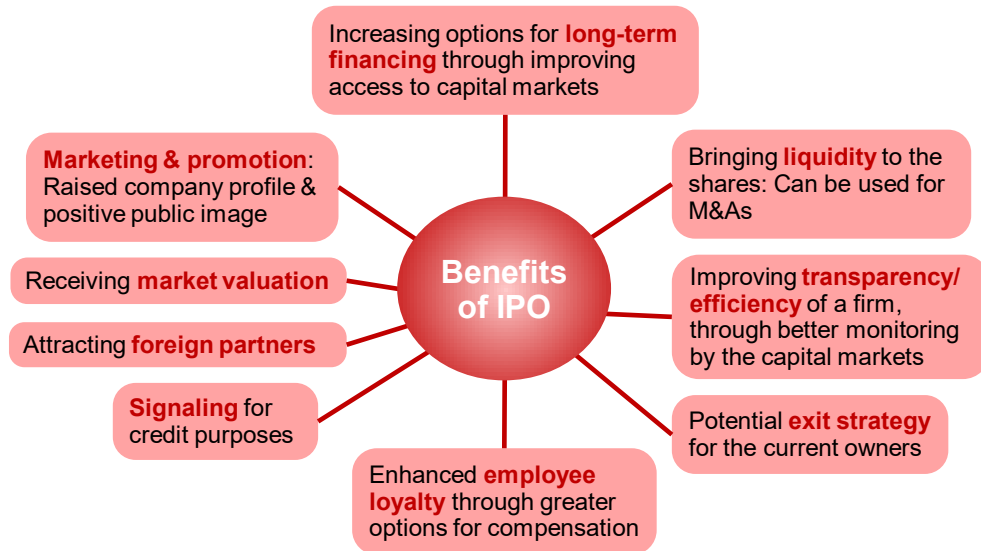
What is IPO (Initial Public Offering)?

A company lists for the first time on a stock exchange and conducts a public offering



6

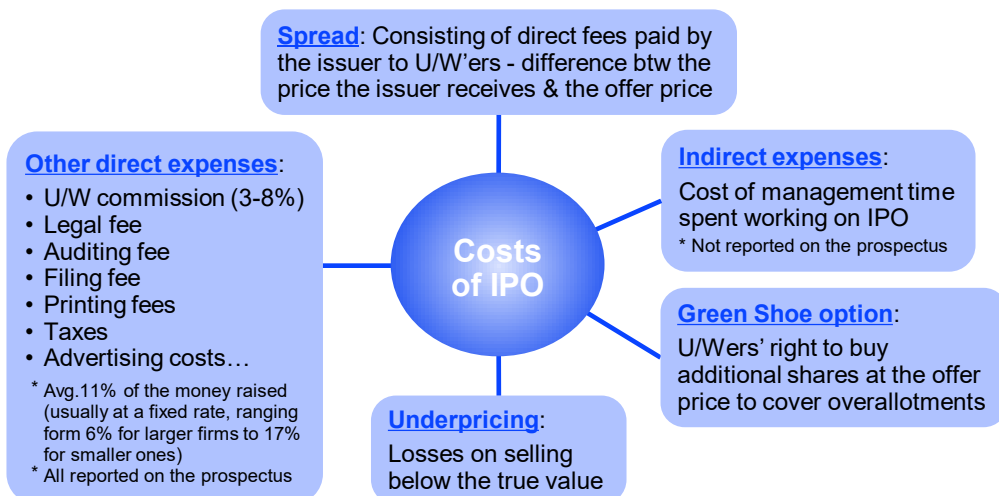
Benefits of IPO



7

Costs of IPO

According to the practices in US, total IPO costs are a big portion of the issue proceeds (avg. **15-30%**), which can be divided into the followings.



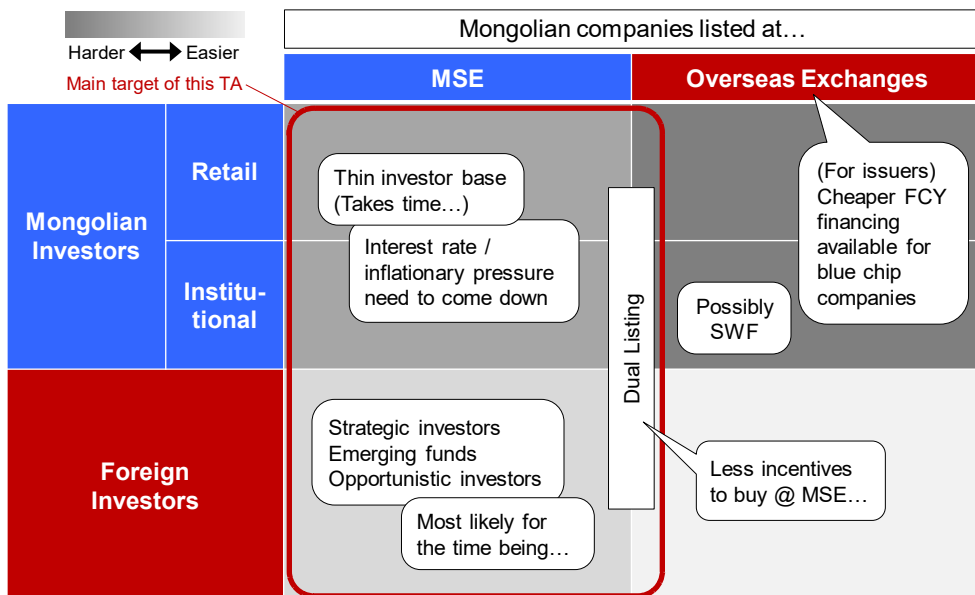
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Concerns Related to IPO



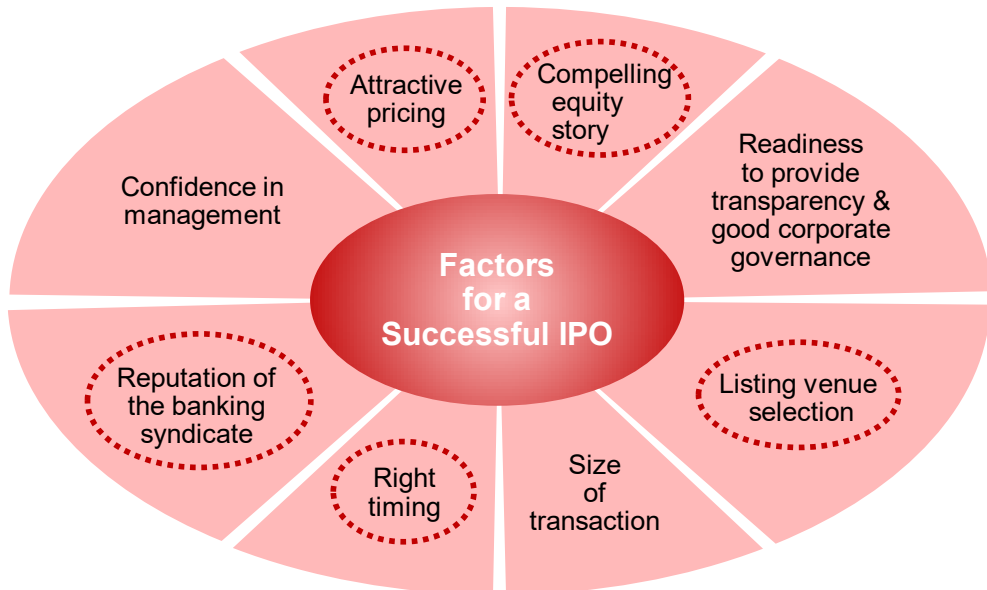
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Equity Financing in Mongolian Context



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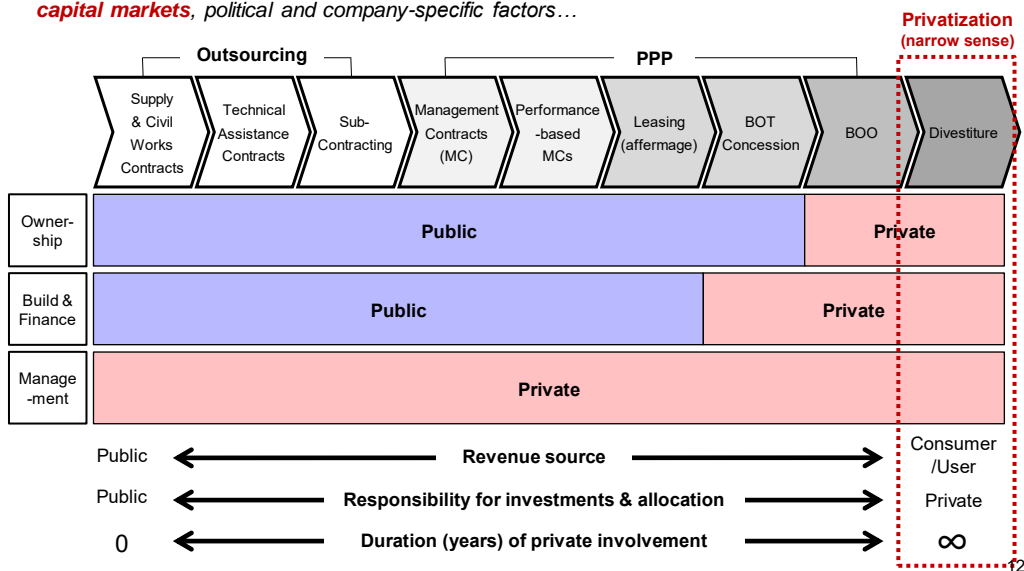
Factors for a Successful IPO



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Privatization: Definition

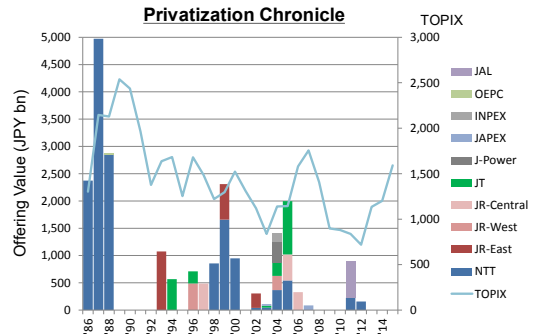
Privatization = 'Process of transferring ownership of a business, enterprise, agency, public service, or public property from the public to the private sector.' Choice of method is influenced by the **depth of capital markets**, political and company-specific factors...



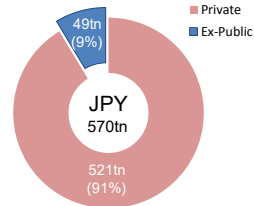
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Privatization: What happened in Japan

- Japanese gov't promoted privatization w/strong leadership in 80's, to address;
 - **Fiscal deterioration**
 - **Slowdown in economy**
 - **Pressure from outside** for deregulation
- As a result of the privatization;
 - **Fiscal position** has improved
 - **Market discipline** has been introduced
 - **Corporate governance** has improved
 - **Domestic capital markets** has grown
- Privatized companies have become global players w/own growth strategies.
- NTT has been the largest privatization, **bringing a number of retail investors** into the capital market
- Privatized companies currently occupy 9% of the total market cap in TSE



TSE1 Market Capitalization (as of May 9, 2015)



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Privatization: Cases in Japan

(As of March 31, 2014) Consolidated	NTT	JR	JT	TEPCO
Establishment / Listed	1985/1985	East: 1987/1992 West&Central: 1987/1993	1985/1994	1951/1951
Paid-In Capital (JPY bn)	938	East: 200 Group total*: 460	100	1,400
Total Revenue (JPY bn)	10,925	East: 2,704 Group total*: 6,432	2,400	6,631
Ownership (Voting rights base) <small>(red= public sector)</small>	MOF: 35.65% Employee: 0.81%	<u>Privatized 3 companies</u> Private: 100.00% <u>Other 4 companies</u> JRTT: 100.00%	MOF: 33.35%	NDF*: 50.10% Employee: 1.46% Tokyo Metropolis: 1.35%

* Nuclear Damage Compensation and Decommissioning Facilitation Corporation

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2. Listing Standard & Examination: Cross National Comparison

Overview of key initial listing regulatory requirements

	London Stock Exchange Main Market	New York Stock Exchange	Hong Kong Stock Exchange Main Board	Singapore Exchange Main Board
Regulatory authority	Financial Conduct Authority (FCA)	Securities and Exchange Commissions (SEC)	- HKSE - Securities and Futures Commission (SFC)	- SGX - Monetary Authority of Singapore (MAS)
Sponsor ¹	Required	Not required	Required	Required
Overall timeline ²	4 +/- months	4 +/- months	6 +/- months	6 +/- months
Accounting standard	IFRS, EU IFRS or equiv	IFRS or US GAAP	IFRS, HK IFRS or equiv	IFRS, SIN IFRS, US GAAP
Audited track record ³	3 years	3 years (2 yrs for EGCs) ⁴	3 years	3 years
Minimum free float	25%	NR	25% (15% for large issuers)	25% (12-20% for large issuers)
Company history	3 years	3 years	3 years	3 years (1 yr market cap ≥\$300m)
Working capital	Covering 12 months	NR	Covering 12 months	Covering 12 months
Market Cap	£700k	NR (unless does not meet earnings test)	HK\$200m	NR (unless does not meet earnings test)
Ongoing obligation requirements (after IPO)				
Financial reporting	• Annual financial report • Half year financial report • Interim management statement	• Annual • Quarterly (not for non-US)	• Annual • Half yearly • Quarterly (optional)	• Annual • Quarterly

1. Sponsor (or equivalent) is an investment bank appointed to manage the IPO process, with responsibilities to both the regulator and the issuer.
2. The Overall timeline from Kick-off of an IPO process to admission, excluding any time required for a pre-IPO preparation or restructuring.
3. All stock exchanges - subject to certain exemption
4. EGCs: Emerging growth companies defined under the JOBS Act.

IPO in the UK – London Stock Exchange (Main Market)



- Regulatory authority ⇒ **Financial Conduct Authority (FCA)** referred to as the *UK Listing Authority (UKLA)*
- The company seeking to have its shares listed must apply to both the **FCA** for *admission to the listing (Official List)* and the **London Stock Exchange (LSE)** for *admission to trading*
 - ✓ **FCA** (also referred to as the UKLA) regulates the Official List and oversees the listing process, reviewing and approving company prospectus documents and ensuring that its rules are met
 - ✓ **LSE** oversees the admission to trading and Disclosure Standards
- The Admission becomes effective only when all the relevant documents have been approved by the FCA, and the decision to admit the securities to trading has been announced jointly by the LSE and the FCA
- In the UK, a company seeking admission to the LSE must appoint a **sponsor**. The sponsor takes a leading role in the listing process, representing the company to both the LSE and the FCA.

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IPO in the US - New York Stock Exchange/NASDAQ



- Regulatory authority ⇒ **Securities and Exchange Commission (SEC)**
- Before undertaking an IPO, the company must file a registration statement (S-1), which includes the prospectus, with the **SEC**. The SEC reviews the S-1 document and declares it effective once they are satisfied.
- **Financial Industry Regulatory Authority (FINRA)** reviews the terms of the offering and the underwriting arrangements to determine whether they are "fair and reasonable" and declares no objections
- **NYSE/NASDAQ** reviews the listing application according to the initial listing standards for authorization

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IPO in Singapore – Singapore Stock Exchange (Main Board)



- Regulatory authority ⇒ **Singapore Exchange Securities Trading Limited (SGX-ST)** and **Monetary Authority of Singapore (MAS)**
- The Company seeking an IPO must submit listing application and company prospectus to **SGX-ST** for review and approval.
- After obtaining SGX's indication of eligibility to list (the letter of eligibility-to-list), the prospectus has to be lodged with **MAS**, where it will be placed on the MAS website for public comments for a period of three to four weeks.
- Upon receipt of MAS' indication of approval for registration, the company will submit final prospectus to **SGX** and **MAS** and register final prospectus with MAS before launching the offer of shares.
- In Singapore, a company seeking admission to the SGX must appoint its **sponsor**.

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IPO in Hong Kong – Hong Kong Stock Exchange (Main Board)

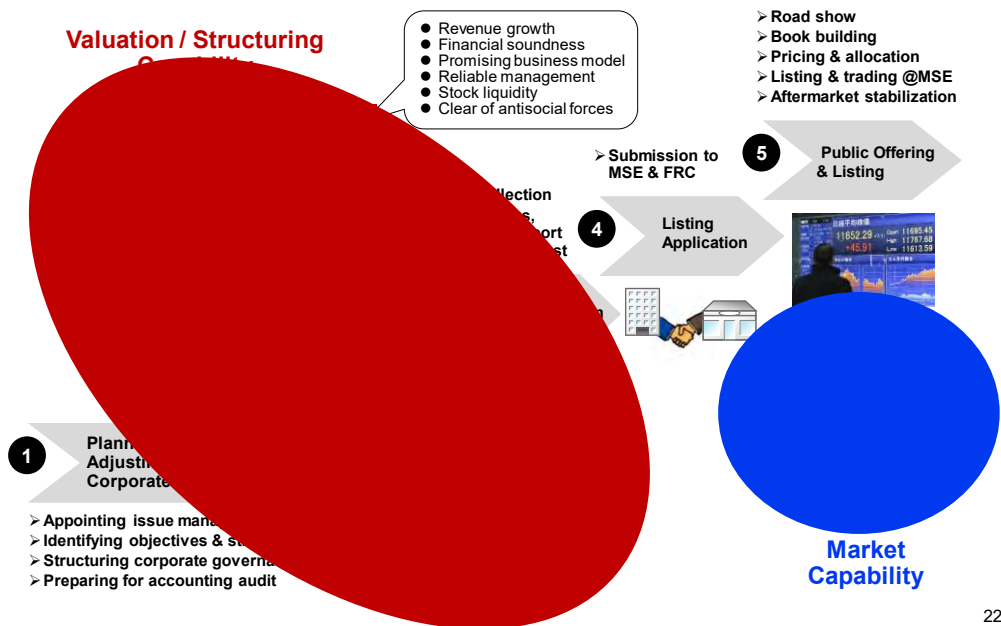


- Regulatory authority ⇒ **The Stock Exchange of Hong Kong Limited (HKSE)** and **Securities and Futures Commission (SFC)**
- **HKSE** oversees the listing process, reviewing and approving company prospectuses and ensuring that its rules are met.
- The sponsor, on behalf of the issuer company, submits a listing application (A1) including a substantially completed draft of the prospectus to the **HKSE** for its review and approval. The Application Proof will be published on the HKSE website at the same time when the listing application is made. (started from April 2014)
- In Hong Kong, a company seeking admission to the exchange must appoint a **sponsor**. The sponsors take a leading role in the listing process and key responsibilities including overall management of the IPO, the preparation of the listing documents, etc.

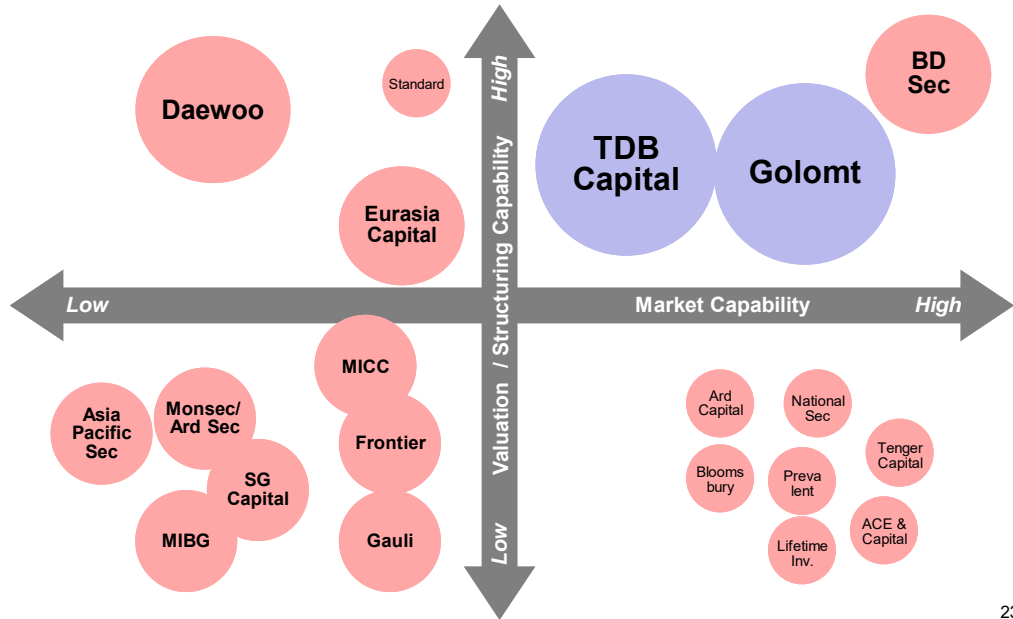
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3. Evaluating Underwriters

Typical Underwriting Process



Evaluating Underwriters



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Audit and Internal Control Report System under the Financial Instruments and Exchange Act

October 7, 2015

Masahiro Tokushige, Deputy Director
Corporate Accounting and Disclosure Division,
Planning and Coordination Bureau,
Financial Services Agency

Audit System under the Financial Instruments and Exchange Act

Corporate Disclosure System under the Financial Instruments and Exchange Act (Outline)

[Primary Market]

- When soliciting 50 or more persons for transactions of securities totaling 100 million yen or more, the issuer of the securities must submit a securities registration statement.

[Secondary Market]

- The following companies must submit an annual securities report:
 - a) A listed company;
 - b) A company who submits an annual securities report;
 - c) A company whose securities are held by 1,000 or more persons and whose stated capital is 500 million yen or more, etc.

2

- 1947: Enactment of the Securities and Exchange Act (amended to the Financial Instruments and Exchange Act in 2006)
- 1947: Establishment and announcement of the audit standards by the Business Accounting Council
- 1948: Enactment of the Certified Public Accountants Act
 - Introduction of the qualification system for certified public accountants
 - Introduction of audit firms (an audit firm may be incorporated by five or more certified public accountants)
- 1957: Obligation to undergo an audit of financial statements by a certified public accountant or an audit firm
- 1970: Obligation to prepare consolidated financial statements and undergo an audit thereof by a certified public accountant or an audit firm
However, the focus is on non-consolidated financial statements. Consolidated financial statements are positioned as secondary documents.
Obligation to prepare interim financial statements and undergo an audit thereof by a certified public accountant or an audit firm
- 1998: Consolidated financial statements came to be considered as major documents.
- 2006: The Securities and Exchange Act was significantly amended and the Financial Instruments and Exchange Act was enacted.
- 2008: Listed companies became obligated to prepare quarterly consolidated financial statements and undergo an audit thereof by a certified public accountant or an audit firm.
Listed companies became obligated to prepare internal control reports and undergo an audit thereof by a certified public accountant or an audit firm.

3

Audit System under the Financial Instruments and Exchange Act (Outline)

[Article 24, paragraph (1)]

- A listed company, etc. shall
 - submit
 - a report stating the financial conditions of the corporate group to which the company belongs and of the company, other important matters, (an “annual securities report”)
 - for each business year
 - to the Prime Minister
 - within three months after the end of that business year.
- (Note 1) There are approximately 3,600 listed companies.
- (Note 2) Listed companies shall submit quarterly reports and internal control reports (since 2008). Companies other than listed companies (companies that have more than a certain number of shareholders, etc.) must submit semiannual reports under the Financial Instruments and Exchange Acts .

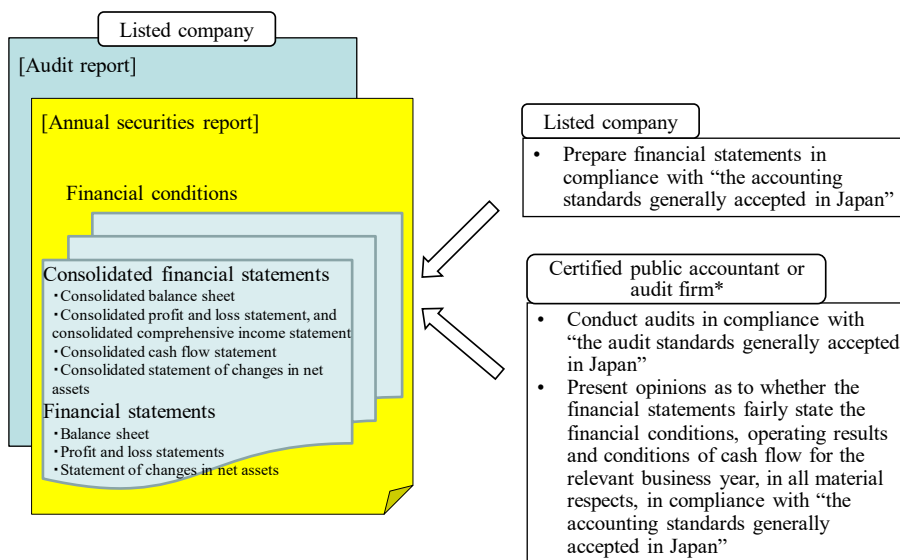
[Article 25, paragraph (1), item (iv)]

- Annual securities reports shall be made available for public inspection for five years after the date of submission.

[Article 193-2, paragraph (1)]

- Financial statements (including quarterly financial statements) of listed companies ,etc .shall be audited by a certified public accountant or an audit firm.

4



*An audit firm may be incorporated by five or more certified public accountants.

5

Standard - Setting Bodies (Outline)

- **Accounting standards**
- Until July 2000, the Ministry of Finance and the Business Accounting Council set up thereunder had developed the accounting standards to be followed by companies subject to disclosure regulations under the Financial Instruments and Exchange Act.
- In July 2000, the Financial Services Agency (FSA) was established.
- From July 2000 to July 2001, the FSA and the Business Accounting Council developed the accounting standards to be followed by companies subject to disclosure regulations under the Financial Instruments and Exchange Act.
- In 2001, the International Accounting Standards Board (IASB) was established.
- In July 2001, the Accounting Standards Board of Japan (ASBJ), which is the independent standard-setting body, was established. Since then, the ASBJ has developed the accounting standards to be followed by companies subject to disclosure regulations under the Financial Instruments and Exchange Act. (The BAC has the authority to develop the accounting standards)

- **Audit standards**

- Until July 2000, the Ministry of Finance and the Business Accounting Council had developed the audit standards.
- Since July 2000, the FSA and the Business Accounting Council have developed the audit standards.

(Business Accounting Council)

- The Business Accounting Council examines and discusses the development of the accounting, audit standards and other matters concerning the improvements of the corporate accounting, audit system and makes a report or a representation (presents opinions) on the results thereof to the Prime Minister, and the Commissioner of the FSA, etc.
- The Business Accounting Council consists of companies, users of financial statements, certified public accountants, and academics, etc.

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Certified Public Accountants and Audit firms (Outline)

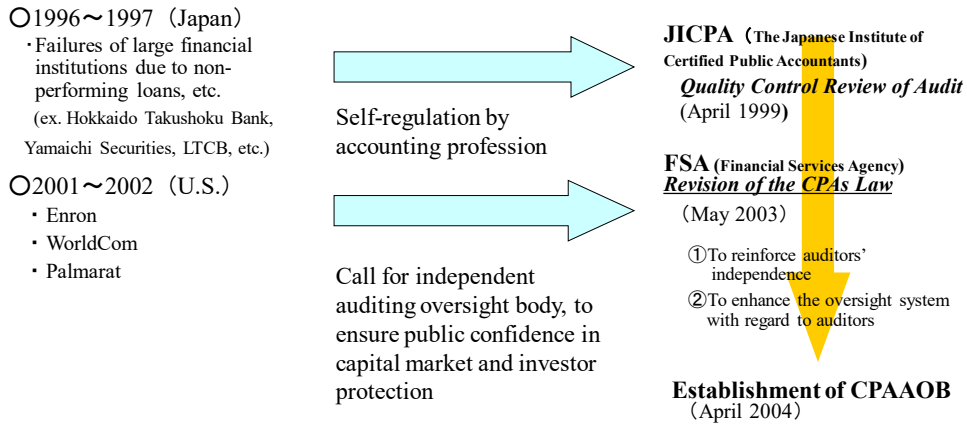
- Number of certified public accountants: Approx. 26,000
- Out of which, approx. 50% belong to audit firms.
- Out of those certified public accountants who belong to audit firms, approx. 80% belong to one of the four major audit firms.
- Number of audit firms : Approx. 210
- Most of the audit firms have no more than 25 certified public accountants as their members.

(March 2016)

7

Establishment of CPAAOB

(Certified Public Accountants and Audit Oversight Board)



8

Inspections of Audit firms (Outline)

(JICPA , a self-regulatory organization)

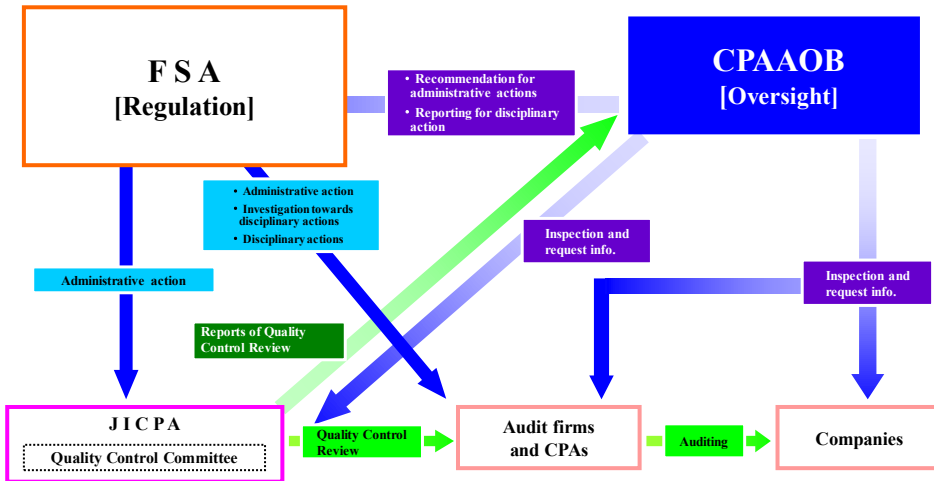
- Audit firms must undergo quality control review by the Japanese Institute of Certified Public Accountants (JICPA), which is a self-regulatory organization, once every three years, in principle.
- However, major audit firms are obliged to undergo quality control review once every two years. (Major audit firms are reviewed by the JICPA every two years.)
- The JICPA shall report the results of the quality control review to the Certified Public Accountants and Auditing Oversight Board (CPAAOB).

(CPAAOB)

- Based on the results of the quality control review and other data, the CPAAOB decides which audit firms shall be inspected.
- However, the CPAAOB conducts inspections of major audit firms once every two years, in principle. (Major audit firms are inspected by the CPAAOB every two years.)
- The CPAAOB conducts inspections about 15 audit firms every year.
- When the CPAAOB finds it necessary as a result of an inspection of an audit firm, it may request the FSA to take an administrative action against the relevant audit firm (the CPAAOB does not have the authority to take administrative actions).

9

Oversight System - Overview



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Internal Control Report System under the Financial Instruments and Exchange Act

11

Development of Internal Control Report System(Outline)

Need for developing internal control

Incidents of inappropriate corporate financial disclosure (e.g. Seibu Railway, Kanebo, etc.)

→ Concerns that the corporate internal control over financial reporting was not functioning effectively

* In the United States, the Sarbanes-Oxley Act (SOX) enacted in 2002 obligates that the internal control over financial reporting must be assessed by the management and audited by a certified public accountant or an audit firm.



Financial Instruments and Exchange Act (amended in June 2006)

- Obligation for "assessment" and "audit" of the internal control over financial reporting (Internal Control Report system)

Standards for Assessment and Audit of the Internal Control over Financial Reporting (published in February 2007)

<Target companies>

Listed companies (about 3,600)

<Timing of application>

Applicable to business years starting on or after April 1, 2008

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- **False statements in an annual securities report by Seibu Railway (2004)**
 - The largest shareholders (top ten) of Seibu Railway held 80% or more of the total shares of Seibu Railway.
 - Under the regulation for listed companies of the day, such company was to be delisted.
 - In order to avoid delisting, the company stated false percentage of shares held by the largest shareholders.
 - As a result of inspections of listed companies, etc. (approx. 4,500 companies), 15% or more companies corrected their annual securities report.
- **False statements in an annual securities report by Kanebo**
 - Delisted in 2005 due to large-scale window-dressing
 - The management and certified public accountants were arrested.
 - The FSA suspended a part of the audit firm's business, and as a result the audit firm was dissolved later. (The audit firm is one of the four largest audit firms.)

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“Laws and Regulations, etc.” pertaining to Internal Control over financial reporting

○ Financial Instruments and Exchange Act (amended on June 14, 2006)

○ Order for Enforcement of the Financial Instruments and Exchange Act (amended on August 3, 2007)
- Companies subject to the Internal Control Report system, etc.

○ Cabinet Office Ordinance on the System for Ensuring the Adequacy of Documents on Financial Calculation and of Other Information (promulgated on August 10, 2007; revised on March 30, 2011)
- Forms of the Internal Control Report, positioning of the standards, etc., handling of foreign companies, etc.

○ Guidelines on the Cabinet Office Ordinance on Internal Control (published on October 1, 2007; revised on March 30, 2011)

○ "Standards for Assessment and Audit of the Internal Control over Financial Reporting" and "Practice Standards for Assessment and Audit Concerning Internal Control over Financial Reporting" (published on February 15, 2007; revised on March 31, 2011; Business Accounting Council)

○ FAQs on the Internal Control Report System (published on October 1, 2007; added on June 24, 2008; added again on April 2, 2009; Financial Services Agency)

○ Eleven Misunderstandings on the Internal Control Report System (March 11, 2008; Financial Services Agency)

○ Collection of Case Examples on the Internal Control Report System (published on March 31, 2011; Financial Services Agency)

○ Practical Guidance Concerning Audit of Internal Control over Financial Reporting (published on October 24, 2007; revised on August 10, 2011; The Japanese Institute of Certified Public Accountants)

- Practical handling pertaining to internal control audit, text examples of an internal control audit report, etc.

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Outline of the Internal Control Report System under the Financial Instruments and Exchange Act

[Article 24-4-4, paragraph (1)]

- A listed company shall,
 - submit, together with an Annual Securities Report,
 - a report (Internal Control Report) in which evaluation is made
 - with regard to internal control over financial reporting (the system necessary for ensuring appropriateness of financial statements and other information)
 - concerning the Corporate Group to which the company belongs and concerning the company.
 - for each business year,

(Note 1) There are approximately 3,600 listed companies.

[Article 25, paragraph (1), item (vi)]

- An Internal Control Report must be made available for public inspection for five years from the day of submission.

[Article 193-2, paragraph (2)]

- An Internal Control Report shall be audited by a certified public accountant or an audit firm.

15

[Reference] Governing Provisions

○ Financial Instruments and Exchange Act <<Extract>>

(System for Ensuring Appropriateness of Documents on Finance Calculation and Other Information)

Article 24-4-4 (1) A company which is required to submit Annual Securities Reports under Article 24, paragraph (1) (including companies which have submitted the Annual Securities Reports under Article 23-3, paragraph (4); the same shall apply in the following paragraph) shall, if the Securities issued by the company are those listed in Article 24, paragraph (1), item (i) or the company is otherwise required by Cabinet Order, submit a report in which evaluation pursuant to the provisions of Cabinet Office Ordinance is made with regard to its system specified by Cabinet Office Ordinance as necessary for ensuring appropriateness of documents on finance calculation and other information concerning the Corporate Group to which the company belongs and concerning the company (hereinafter referred to as an "Internal Control Report") to the Prime Minister together with an Annual Securities Report (or a Foreign Company Report in cases where Foreign Company Reports are submitted instead of Annual Securities Reports, etc. as defined in Article 24, paragraph (8) under that paragraph) for each business year, pursuant to the provisions of Cabinet Office Ordinance.

(2) to (6) (omitted)

(Public Inspection of Securities Registration Statement, etc.)

Article 25 (1) The Prime Minister shall, pursuant to the provisions of Cabinet Office Ordinance, make the documents listed in the following items (hereinafter referred to as the "Documents for Public Inspection" in this Article and paragraph (1) of the following Article) available for public inspection for the period specified in the respective items from the day when he/she receives the Documents for Public Inspection (omitted):

(i) to (v) (omitted)

(vi) an Internal Control Report and documents attached thereto, and an amendment report submitted for any of these documents: five years;

(vii) to (xii) (omitted)

(2) to (8) (omitted)

(Audit Certification by Certified Public Accountants or Audit firm)

Article 193-2 (1) (omitted)

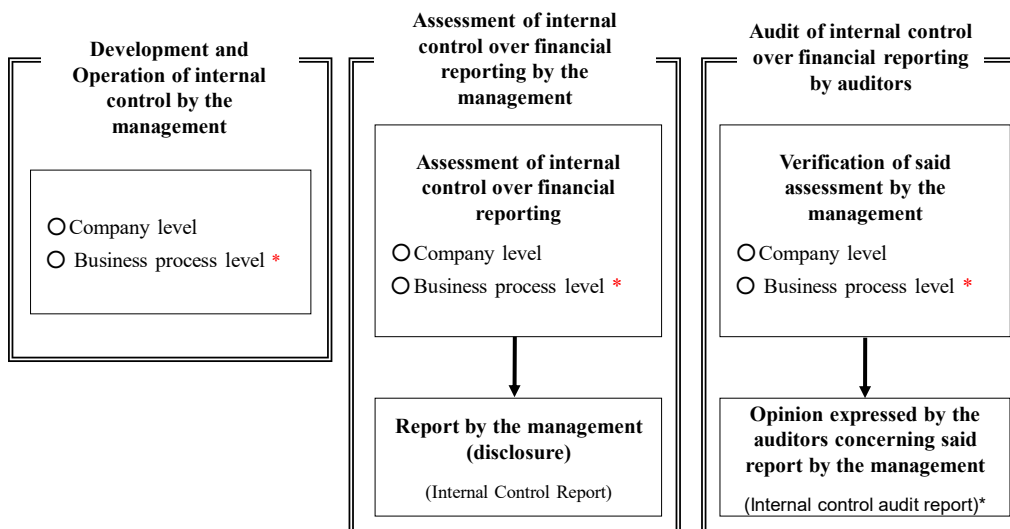
(2) An Internal Control Report which shall be submitted pursuant to the provisions of Article 24-4-4 by an issuer company of Securities listed on a Financial Instruments Exchange or any other person specified by Cabinet Order shall require an audit certification by a certified public accountant or an audit firm that has no Special Interest in said company or person; provided, however, that this shall not apply in the following cases:

(i) to (iii) (omitted)

(3) to (8) (omitted)

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Flow of Assessment and Audit of Internal Control over Financial Reporting (Financial Instruments and Exchange Act)



* Prepared (disclosed) as part of the financial statement audit report

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* Business Processes

- A company as a whole is deemed as a single series of business processes.
- A company has sub-processes that constitute the single series of business processes and further divided sub-processes that constitute such sub-processes.
- For example, a company has a sales process.
A sales process may consist of sub-processes, such as
 - a process to take an order from a customer
 - a process to evaluate the customer's credit standing
 - a process to direct a shipment
- The personnel department and financial department of the headquarters, plants, and business offices are also parts constituting the series of business processes.
- Not only various elements of the company itself but also its subsidiaries constitute the whole series.

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Basic Framework of Internal Control

**“Standards and Practice Standards for Management Assessment and Audit Concerning Internal Control Over Financial Reporting”
(Business Accounting Council; February 15, 2007)**

<Definition of internal control>

- In principle, “internal control” is a process undertaken by everyone in an organization in order to achieve the four company objectives ((i) effectiveness and efficiency of business operations, (ii) reliability of financial reporting, (iii) compliance with applicable laws and regulations relevant to business activities and (iv) safeguarding of assets), which consists of six basic components ((A) control environment, (B) risk assessment and response, (C) control activities, (D) information and communication, (E) monitoring and (F) response to IT).

“Standards and Practice Standards for Management Assessment and Audit Concerning Internal Control Over Financial Reporting” (Business Accounting Council)

- “Internal control over financial reporting” is defined as internal control that is necessary to ensure the reliability of financial reporting.
- This standards show the ideas concerning the method and procedures for an assessment by the management and an audit by a certified public accountant or an audit firm with regard to the effectiveness of the internal control over financial reporting.

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Four Objectives of Internal Control

(i) Effectiveness and efficiency of business operations

- To enhance the effectiveness and efficiency of business operations for achieving the purpose of business activities

(ii) Reliability of financial reporting

- To ensure the reliability of financial statements and information that may have a material effect on financial statements

(iii) Compliance with applicable laws and regulations relevant to business activities

- To promote compliance with applicable laws and regulations, and other rules relevant to business activities

(iv) Safeguarding of assets

- To ensure that necessary information is identified, understood, and processed and is accurately communicated throughout the organization and to relevant parties

- “Safeguarding of assets” (objective (iv)) is not clearly indicated in the objectives of the internal control of COSO.
- COSO does not position “safeguarding of assets” as an independent objective but associates it with the other three objectives (i) to (iii).
 - When dividends are paid as a result of false financial reporting, this will result in undue outflow of profits, meaning that company assets have not been properly preserved. Such incident may damage the reliability of financial statements (relating to objective (ii)).
 - A failure to properly preserve company assets affects the effectiveness and efficiency of business operations (relating to objective (i)).
 - Undue outflow of company assets may lead to violations of relevant laws (relating to objective (iii)).
- In Japan, it is emphasized that the acquisition, use and disposition of assets shall be executed through due procedures and authorizations. Therefore, “**safeguarding of assets**” (objective (iv)) is clearly indicated as an independent objective.
- Four objectives of internal control mutually relate to one another.
- Companies are supposed to achieve these four objectives through the development and operation of their own internal control.

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Six Basic Components of Internal Control

Basic components of internal control are components necessary for achieving the objectives of internal control and serve as the criteria for assessing the effectiveness of internal control.

(i) Control environment

- The control environment determines the tone of an organization (company culture), influences the awareness of its people toward control, lays the foundation for all other components (ii) to (vi), and serves as an infrastructure that affects all of them.
e.g.) Management’s conscientiousness and ethics view, management’s business attitude and managerial philosophy, operational system of the board of directors, operational system of the audit committee, etc.

(ii) Risk assessment and response

- Risk assessment and response constitute a series of processes aimed at identifying, analyzing and assessing factors that could adversely affect the achievement of the organization’s objectives and selecting appropriate responses to those risks.

(iii) Control activities

- Control activities are policies and procedures established to ensure that the orders and instructions of the management are followed in an appropriate manner.

(iv) Information and communication

- Information and communication are to ensure that necessary information is identified, understood, processed and is accurately communicated throughout the organization and to relevant parties.

(v) Monitoring

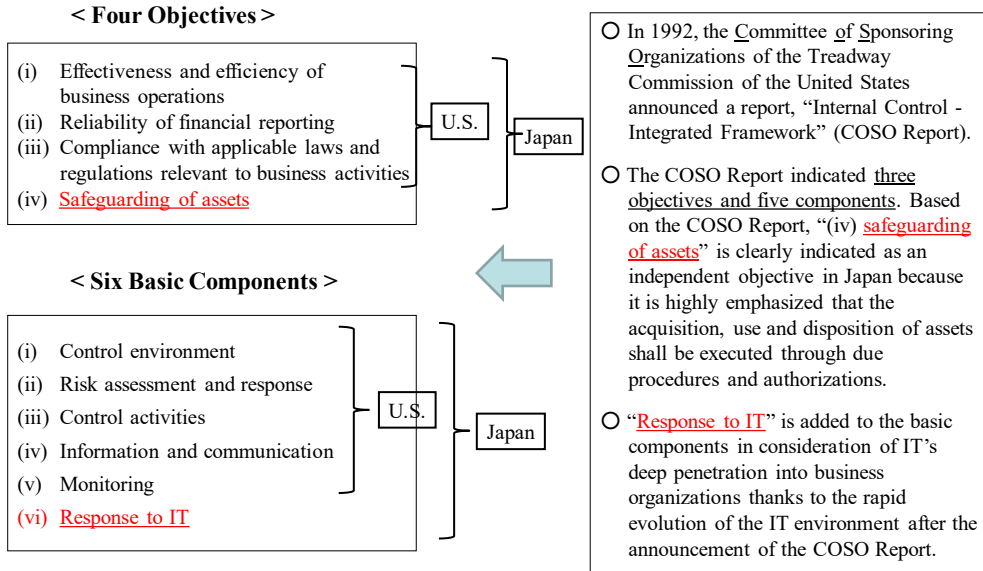
- Monitoring is a process that continuously assesses the effectiveness of internal control. Monitoring provides a means of continually observing, assessing and correcting internal control. Monitoring includes ongoing monitoring that is performed in the course of business operations and separate evaluations that are conducted from perspectives independent of business operations.

(vi) Response to IT

- Response to IT is to establish appropriate policies and procedures in advance to achieve organizational objectives and to respond appropriately to IT inside/outside the organization during the course of business activities based on the policies and procedures.

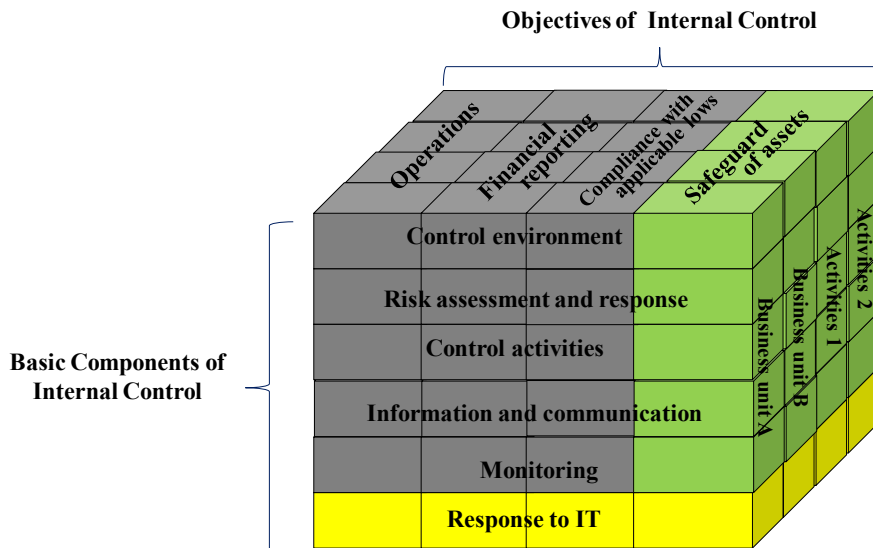
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Basic Framework of Internal Control



22

Objectives and Basic Components of Internal Control

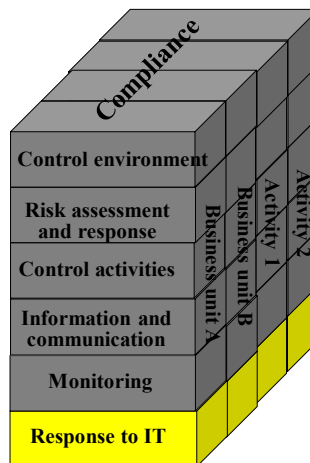


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- The framework for the assessment of internal control is indicated with three axes, i.e., objectives of internal control, components of internal control, and business processes subject to the assessment of internal control.
- An assessment is to be conducted for each component of internal control with regard to a specific business process in order to check whether the objectives of internal control are effectively achieved as a whole.
- Which objective to select varies by the person who conducts the assessment of internal control.
- In the case of an audit of an internal control report under the Financial Instruments and Exchange Act, the objective “reliability of financial reporting” is selected.
- Components, “control environment,” “risk assessment and response,” “control activities,” “information and communication,” “monitoring,” and “response to IT,” serve as the criteria for assessing internal control.
- First specify a business process, assess the effectiveness for each of the six components, and lastly assess the effectiveness of internal control as a whole.

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- For example, when selecting the objective “compliance” for business unit A, the six components are required to be properly developed and operated in business unit A.



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Assessment and Report Concerning Internal Control Over Financial Reporting by the Management

1. Significance of assessment of internal control over financial reporting

The management shall assess the effectiveness of the internal control over financial reporting in compliance with the “internal control assessment standards generally accepted in Japan” and shall announce the results thereof externally.

- Scope of financial reporting
 - (i) Financial statements
 - (ii) Disclosure information and other matters that could have a material effect on the reliability of financial statements
 - a. Disclosure information to be provided as a summary, excerpt, or breakdown, or by use of the amounts and values presented in, or notes to, the financial statements
 - b. Matters that are closely related to the decision of whether an entity is an affiliate, decision on the scope of consolidation or the necessity to apply the equity method, determination of whether a party is a related party and other decisions involved in preparing financial statements

2. Assessment of Internal Control Over Financial Reporting and Scope of Assessment

- (1) The assessment of the effectiveness of internal control over financial reporting shall be, in principle, conducted on a consolidated basis.
 - (i) Consolidated subsidiaries and others
 - (ii) Equity method affiliated companies
 - (iii) Foreign subsidiaries

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(2) Determination of the Scope of Assessment

The management shall assess company-level controls and use the results as a basis to determine the scope of the business processes that shall be subject to the internal control assessment.

< Assessment of company-level controls >

For all locations and business units from a company-wide perspective, in principle

< Determination of the scope of assessment of business processes relating to accounting and financial reporting >

With regard to matters for which an assessment from a company-wide perspective is considered to be appropriate, such assessment shall be conducted for all locations and business units in line with company-level controls.

- Procedures for preparing financial statements based on the general ledger
- Procedures for journalizing and recording for preparing consolidated financial statements (consolidation adjustments, aggregation, reclassification and others)
- Procedures for stating disclosure information relevant to financial statements

***< Determination of the scope of assessment of other business processes >**

The scope of assessment may be narrowed down.

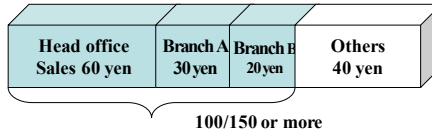
- (i) Selection of significant locations or business units
 - Determine targeted locations and business units based on the degree of materiality of their sales or other factors
Select locations or business units in descending order of sales or other factors until their combined amount reaches a certain ratio of the total (for example, approx. two-thirds)
- (ii) Identification of business processes to be assessed
 - Cover all business processes which significantly relate to the accounts that are closely associated with the company’s business objectives (in the case of a general company, the accounts closely associated with **sales, accounts receivable, and inventory**, in principle)
- (iii) Addition of material business processes

Consultation with auditors on the scope of assessment as necessary

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Method of Determining the Scope of Assessment

1. Significant business locations/units are selected in the descending order of sales until their combined amounts reach about two-thirds of the total amount.



2. All business processes of significant business locations/units which impact the accounts of sales, accounts receivable and inventory are included the scope of assessment.

- Sales
- Accounts receivable
- Inventory

3. Business processes that have a significant impact are added to the scope of assessment individually.

- High-risk transactions
- Accounts involving estimates and management’s judgment
- Exceptional, non-routine, or irregular transactions

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3. Method of Assessing Internal Control Over Financial Reporting by the Management

The management shall first assess internal control that has a material impact on overall consolidated financial reporting and, based on the results thereof, assess internal control over business processes. These assessments shall be conducted as of the end of the fiscal year.

- (1) Assessment of company-level controls
- (2) Assessment of process-level controls
- (3) Judgment on the effectiveness of internal control
 - Judgment on the effectiveness of company-level controls
 - Judgment on the effectiveness of process-level controls
- (4) Correction of “material weaknesses to be disclosed” in internal control

Control deficiencies shall be recognized on a timely basis and appropriately dealt with. Even when material weaknesses are identified, internal control over financial reporting can be judged to be effective as long as the weaknesses are corrected by the end of the business year.

→ Any “material weaknesses to be disclosed” and “ control deficiencies” identified in the course of the management’s assessment are expected to be corrected and improved by the end of the business year.

In other words, it is expected that it will be possible to realize reliable financial reporting under corrected and improved effective internal control.

→ However, if there are any remaining “material weaknesses to be disclosed” as of the end of the business year, the management must state the details of the weaknesses and the reason why they have not been corrected in an internal control report.

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Material Weaknesses to be Disclosed

○ Meaning of “material weaknesses to be disclosed”

- “Material weaknesses to be disclosed” refer to weaknesses in internal control that are highly likely to have a material effect on financial reporting.
- When there are any “material weaknesses to be disclosed” in internal control, they may have a material effect on financial reporting. However, the existence of such weaknesses itself does not directly deny the appropriateness of the financial reporting stated in the relevant company’s annual securities report.
- This shows to investors, etc., who intend to use the data disclosed in financial reporting, the fact that the relevant internal control over financial reporting contains a material problem that needs to be corrected.

○ Disclosure of the fact that there are any “material weaknesses to be disclosed” does not necessarily serve as the grounds for delisting or punishment

The existence of any “material weaknesses to be disclosed” in internal control does not directly deny the appropriateness of the financial reporting stated in the relevant company’s annual securities report. Therefore, even if a company discloses the fact that there are any “material weaknesses to be disclosed” in internal control, or that the internal control contains a material problem that needs to be corrected, this does not necessarily serve as the grounds for delisting or punishment for a violation of the Financial Instruments and Exchange Act.

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Audits of Internal Control over Financial Reporting by a Certified Public Accountant or an Audit firm

1. Purpose of internal control audits

- Auditors present their opinions as to whether the management’s internal control report fairly states the results of the assessment of internal control over financial, in all material respects, in compliance with the internal control assessment standards generally accepted in Japan.
- Auditors present their opinions based on the management’s assertion regarding its assessment results on the effectiveness of the internal control.
- Direct reporting is not adopted. Direct reporting refers to a system under which auditors directly verify the status of development and operation of internal control, irrespective of the results of the management’s assessment of the effectiveness of the internal control.
(Note) Direct reporting is adopted in the United States.
- In Japan, the following adverse effects of direct reporting were taken into consideration.
 - Auditors need to conduct audits covering matters outside the scope of the internal control assessment determined by the management, and this requires higher costs.
 - Auditors are apt to be too conservative and may request companies to prepare unnecessary documents and take unnecessary assessment procedures.

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2. Relationship between internal control audits and financial statement audits

- An internal control audit is to be conducted integrally with a financial statement audit by the same auditor, in principle.
- Any audit evidence obtained in the process of an internal control audit may be used as audit evidence for a financial statement audit, and vice versa.

(Note) The term “by the same auditor” means that not only the audit firm but also the engagement partner thereof performing audit duties need to be the same.

In the United States, an internal control audit and financial statement audit are required to be conducted by the same audit firm, but not necessarily by the same engagement partner.

3. Audit planning and evaluation of the appropriateness of the scope of assessment

- Auditors are to establish an internal audit plan by incorporating it into a financial statement audit plan.

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4. Implementation of internal control audits

- (1) Evaluation of the assessment of company-level controls
- (2) Evaluation of the assessment of process-level controls
- (3) Reporting and correction of “material weaknesses to be disclosed” in internal control

- | |
|---|
| <ul style="list-style-type: none">• When an auditor finds any “material weaknesses to be disclosed” in internal control in the course of an internal control audit, the auditor must report such fact to the management and request correction thereof and must also examine the status of the correction on a timely basis.• An auditor must report to the board of directors, etc. the details of the “material weaknesses to be disclosed” and the results of the correction thereof. |
|---|

33

Measures to Prevent an Excessive Cost Burden in Assessment and Audit

After verifying the status of operation of the system that was already being introduced in the United States, the Business Accounting Council incorporated the following measures in the standards and practice standards:

1. Using top-down/risk-based approach

Business process-level controls are assessed to the extent necessary based on the assessment of the results of company-level controls, focusing on the risks that could create material misstatements.

2. Simplifying classification of deficiencies of internal controls

Classification of deficiencies in internal control was simplified into two categories: "material weaknesses to be disclosed" and "deficiencies" (the deficiencies are classified into three categories in the United States: "material weakness," "significant deficiencies," and "deficiencies").

3. Not adopting direct reporting

The auditors audit only the assessment of the internal control that has been conducted by management.

4. Integrated implementation of internal control audit and audit of financial statements

Internal control audits are to be performed by the same auditors responsible for auditing the company's financial statements.

5. Preparation of internal control audit report and financial statement audit report in a unified form

The internal control audit report is, in principle, to be prepared in conjunction with the report of financial statements audit.

6. Coordination between auditors and audit committee/internal auditors

Auditors are to appropriately coordinate with the audit committee, etc. and, when necessary, make use of the work of internal auditors.

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Supervision of Large Securities Firms in Japan

** Views expressed in this presentation are those of the speaker, and not necessarily identical to those of the JFSA or any other institution.*



Large Securities Firms in Japan

	Classification (No. of firms)	Firm name
Major	Designated Parent Company (2)	<ul style="list-style-type: none">• Nomura• Daiwa
Second-tier	Consolidated Subsidiary of Large Banking Group (3)	<ul style="list-style-type: none">• Mitsubishi UFJ Morgan Stanley Securities• Mizuho Securities• SMBC Nikko Securities
	Independent Securities Firms (4)	<ul style="list-style-type: none">• Okasan etc.

Large Securities Firms in Japan

(¥bil, as of end June 2015)

	Firm name	Net Operating Revenue	Ordinary P/L	Total Assets	Client Assets	No. of Accounts (active, in thousands)	No. of Staff	No. of Offices
Major	Nomura Securities	194	70	13,267	116,825	5,466	13,392	159
	Daiwa Securities	107	47	12,233	56,663	2,871	8,755	143
Second-tier	Mitsubishi UFJ Morgan Stanley Securities	87	31	13,800	31,367	1,275	5,242	65
	Mizuho Securities	75	20	10,875	38,307	1,585	8,092	282
	SMBC Nikko Securities	86	23	9,673	43,759	1,860	9,517	136
	Okasan Securities	18	5	500	4,351	421	2,591	61

Designated Parent Company

- Securities firms which are engaged in large and complex businesses as a group

<Requirements to be designated>

- ✓ Parent Company (or a subsidiary) of a Special Financial Instruments Business Operator (Special FIBO, more than 1 trillion yen of total assets)
- ✓ Engages in management of the Special FIBO
- ✓ Operates businesses which are necessary for the Special FIBO to appropriately operate its business (lending, guarantee, etc.)

Designated Parent Company

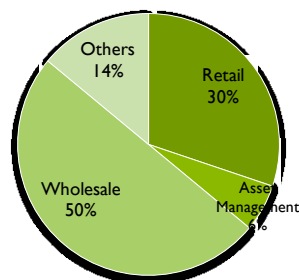
- Business Model
 - ✓ Retail business (securities distribution and intermediation)
 - ✓ Wholesale business (sales and trading, securities underwriting, advisory business etc.)
 - ✓ Asset management business
 - ✓ Operating Globally
 - Risk Profile
 - ✓ Exposed to risks mainly through securities trading and investment banking related business.
- **Subject to the prudential regulation based on Basel III.**

5

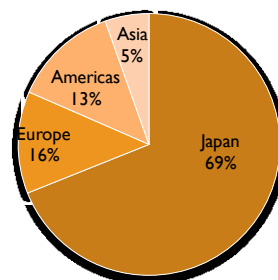
Designated Parent Company

- (Example) Nomura Holdings

Revenue by Segment



Revenue by Region



(as of end March 2015)

6



Consolidated Subsidiary of Large Banking Groups

- Business Model
 - ✓ Engage in both retail and wholesale business
 - ✓ Operating globally
 - ✓ Tie-up with banking subsidiary
 - Risk Profile
 - ✓ Exposed to risks mainly through securities trading and investment banking related business.
- **Prudentially regulated (Basel III) through parent banking group consolidation.**

7



(ref.) Other Securities Firms

- Business Model
 - ✓ Mainly engaged in retail brokerage business
 - ✓ Focus on Domestic Business
- Risk Profile
 - ✓ Due to focus on retail business, business performance is influenced by economic trend in Japan.
 - ✓ Due to focus on pure brokerage service, risk exposure arising from asset trading/holdings are limited.

8



What we check

Supervisory Guideline (April 2015)

IV. Treatment of Designated Parent Company Groups

- Governance
 - ✓ efficient knowledge and experience of the directors to conduct governance including overseas bases
 - ✓ clearly specified a management policy etc. of the group companies including overseas bases
- Appropriateness of Business Operations
 - ✓ group-wide compliance with the relevant laws, regulations and rules of each country
 - ✓ an appropriate control environment for legal compliance in accordance with the size of its overseas bases and the characteristics of its business operations

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What we check (cont.)

Supervisory Guideline (April 2015)

IV. Treatment of Designated Parent Company Groups

- Adequacy of Equity Capital
 - ✓ Quality and Quantity of Equity Capital
 - ✓ Adequacy of Equity Capital (Disclosure, Early Corrective Action and Early Warning System)
 - ✓ Capital Buffer (2016.3~)
- Control Environment for Risk Management
 - ✓ Integrated Control Environment for Risk Management
 - ✓ Recovery and Resolution Plans
- Compensation Structure

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Office of Securities Business Monitoring (1)

(1) **Mandate**

- Ensure financial soundness and risk management system of large (and second-tier) securities firms

(2) **Procedure**

- Integrate on-site and off-site monitoring process
- Each member of the office is appointed to specific areas of focus and horizontally monitors financial institutions

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Office of Securities Business Monitoring (2)

(3) **Focused Areas**

- Examples of key areas of focus are:
 1. Liquidity Risk
 2. Market Risk
 3. Credit Risk
 4. Revenues Trend
 5. Operational Risk
 6. Internal Audit
 7. Model Approval
 8. Product Control
- We also take into account the development of international financial regulation and global practices in risk management to improve the overall governance structure of securities firms.

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Our focus this year

The JFSA Policy (September 2015)

- For a large securities firm group, it is expected that efficient intermediary function to be ensured even under the stressed market conditions. JFSA will focus on verifying whether:
 - a) Robust risk governance is established by building Risk Appetite Framework
 - b) Robust stress testing is in place and its result is examined and utilized at the management level
 - c) Risk management framework is established at the front office level by setting management indicators to comply
- By verifying above, JFSA will assess the extent of loss absorbing capacity and impact of crisis management actions to the financial system. Furthermore, JFSA will require the group to develop its recovery planning and strengthen its risk management. JFSA will also carry forward the resolution planning.
- From group governance perspective, JFSA will examine whether the group business is well managed to be less sensitive to business cycle fluctuations.



An Overview of the Securities and Exchange Surveillance Commission (SESC)

8 October, 2015

Kaoru Murakami
Deputy Director for Coordination Division
Securities and Exchange Surveillance Commission



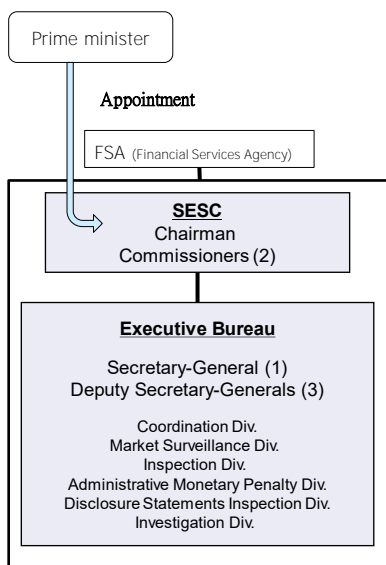
1. Introduction
2. History
3. Policy Statement
4. Organization and Primary Functions
5. Cooperation with Related Entities



1. Introduction



(1) Basic Structure



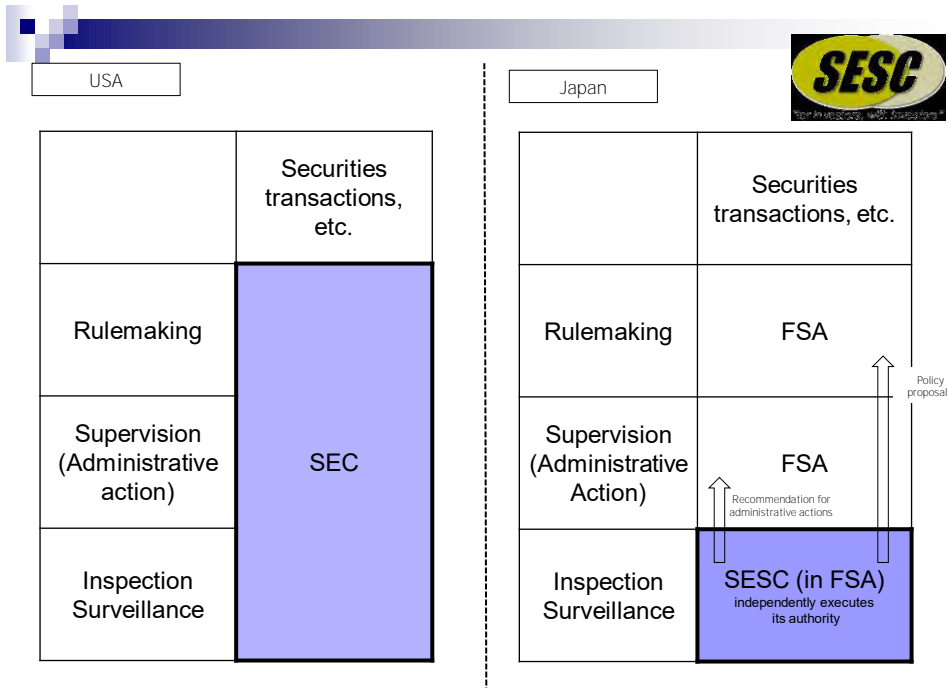
SESC:

The Securities and Exchange Surveillance Commission
(Established in July 1992)

- Conducting
 - Market oversight
 - Securities inspection, etc.
 - Investigation of market misconduct
 - Disclosure statements inspection
 - Criminal investigation

【Executive Bureau】

- Composed of six divisions with 409 officials (as of FY2014)



4



- The SESC (chairman and commissioners) executes its official authority independently, though it is within the Financial Services Agency (FSA).
(Chairman and commissioners will not be dismissed against their will.)
- The SESC doesn't have the power to make rules or to take administrative actions. Instead, it can submit policy proposals or make recommendations to take administrative actions.

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(2) Mission / Purpose



Daily market surveillance activities



Actions

Recommendation for administrative actions, etc.



Ensuring the integrity of capital markets
Protecting investors



Development of capital markets
Vitalization of international competitiveness of capital markets

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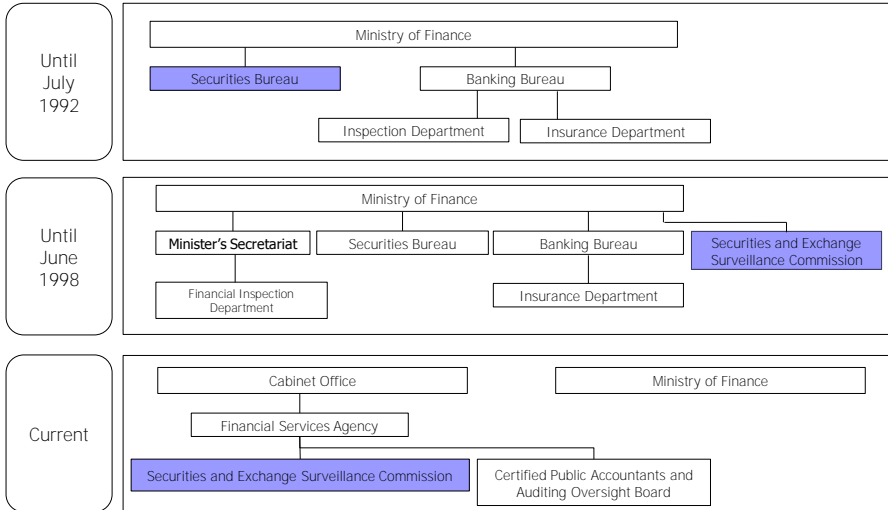


2. History

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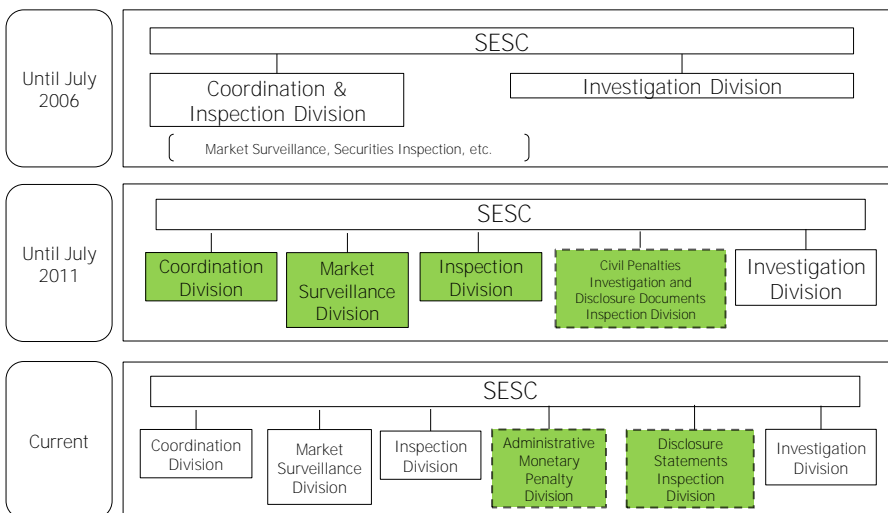
(1) Changes in Financial Administration



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(2) Changes in SESC Administration



9



(3) Changes in SESC Functions



1. Securities Inspection **【since 1992】**

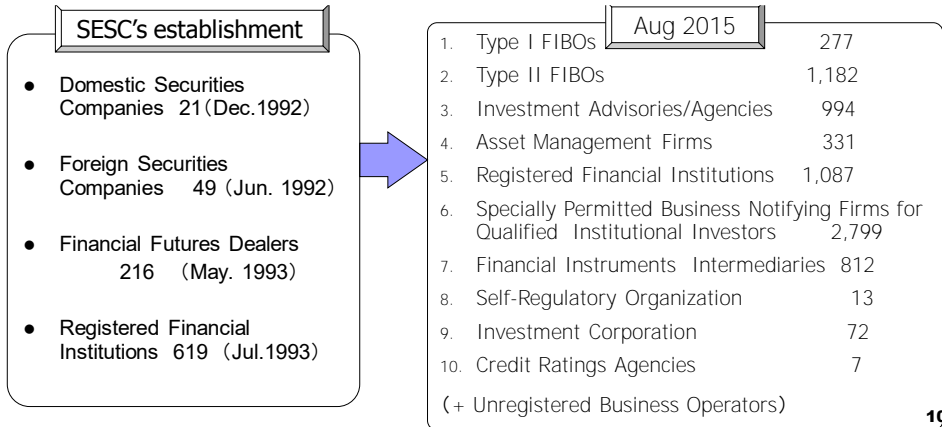
【in 1992】 firms: securities companies, etc.

scope: compliance

【current】 firms: various kinds of financial instrument business

operators, etc. (including Investment advisory companies and funds, etc.)

scope: compliance, financial soundness and management systems



(3) Changes in SESC Functions



2. Investigation of unregistered business operators, etc. **【since 2008】**

【in 1992】 not delegated to SESC

* MOF had this authority

【current】 firms: unregistered entities,

persons making notification for business specially permitted for qualified institutional investors, etc.

3. Investigation of Market Misconduct, Disclosure Statements Inspection

(⇒Administrative monetary penalty)

【since 2005】

【in 1992】 none

【current】 subjects: persons concerned with a case or witnesses

〈Investigation of market misconduct〉

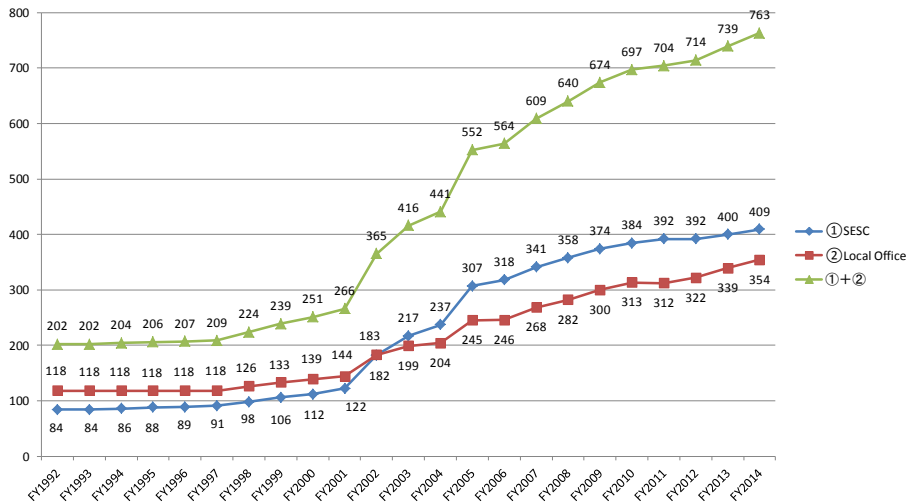
: submitters of disclosure statements (=listed companies, etc.)

〈Inspection of disclosure statement〉

4. Criminal Investigation (⇒Criminal trial) **【since 1992】**



(4) Changes in Number of SESC Staff Members



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3. Policy Statement

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Outline of Policy Statement



SESC's Policy Statement for the 8th Term (January 21, 2014)

(<http://www.fsa.go.jp/sesc/english/news/others/20140131.pdf>)

- Policy Directions
 1. Market oversight with prompt and strategic actions
 2. Enhanced surveillance in response to the globalization of markets
 3. Efforts for enhanced market integrity

- Policy Priorities
 1. Proactive market oversight through enhanced information-collecting ability
 2. Strict action against severe and malignant market misconduct and false disclosure statements
 3. Timely and efficient inspections and investigations in response to disclosure violations
 4. Use of administrative monetary penalty system against market misconduct, etc.
 5. Efficient and effective inspections corresponding to the characteristics of firms to be inspected
 6. Responding to malicious businesses engaged in fraudulent operations
 7. Effective dissemination of information
 8. Enhanced cooperation with SROs

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4. Organization and Primary Functions



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(1) SESC Members (8th term)

(Notes)

1. Appointed by the prime minister with consent of both the House of Councilors and the House of Representatives
2. Term: three years

Chairman: Mr. Kenichi Sado, prosecutor (reappointed)

Appointed in July 2007

Superintending public prosecutor of the Fukuoka High Public Prosecutors Office (2006-2007)

Commissioner: Mr. Masayuki Yoshida, lawyer (reappointed)

Appointed in December 2010

Served as an advisor, Nagashima Ohno & Tsunematsu Law Firm.

Commissioner: Ms. Mari Sono, CPA (newly-appointed)

Appointed in December 2013

Served as a Senior Partner of Ernst & Young ShinNihon LLC.

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(Ref.) Career of SESC Ex-members



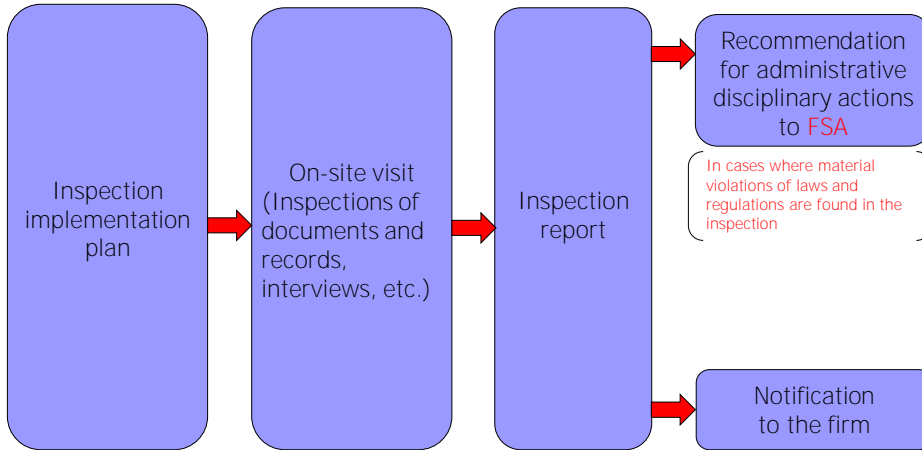
Term		Chairman	Commissioner	Commissioner
1 st Term	July 20, 1992 -July 19, 1995	Former Superintending Prosecutor of Nagoya High Prosecutors' Office	Former Secretary General of the Board of Audit	Former broadcast commentator
2 nd Term	July 20, 1995 -July 19, 1998	(Reappointed)	Former Deputy Vice-Minister of Ministry of Labor/ Former Ambassador to Kenya	(Reappointed)
3 rd Term	July 20, 1998 -July 19, 2001	Former Deputy Vice-Minister of Labor/ Former Ambassador to Kenya	Former Superintending Prosecutor of Fukuoka High Prosecutors' Office	Former deputy chief editorial writer for a newspaper
4 th Term	July 20, 2001 -July 19, 2004	Former Superintending Prosecutor of Fukuoka High Prosecutors' Office	Certified Public Accountant	(Reappointed)
5 th Term	July 20, 2004 -July 19, 2007	(Reappointed)	(Reappointed)	Former broadcast commentator
6 th Term	July 20, 2007 -December 12, 2010 ※	Former Superintending Prosecutor of Fukuoka High Prosecutors' Office	Certified Public Accountant	Former Director of Nomura Holdings, Inc.
7 th Term	December 13, 2010 -December 12, 2013	(Reappointed)	(Reappointed)	Former Advisor to Nagashima Ohno & Tsunematsu Law Firm

※ Job authority continued between July 20 and December 12, 2010, according to the Financial Services Agency Establishment Act (FSAEA). (Para. 3, Art. 13 FSAEA: When the term of chairman and commissioners has expired, the chairman and commissioners shall continue to assume their job authority until their successors have been appointed.)

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(2-1) Securities Inspection



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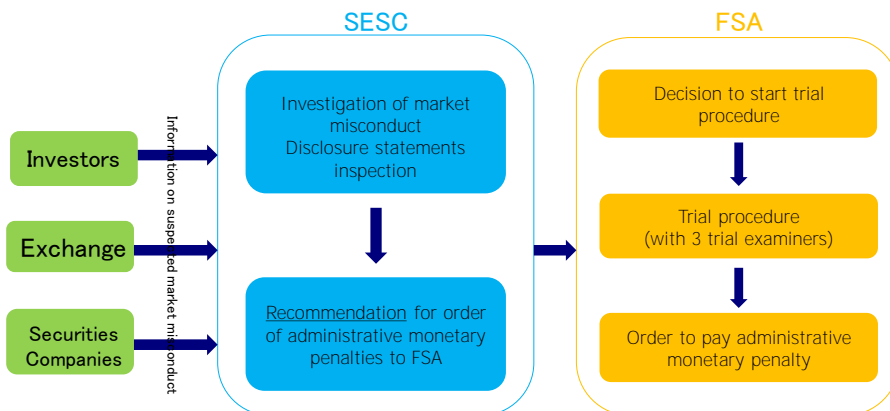
(2-2) Administrative Monetary Penalty Investigation, etc.



Subjects of penalties

: insider trading, market manipulation and fraudulent means, etc.

: false disclosure statements



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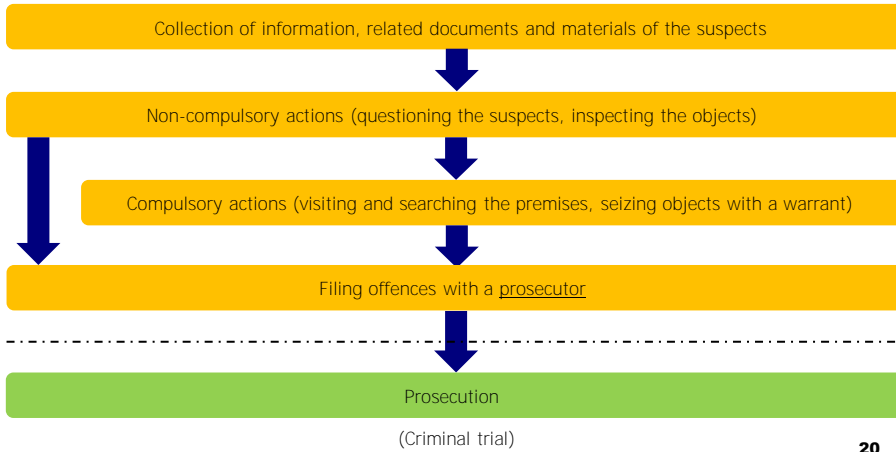


(2-3) Criminal Investigation



Subjects of Investigation

: Severe and malignant market misconduct and false disclosure statements



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(Ref.) Activities in Figures



	BY 2007	BY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Filing offences with prosecutor	10	13	17	8	15	7	3	6
Recommendations	59	50	74	64	45	62	70	66
Recommendations based on securities inspections	28	18	21	19	16	20	18	16
Recommendations concerning orders to pay administrative monetary penalties (market misconduct)	21	20	43	26	18	32	42	42
Recommendations concerning orders to pay administrative monetary penalties (false disclosure statements)	10	12	10	19	11	9	9	8
Recommendations concerning orders to submit revised reports	0	0	0	0	0	1	1	0
Petition for a court injunction, etc. against unregistered business operators, solicitation without filing, etc.	-	0	0	2	3	1	2	6
Policy proposals	0	4	4	2	1	1	0	1

Note: The Business Year (BY) starts on July 1.

The Fiscal Year (FY) starts on April 1.

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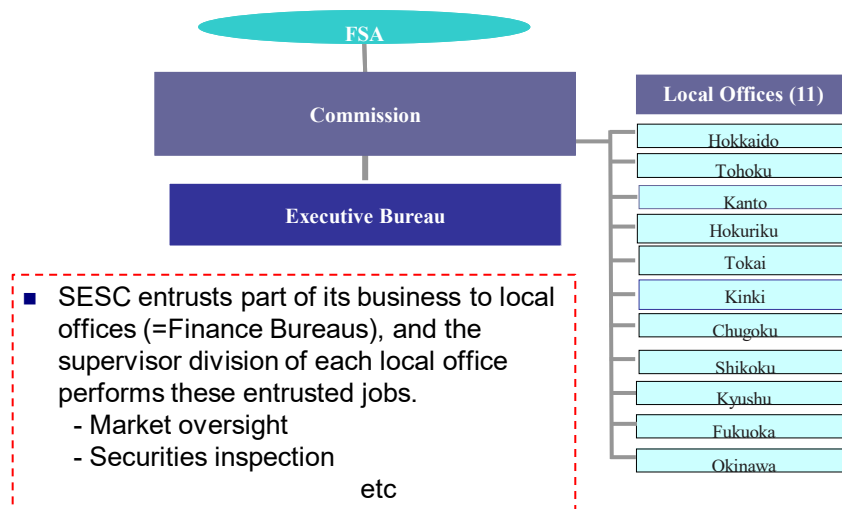


5. Cooperation with Related Entities

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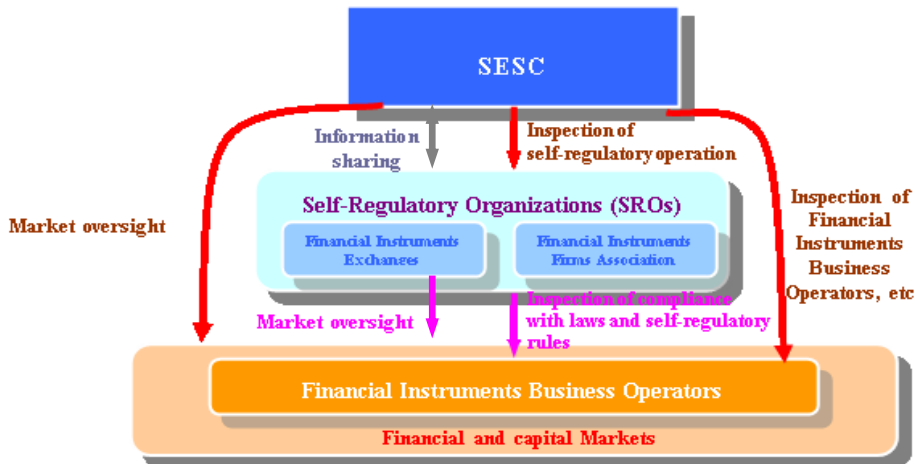


(1) Cooperation with Local Offices



23

(2) Cooperation with Self-Regulatory Organization



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- The daily market monitoring activity is also being conducted by self-regulatory organizations (SROs: financial instruments exchanges, financial instruments firms associations) as well, having essential functions such as trading examination, listing control or review of appropriateness of the business of their members.

〈Examples of cooperation〉

- Monthly and spot level exchange of opinions is conducted with the Tokyo Stock Exchange, Japan Securities Dealers Association and so on.
- Respect to inspection conducted by SROs for their members and FIBOs inspection conducted by SESC, implement joint workshops to discuss coordination of inspection plans, and suggest cases which are useful for inspection jobs

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(3) Cooperation with Overseas Regulators

- To deal with cross-border market abuse, SESC cooperates closely with overseas regulators, utilizing exchange-of-information frameworks amongst securities regulators (IOSCO-MMOU).

- Cases of collaboration with overseas regulators
 - market manipulation (Singapore MAS, Ontario OSC)
 - insider trading (Singapore MAS)
 - fraudulent means (Thailand SEC) etc

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Thank you

<http://www.fsa.go.jp/sesc/english/index.htm>



The Inspection Policy and Inspection Program (SESC)

8 October, 2015

Hironobu Akamatsu
Senior Inspector for Inspection Division
Securities and Exchange Surveillance Commission

1. Basic Direction of the Inspection Policy and Inspection Program for FIBOs

Basic Direction

Role of inspections

Ensure investor confidence in the markets by ensuring the integrity of capital markets, protecting investors, enhancing self-discipline of BOs, and taking rigorous actions against illegal activities.

Change in Circumstances

- Diversification and increase in the number of BOs (around 8,000)
- Financial instruments and transactions have become more diverse and complex
- Increase in high-frequency trading (HFT), direct market access (DMA)
- Increase in losses of retail investors and consumers from sales and solicitation of funds

Efforts toward efficient, effective, and viable securities inspection

- Strengthening the capabilities to collect and analyze information and risk-based approaches to decide the BOs inspected
- Targeting inspections for multiple BOs for issues that encompass multiple markets
- Interactive discussions with the BOs considering business conditions, scale, characteristics, and urging them to improve their business operations

Securities Inspection that keeps the Financial Monitoring Policy in mind

- Enhancement of cooperation with the FSA through combined on- and off-site monitoring
- Conducting inspections that keep in mind the key priority measures and focuses of supervision (ex) Effective response to the needs of customers
- Grasp of the actual state of BOs, and the establishment of common views with BOs for better business management

Inspection items in Securities Inspection

<p><Focuses of verification corresponding to business type></p> <p>○ Large-scale securities company groups: Appropriateness of internal control, governance, and risk management from a forward-looking perspective</p> <p>○ Type I FIBOs: •Management of material non-public information, viable trade surveillance systems for DMA •Appropriateness of securities underwriting •Financial soundness •Terrorism financing •Appropriateness of business operations and foreign exchange risk management of FX BOs</p> <p>○ Type II FIBOs (fund BOs): •Appropriateness of business operations •Legal compliance •Appropriateness of customer solicitation activities selling overseas funds</p>	<p>○ IMBOs: •Verification of due diligence and monitoring •Appropriateness of investment solicitation •Managing conflicts of interest</p> <p>○ Persons making Notification for Business Specially Permitted for Qualified Institutional investors (QII BOs): •False explanations •Misappropriation of funds •Qualify for specially permitted businesses •Verification of investment and the operation situation</p> <p>○ Unregistered BOs: •Filing petitions for court injunctions to deal with serious FIEA violations such as sales and solicitations of funds by unregistered BOs</p>
<p><Focuses of verification corresponding to the inclusion of multiple types of businesses></p> <p>○ Verification of proper sales and solicitations of financial instruments and that good care is taken with customers</p> <p>•Principle of suitability •Appropriate explanations for sales and cancellations •Switching of investment trusts and sales of OTC derivatives products •Systems for solicitations and explanations for aged and NISA customers</p>	<p>○ Appropriateness and viability of IT systems risk management systems</p> <p>•Information security management •Cyber security measures •Efficacy of business continuity plans •Engagement of top management</p> <p>○ Verification of measures to eliminate relations with anti-social groups</p> <p>•Comprehensive internal systems •Avoid new transactions, ex-post reviews of the existing transactions, canceling transactions</p>
<p><General verification items> Review issues associated with Internal Control Systems through the use of the Inspection Manual for FIBOs</p>	


Securities Inspection Program

<ul style="list-style-type: none"> ○ Inspections of 270 business operators (of which 220 were by relevant Local Finance Bureaus) ○ Establishment of inspection methods for crowdfunding business operators 	<ul style="list-style-type: none"> ○ Post-registration review ○ Improvement of inspection methods to increase the number of inspections for QII BOs ○ Rigorous actions against attempts to avoid inspection
--	--

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2. Number of Inspected Entities

Business categories	Apr-9	Apr-10	Apr-11	Apr-12	Apr-13	Apr-14	Number of Inspected Entities
	Mar.-10	Mar.-11	Mar.-12	Mar.-13	Mar.-14	Mar.-15	
Type I Financial Instruments Business	91	91	85	57	69	77	278
Registered Financial Institution	24	28	32	28	9	1	1,107
Asset Management Firms	18	15	9	36	16	15	314
Investment Companies	9	6	2	0	3	2	60
Credit Rating Agencies	—	0	4	3	0	2	7
Type II Financial Instruments Business	22	6	14	20	108	72	1,272
Investment Advisories/Agencies	45	36	40	40	29	42	1,008
Specially Permitted Business Notifying Person	1	2	6	21	23	31	3,022
Financial Instrument Intermediary Service Provider	1	1	9	9	8	18	791
Self Regulatory Organizations	5	1	0	0	3	3	13
Others	0	0	1	0	3	3	
Total	216	186	202	214	271	266	
Firms with problems found	125	105	87	102	118	105	
Recommendation	21	19	16	18	18	16	


 Number of Inspected Firms
 Total of Roughly 8,000 Firms

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3. Progress of Inspections in FY2014

	(1) Financial Instruments Firms			Type I Financial Instruments Business			Type II Financial Instruments Business			Investment Advisories/Agencies			Asset Management Firms			(2) Registered Financial Institution			(3) Financial Instrument Intermediary Service Providers			(4) Specially Permitted Business Notifying Person				
	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)	Number of Inspected Entities	Number of Inspected Entities	Rate (%)		
SESC	21	2	9%	50	12	24%							152	9	6%	74	0	0%							6	0%
KANTO	1,385	101	7%	148	43	29%	690	32	4%	425	22	5%	122	4	3%	288	0	0%	368	1	0%			2,823	24	1%
KINKI	201	26	12%	24	0	0%	138	11	7%	35	0	0%	4	0	0%	113	0	0%	174	0	0%			55	1%	
HOKKAIDO	20	0	0%	1	0	0%	15	4	26%	4	0	0%				64	0	0%	22	0	0%			18	0%	
TOHOKU	22	7	31%	2	0	0%	20	0	0%							119	0	0%	20	0	0%			10	0%	
TOKAI	96	15	15%	16	0	0%	60	4	6%	20	0	0%	2	0	0%	119	0	0%	78	0	0%			48	0%	
HOKURIKU	11	0	0%	9	4	44%	1	0	0%	1	100%					68	0	0%	10	4	21%			6	0%	
CHUGOKU	27	0	0%	6	2	33%	17	0	0%	4	25%					87	1	1%	32	4	12%			18	0%	
SHIKOKU	11	3	27%	7	3	42%	3	0	0%	1	0%					51	0	0%	20	4	20%			9	11%	
KYUSHU	7	3	42%	1	0	0%	3	2	66%	3	33%					64	0	0%	12	2	16%			7	0%	
FUKUOKA	61	0	0%	3	0	0%	46	0	0%	11	0	0%	2	0	0%	54	0	0%	32	0	0%			15	0%	
OKINAWA	0	0	0%	0	0	0%	0	0	0%	0	0%					0	0	0%	0	0	0%			0	0%	
TOTAL	2,051	203	9%	278	77	27%	992	71	7%	506	42	8%	282	14	4%	1,107	0	0%	791	13	2%			3,022	31	1%

(Note) As of 31 March 2015

TOTAL(1) ~ (4)	
Number of Inspected Entities	Number of Inspected Entities
3,955	224

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4. Method for Selecting Inspection Targets

- (i) Large-scale securities company group
 - Conduct effective and efficient on-site inspections by understanding the actual situation of operations through off-site monitoring etc. throughout the year, clarifying issues and risks, and narrowing down the examination themes.
 - Continue horizontal risk assessment by risk categories, while understanding the business strategy and model etc. of each company through the off-site monitoring etc.

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4. Method for Selecting Inspection Targets

- (ii) Small and Medium Securities Companies
 - Conduct risk assessment, including the governance, financial position, arrangements for compliance etc., while understanding the business strategy and model etc. of each company through off-site monitoring etc.
- (iii) Investment management companies
 - For the sophistication of investment management, encourage initiatives based on fiduciary duties, by discussing with investment management companies product development and management which contribute to clients' asset formation, securing of the independence of the management, strategic development of core funds, securing and development of human resources etc.

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5. List of the item we ask for

検査会場においてご準備いただきたい資料等 (Material to submit)					
検査基準日：平成27年3月8日 (AS of 3/8/2015)					
番号 (No.)	項目 (Items)	期間 (Term)	提出形態等 (Submission method)	提出期限 (Due Date)	備考 (Remarks)
1. 全般資料 (General)					
1-1	組織図 (Organizational chart)	2012/4~2015/3	インターネット	2015/3/19	改正の経緯がわかるもの、検査基準日現在では部署毎に実働職員数記入のごと (include the number of the employees)
1-2	ガバナンス (Governance chart)	2012/4~2015/3	インターネット	2015/3/19	改正の経緯がわかるもの (include transition)
1-3	各社社内規程 (Internal rule)	最近のもの (Latest)	インターネット	2015/3/19	各業務マニュアル等も含む (include various operating manual)
1-4	役員の実態 (List of the executive)	最近のもの (Latest)	インターネット	2015/3/19	検査対象期間中に退任した役員も含む、役員については兼職状況も併せて記載 (include ex-executives)
1-5	業務概要メモ (Operation overview)	最近のもの (Latest)	インターネット	2015/3/19	対象は営業部門のみ、各営業部門の提出資料と重複しないように要相談。 (only for sales division)
2. 会議資料 (Minutes)					
2-1	理事会議事録 (Board Minutes, etc.)	2012/4~2015/3	インターネット	2015/3/19	議事録等の一覧を提出、個別記録は別途相談 (submit the list of the minutes at first)
3. 法定帳簿等 (Statutory Books)					
3-1	注文伝票 (Order Invoice)	2012/4~2015/3	インターネット	2015/3/19	
3-2	取引日記帳 (Trading diary)	2012/4~2015/3	インターネット	2015/3/19	
3-3	顧客勘定元帳 (Customer accounts ledger)	2012/4~2015/3	インターネット	2015/3/19	
3-4	トレーディング商品勘定元帳 (traded instruments accounts ledger)	2012/4~2015/3	インターネット	2015/3/19	
3-5	法定帳簿のコード索引表等 (Code table of the books)		インターネット	2015/3/19	電子データで保存の場合、その使用手続き等を含む (include manual that explains how to use)
4. 内部管理 (Internal Control Systems)					
4-1	内部統制・法令遵守・内部管理体制について (Management system)		インターネット	2015/3/19	① 会社の内部統制・法令遵守・内部管理体制等について記載 ② については当社営業部門に対する審判、モニタリング等について記載 (describe management system)
4-2	メール記録等 (E-mail data)	最近のもの (Latest)	インターネット		検査予告後削除禁止 (don't delete until a further instruction)
4-3	証券事故関係 (Reporting of problematic conduct)	2012/4~2015/3	インターネット	2015/3/26	
4-4	苦情処理・訴訟関連 (The list of complaints)	2012/4~2015/3	インターネット	2015/3/26	
5. Stock Sales					
6. Debenture Business					
7. Investment Banking Business					
8. Property and Accounting					
9. Separate Management					
10. Internal Audit System					
11. Risk Management System					
12. Liquidity Risk Management System					
13. Market Risk Management System					
14. Credit Risk Management System					
15. Operational Risk Management System					
16. Information Technology Risk Management System					

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6. Issues to Check in the inspection (Key Words) (i)

(1) Macro-prudence policy

→ Reduction of systemic risks → RRP (Recovery and Resolution Plan)

(2) Strengthening of financial regulations (Basel III and others)

(i) Quality of equity capital (Emphasis on Tier 1, mainly consisting of common stocks)

(ii) Emphasis on the stress test

(iii) Regulation on leverage (Leverage ratio)

(iv) Regulation on liquidity (Liquidity coverage ratio/Stable funding ratio)

(v) Regulation on over-the-counter derivatives

(vi) Shadow banking

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6. Issues to Check in the Inspection **(Key Words) (ii)**

- (3) Global Systemically Important Financial Institutions (G-SIFIs)
- (4) Sophistication of the MIS (Management Information System)
- (5) Integrated Risk Management (Risk Appetite Framework)
- (6) Sophistication of the Internal Audit (Risk-based Audit: Control/Self-assessment)
- (7) Three Lines of Defense

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7. Three Lines of Defense (I) **(Three Lines of Defense Model)**

- In financial institutions and other companies which face various risks, many sections are generally engaged in risk management, including sections in charge of each category of risks, compliance, and internal audit.
- Under these circumstances, financial institutions — reflecting on the recent financial crisis — have recognized the limit of managing risks arising from complex businesses mainly by sections in charge of each risk category as before, and moved to review the role and responsibility of each section engaged in risk management.

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7. Three Lines of Defense (ii) (Three Lines of Defense Model)

- Against such a background, the framework of risk management based on the “Three Lines of Defense” clarifies — after arranging an organization into the First, Second, and Third Lines of Defense — their respective role and responsibility in the risk management.
- In the consultative document, “Corporate governance principles for banks” in October 2014, the Basel Committee on Banking Supervision referred to:
 - (i) “Roles in risk management to be performed by the business department, risk management section, and internal audit and control function” (Three Lines of Defense); and
 - (ii) Reinforcement of risk governance, including the importance of the sound risk culture to promote risk management.

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7. Three Lines of Defense (iii) (Three Lines of Defense Model)

- The Institute of Internal Auditors stated in the “Three Lines of Defense in Effective Risk Management and Control” in January 2013 that the Three Lines of Defense Model is “a simple and effective approach to strengthen the communication between risk management and control by clarifying essential roles and duties.”

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7. Three Lines of Defense (IV) (Three Lines of Defense Model)

- The following roles and responsibilities are envisaged, respectively, in the “Three Lines of Defense”:
Figure III-1-3 “The Three Lines of Defense” in “The Internal Audit Function in Banks” (Basel Committee on Banking Supervision (BCBS))

• The First Line of Defense (Business section, and the section contacting customers) assumes the risk within the allocated risk exposure, while having the responsibility and accountability for the identification, assessment and control of business risks.
• The Second Line of Defense (Risk management section, compliance section, etc.) ensures that risks for the First Line of Defense are appropriately identified and managed.
• The Third Line of Defense (Internal audit section) independently assesses the effectiveness of the process established by the First and Second Lines of Defense.

(Source) Financial Services Agency (Prepared based on “The Internal Audit Function in Banks”) (Basel Committee on Banking Supervision (BCBS))

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7. Three Lines of Defense (V) (Three Lines of Defense Model)

- Managers of financial institutions are expected to develop a stronger and sounder risk management framework by allocating sufficient management resources to the sections composing each Line of Defense in accordance to the business strategy and others, while each section fulfils its responsibility under the clarified role and mandate, and promotes cooperation, if necessary.

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Thank you



Financial Analysis (SESC)

8 October, 2015

Hiromi Sano
Inspector for Inspection Division
Securities and Exchange Surveillance Commission

1. Preface

- ◆ The Financial Services Agency has adopted the risk-based approach to efficiently supervise and inspect thousands of financial institutions with the limited staff.
- ◆ Specifically, detailed inspections and checks are conducted after grasping the overall picture of the target financial institutions off-site and selecting those with risks.
- ◆ Assessment of risks is conducted through the qualitative analysis using the information etc. provided to the authority as well as the comparative financial analysis (quantitative analysis) using figures in financial statements of each company.
- ◆ This seminar presents the methods and perspectives of financial analysis as well as the cases (financial figures related) that have been identified by the inspection of those selected.



1. Preface

- ◆ The Securities Inspection Policy and the Program for FY2015

– Verification of financial soundness

Previous inspections of Type I FIBOs have revealed violations arising from deterioration of financial conditions, 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 defects in net assets and capital adequacy ratios against statutory requirement. The SESC will continue to 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.

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1. Preface

* (Reference) Recent Performance of Securities Companies

(Unit: Billion Yen)

	2011/3	2012/3	2013/3	2014/3	2015/3
Total Assets	100,618	110,859	113,641	126,154	140,187
Total Net Assets	5,856	5,780	6,320	7,091	7,477
Net Income/Loss	-219	-127	496	968	NA
Nikkei Average (Yen)	9,755	10,083	12,397	14,827	19,206

(Financial figures are from “Composite Balance Sheet of Securities Firms and Number of Customer Accounts, etc.” published by the Japan Securities Dealers Association)

- ✓ The industry as a whole turned into surplus in FY ended March 2013, and increased profit in FY ended March 2014. Accordingly, concerns about the “Deterioration of financial positions” seem to have been lessened to some extent.
- ✓ However, caution is still required as on an individual company basis, some companies continue to see their financial position deteriorating. Moreover, as a result of starting to deal with new transactions and products upon a favorable turn in earnings, it is expected that there will be higher risks (or new risks incurred).

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2. Outline of Financial Analysis

(1) Method of financial analysis

- (i) "Deterioration of financial positions" mentioned above can be understood in more detail by checking the trends of not only the recent time but also the past several years.
- (ii) Since results of marketing activities (incl. solicitation by marketing staff, and proprietary trading by securities companies) appear in financial statements, it is possible to grasp the trend of marketing activities by conducting financial analysis, and to give feedback to other examination items (marketing related, internal control etc.).
- (iii) It is possible to understand the characteristics of the company by conducting comparative analysis of other companies in the industry (ex. Large-scale securities companies, foreign securities companies, and internet securities companies).

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2. Outline of Financial Analysis

(1) Method of financial analysis

- ✓ When conducting financial analysis, one should grasp the contents of increase or decrease in each item, by horizontally comparing financial figures (Those in the balance sheet and the profit and loss statement) in the recent several years. The following are important points in doing so:
 - (i) Analysis of changes in the level of profit and net assets
 - ⇒ Grasp an increase/decrease and change in net income, ordinary income and others. (Having stable profit in every period? Barely surplus?)
 - ⇒ Moreover, grasp the level of net assets (Amount of the minimum net asset is a guide). (Substantially exceeding the level prescribed by laws and regulations? Concerns about the level of violation?)
 - (ii) Analysis of changes in profit and loss items
 - ⇒ Grasp the causes of significant changes in items (Changes in transaction volume? Start of new transactions or businesses?). Note that since no significant increase or decrease is unusual in some cases, there is a need to grasp from which kind of transactions the item is incurred from.
 - ⇒ Understand the source from which profits are incurred by grasping the breakdown of operating revenue etc. (Only the intermediation of stocks? Active in proprietary trading as well? Moreover, are there changes in their breakdowns?)

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2. Outline of Financial Analysis (Image of Analysis)

B/S Item	Period X1 (A)	Period X2 (B)	{(B)-(A)} / (A)	Period X3 (C)	{(C)-(B)} / (B)	Total Asset Ratio	Reason for Increase/Decrease
Cash and deposit							
Trust of individual customers							
Deferred tax assets							
:							
P/L Item	Period X1 (A)	Period X2 (B)	{(B)-(A)} / (A)	Period X3 (C)	{(C)-(B)} / (B)	Operating Revenue Ratio	Reason for Increase/Decrease
Commissions							
Stock trading profit/loss							
Personnel expense							
:							

Check whether there are significant changes in comparison to the previous period etc., and whether extraordinary figures are recorded in terms of the situation of markets and transactions

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2.(2) Regulations etc. on Securities Companies etc. (Registration Requirements)

(i) Registration Requirements of Financial Instruments Business Operators (Financial figures related)

	Type I Financial Instruments Business	Type II Financial Instruments Business	Investment Management Business	Investment Advisory and Agency
Minimum Capital	50 million yen (*1)	Corporation) 10 million yen Individual) Deposits for Operation 10 million yen	50 million yen	Deposits for Operation 5 million yen
Net Assets	○	None	○	None
Capital Adequacy Ratio	○ (*2)	None	None	None

*1 : 300 million yen when conducting PTS business, and 500 million yen for wholesale underwriting business (3 billion yen for the lead managing wholesale underwriter) (Article 29-4, Paragraph (1), Item (iv) of the Act, Article 15-7 of the Order)

*2 : It is stipulated that they cannot be registered if under 120% (Article 29-4, Paragraph (1), Item (vi) (a) , and Article 46-6, Paragraph (1), Item (ii) of the Act)

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2.(2) Regulations etc. on Securities Companies etc. (Amount of Net Assets)

(ii) Amount of Net Assets

- Calculation Method
 - ✓ Amount of net assets is calculated by deducting the total amount of liabilities from that of assets in the balance sheet (excluding Financial Instruments Transaction Liability Reserves, etc.) (Article 14, Paragraph (1) of the Cabinet Office Ordinance)

Namely $\text{Amount of Net Assets} = \text{Total Assets} - (\text{Total Liabilities} - \text{Financial Instruments Transaction Liability Reserves etc.}) = \text{Net Assets} + \text{Financial Instruments Transaction Liability Reserves etc.}$

(Example of Calculation)
• Balance Sheet of a securities company

Current Assets: 8,000	Current Liabilities: 1,500	Calculation of net assets (Application of the above formula) $= 9,000 - (6,000 - 500)$ $= 9,000 - 6,000 + 500$ $= 3,000 + 500$ $= 3,500 \text{ (a + b in the left figure)}$
	Fixed Liabilities: 4,000	
	Financial Instruments Transaction Liability Reserves, etc.: 500 (b)	
Fixed Assets: 1,000	Total Liabilities: 6,000	
Total Assets: 9,000	Total Net Assets: 3,000 (a)	

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2.(2) Regulations etc. on Securities Companies etc. (Amount of Net Assets)

- Regulations on the amount of net assets
 - ✓ If the amount of net assets of Type I Financial Instruments Business Operator becomes less than is prescribed by laws and regulations, its registration may be rescinded, or suspension of all or part of its business may be ordered by specifying a period not exceeding six months. (Article 52, Paragraph (1), Item (iii) of the FIEA)
- Amount prescribed by laws and regulations

Category (*)	Minimum Amount of Property
Among Wholesale Underwriting of Securities, when conducting those that are prescribed by Cabinet Order as highly in need of managing risks of losses (See Article 15 of the Order and Article 4 of the Cabinet Office Ordinance).	3 billion yen
Among Wholesale Underwriting of Securities, when conducting those other than the above	500 million yen
(Excluding the above) Type I Financial Instruments Business Operators and Investment Management Business Operators	50 million yen

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2.(2) Regulations etc. on Securities Companies etc. (Capital Adequacy Ratio)

(iii) Capital Adequacy Ratio

a) What is Capital Adequacy Ratio?...As with the Capital Adequacy Ratio (BIS regulation) for banks, it is considered as an indicator to show soundness, and is calculated by the following formula:

$$\text{Capital Adequacy Ratio (\%)} = \frac{\text{Amount of Non-fixed Equity Capital}}{\text{Risk Equivalent Amount}} \times 100$$

$$= \frac{\text{Basic Items} + \text{Supplementary Items} - \text{Deductible Assets}}{\frac{\text{Value of Market}}{\text{Risk Equivalent}} + \frac{\text{Value of Counterparty}}{\text{Risk Equivalent}} + \frac{\text{Value of Basic}}{\text{Risk Equivalent}}} \times 100$$

(Image of the Equation) B/S

Non-fixed Assets	Liabilities	} Value of Non-fixed Equity Capital
	(Subordinate debts, allowances etc.) [Supplementary items]	
Fixed Assets [Deductible Assets]	... Equity Capital ... [Basic Items]	

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2.(2) Regulations etc. on Securities Companies etc. (Capital Adequacy Ratio)

b) Definition of Risk Equivalent Amount (Article 178 of the Cabinet Office Ordinance)

- **Market Risk Equivalent Amount**
Amount equivalent to the potential risk arising from changes in the price of Securities etc. owned and other reasons (Market Risk)
- **Counterparty Risk Equivalent Amount**
Amount equivalent to the possible risk arising from the breach of contract by the counterparty or other reasons (Credit Risk)
- **Basic Risk Equivalent Amount**
Amount equivalent to the possible risk arising from errors in administrative processing and other ordinary operations

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2.(2) Regulations etc. on Securities Companies etc. (Capital Adequacy Ratio)

c) Regulatory treatment

Capital Adequacy Ratio	Treatment under the FIEA etc.
Less than 140%	Notify FSA (Article 46-6 of the FIEA, and Article 179 of the Cabinet Office Ordinance)
Less than 120%	FSA may order the change of the methods for business, deposition of its property, or other matters necessary for supervision (Article 53 of the FIEA)
Less than 100%	FSA may order the suspension of whole or part of its business by specifying a period not exceeding three months (Article 53 of the FIEA)

- Keep the document which shows the Capital Adequacy Ratio as of the end of each quarter in business offices for public inspection for three months from the end of the following month.
- Financial Instruments Business Operators should grasp the market risk and counterparty risk equivalent amounts for each business day by a reasonable method in accordance to their mode of businesses. Moreover, they should grasp their Capital Adequacy Ratio for each business day appropriately.

2.(2) Regulations etc. on Securities Companies etc. (Financial Information etc. to Submit to Authority)

Submissions	Frequency of Submission	Applicable Provisions
Business reports (BS, PL, and other formats prescribed by the Cabinet Office Ordinance)	For every fiscal year, submit within three months after end of each fiscal year	Article 46-6 of the FIEA Article 47-2 of the FIEA
Capital Adequacy Ratio	Every month	Article 46-6 of the FIEA
Reports etc. that can be referred to concerning businesses or property	Every month	Article 56-2 of the FIEA

3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

Case (i) (Securities Company A Notification in July 2009)

- ✓ Facts (Excerpts from the notification contents)
 - The Company, while its earnings were deteriorating, was increasing the amount of net assets and the Capital Adequacy Ratio year after year due partly to capital increase.
 - However, although the Company had concluded the contract to pay 25 million yen to the former president when he/she retired, the current president planned to conceal the existence of the said retirement benefit, thinking it was a priority to prevent the lowering of the Capital Adequacy Ratio and the worsening of financing due to the deterioration of earnings.
 - As a result, the Capital Adequacy Ratio after an appropriate processing was falling to below 140% from time to time, and therefore, was required to be notified; however, it was not done so to that effect.
- ✓ Application of Laws and Regulations
 - In violation of Article 179, Paragraph (1) of the Cabinet Office Ordinance based on Article 46-6, Paragraph (1) of the FIEA

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

Case (i) (Securities Company A Notification in July 2009)

- ✓ Recent situation
 - It did not undergo external audit.
 - Its financial position in the preceding two years before the inspection was as follows (The cut-off date of inspection was March 2009):

(Unit: Million Yen)

Item	End-March 2007	End-March 2008
Share Capital	650	996
Net Assets	222	255
Operating Revenues	126	246
Operating Expense	410	492
Net Income	-304	-315
Capital Adequacy Ratio	147.9%	180.2%

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

Case (i) (Security Company A Notification in July 2009)

- ✓ Points of the Analysis
 - While earnings have been net loss for every period, the net assets amount and Capital Adequacy Ratio have been improving due to capital increase. However, it is highly likely to be difficult to continue improving the net assets etc. by capital increase.
 - As for the profit and loss, while on a recovering trend, Operating Revenues has not been able to pay for operating expense. Accordingly, it is expected to continue incurring deficit going forward.
 - As a result, given the possibility of having difficulty in strengthening capital by the continuous capital increase, subordinate loans, and other measures—despite the recovering Capital Adequacy Ratio etc. most recently—the Capital Adequacy Ratio and net assets are expected to decrease by the amount of net loss every period; and therefore, it is highly likely to infringe on the minimum net assets and the Capital Adequacy Ratio required by laws and regulations in the near future.

∴ For the net assets and the ratio, it is important to consider not only changes in numbers but also their causes, expected changes in numbers etc. going forward.

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

Case (ii) (Securities Company B Recommendations in December 2012)

- ✓ Facts (Excerpts from part of the contents)
 - As of the inspection cut-off date (November 2012), the Company recorded 214 million yen in the deposit account, of which 200 million yen did not exist, with the true deposit balance of 14 million yen.
 - The net assets as of the inspection cut-off date based on the true deposit balance etc. was -121 million yen, which was less than the amount (50 million yen) prescribed by Article 15-9, Paragraph (1) of the Order based on Article 29-4, Paragraph (1), Item (v) (b) of the FIEA, and the Capital Adequacy Ratio was also significantly below the number prescribed by Article 46-6, Paragraph (2) of the FIEA.
 - Furthermore, it was found that the necessary amount which should be separately managed was used as operation funds.
- ✓ Application of laws and regulations
 - Falls under the provisions of Article 52, Paragraph (1), Item (iii) (Disposition Rendered to a Financial Instruments Business Operator for the Purpose of Supervision) and Article 53, Paragraph (2) (Order Concerning Capital Adequacy Ratio) of the FIEA
 - Infringes on the obligation of separately managing the assets of customers prescribed by Article 43-3, Paragraph (2) of the FIEA.

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

(2) Case (ii) (Securities Company B Recommendations in December 2012)

- ✓ Recent situation
 - It has undergone external audit by an audit firm, which had been giving the “disclaimer of opinion” since March 2010 because “There were material doubts about the Going Concern Assumption.”
 - The financial positions in the three years before the inspection were as follows:

(Unit: Million Yen)

Item	End-March 2010	End-March 2011	End-March 2012
Current Assets	367	429	447
Total Assets	419	469	520
Net Assets	253	119	122
Share Capital	1,143	1,244	1,331
Operating Revenues	33	176	178
Operating Expenses	447	425	299
Net Income	-492	-355	-171
Capital Adequacy Ratio	270.7%	156.1%	160.4%

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

(2) Case (ii) (Securities Company B Recommendations in December 2012)

- ✓ Points of the Analysis
 - When external audit has been conducted, it is necessary to check the contents of the audit opinion (Please refer to the next slide for the contents of the audit opinion).
 - In regards to the profit and loss, while on a recovery trend due to the profits from FX transactions, Operating Revenue was not enough to pay for operating expense; accordingly, as with the case (i), it is expected to continue incurring deficit going forward.
 - As for the level of current assets and total assets, deposit account accounts for about 40 - 50% of assets. Therefore, when actually conducting examination, attention should be paid to the said deposit account (However, in such cases where there is no need to have proprietary positions, the ratio of the deposit account may become high to some extent).
- ∴ In the examination of the net assets and others, while items such as impairment loss of securities and fixed assets etc. are important, the breakdown of asset items should be considered when deciding the items to examine.

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3. Financial Analysis (1) Financial Analysis of Analyzing Changes in the Levels of Profits and Net Assets

(Reference) Types of Audit Opinions

- There are the following four types of audit opinions (From The Japanese Institute of Certified Public Accountants website):
 - (i) Unmodified opinion Describes in the audit report to the effect that in accordance with generally accepted accounting principles, "presenting fairly, in all material matters," the financial position of the company.
 - (ii) Qualified opinion If the existing inappropriate matters in some part are not regarded so material to the financial statements as a whole, describes in the audit report, with a description of such inappropriate matters, that the financial positions of the company "present fairly in all material matters, except for said matters."
 - (iii) Adverse opinion If an inappropriate matter is found and it leads to a material effect on the financial statements as a whole, describes the financial positions of the company in the audit report as "not fairly presented," specifying the reasons for the adverse opinion.
 - (iv) Disclaimer of opinion .. If the important audit procedures cannot be performed, resulting in the inability to obtain sufficient audit evidence, and whose effect is judged to be material enough not to express the opinion on the financial statements etc., describes in the audit report to the effect that "The opinion on whether the financial positions of the company are fairly presented shall not be expressed" with its reason.

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3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items

- Items in the Profit and Loss Statement
 - Commissions...Fees for intermediating transactions of securities etc. (market transactions) by the orders from customers etc., those for underwriting and public offering and others
 - Gain or loss on trading, net ...A gain or loss etc. arising from transactions of trading products (securities and derivatives owned by securities companies themselves) by securities companies with customers
 - Financial revenue (expense)...Interest received (paid) or dividends arising from trading products, income (expense) of margin transactions, etc.
 - Selling and administrative expenses...Personnel expense accounts for a large part among the breakdowns. In addition, transaction-related expenses, depreciation allowances etc. are included.

(Reference)

Operating revenue	
Commissions	400
Gain or loss on trading	300
Financial revenue	100
Total operating revenue	800
Financial expense	300
Net operating revenue	500
Selling and administrative expenses	200
Operating income	300
Non-operating income/loss	100
Ordinary income/loss	400
Extraordinary income/loss	50
Net income before tax	450
Corporate tax, etc.	-70
Net income	380

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3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items

- Commissions, Trading Profit/Loss and Transaction Contents

- ✓ Check the link between commissions and trading

Item (Breakdown of Commissions)	Major Transactions
Brokerage commissions	<ul style="list-style-type: none"> • Brokered intermediation of domestic stocks and ETFs • Intermediation of foreign stocks to overseas markets
Commissions on Underwriting/Secondary Distribution (So-called "Underwriting Business")	<ul style="list-style-type: none"> • Underwriting Business of stocks and bonds etc. (Commissions for Managing Underwriter, Sales Commissions, etc.)
Commissions on Public Offering/Secondary Distribution (So-called "Selling Business")	<ul style="list-style-type: none"> • Public Offering of stocks and bonds (Commissions for Public Offering etc.) • Sales of investment trust (Sales commission part when customers purchase investment trusts)
Other Commissions	<ul style="list-style-type: none"> • Trust remunerations of investment trusts (Selling company's share in agency administration fees) • Commissions on M&A businesses • Commissions on advisory business etc. • Intermediation commissions on insurance sales etc.

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3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items

- Commissions, Trading Profit/Loss and Transaction Contents

- ✓ Check the link between trading profit/loss and transactions

Breakdown Items	Major Transactions (*1)
Stock (bond) trading profit/loss	<ul style="list-style-type: none"> • Stock (bond) trading on its own (Proprietary Trading. Also includes profit/loss from algorithm transactions using the system.) • Derivative transactions to hedge (*2) proprietary trading in stocks (bonds) etc. (ex. Nikkei 225 Futures and selling of bond futures) • Negotiated transactions with customers (Cases where the company sells to customers foreign bonds it owns by itself etc. In particular, since bonds are mostly unlisted, the company itself becomes the counterparty in many cases.) • Profit/loss arising from stock (bond) related derivative transactions (on its own)
Other trading profit/loss	<ul style="list-style-type: none"> • Customers' transactions of foreign currencies (The company itself is the counterparty of the transaction) • Profit/loss arising from derivatives with the underlying assets other than stocks and bonds (ex. currencies, and credit-related) (including foreign exchange futures to hedge the position in foreign currencies)

*1: Note that trading profit/loss includes valuation gain/loss of trading products.

*2: Even if the net profit/loss is small, gross profit/loss of the hedging targets and hedging transactions may be large.

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3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items

- If a large change is found as a result of analyzing changes in items under operating income, the following events may be expected.
 - ✓ Increase in transaction volume
 - ⇒ If there was an increase far exceeding the increase in the market as a whole, the company may have focused on sales and so on. In such cases, since inappropriate solicitations, loss of substance in the management arrangements etc. are expected, care should be taken including as to whether sales are concentrated on particular issues of stocks and so on.
 - ✓ Launch of new transactions, and enhancement of products to deal with
 - ⇒ Do they have appropriate internal management arrangements established for the said transactions and products?
- It is also useful to pay attention to the relationship with other changes.
 - ⇒ While a large increase in the sales volume of investment trusts (i.e., commissions on public offering/handling) usually leads to an increase in the deposit balance of investment trusts (i.e., trust fees), if transfers among investments trusts are frequently conducted, the increase of the deposit balance is expected to be slower than that of sales volume.

3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items (Relevance to the Business Report)

(i) Transaction of Securities

		Entrustment	Proprietary	Total	
Stock	No. of Stocks	In-market transactions	()	()	()
		Off-market transactions	()	()	()
		Total	()	()	()
	Amount	In-market transactions	()	()	()
		Off-market transactions	()	()	()
		Total	()	()	()
Bond	Government bond certificates		()	()	()
	Local government bond certificates		()	()	()
	Special bond certificates		()	()	()
	Corporate bond certificates		()	(XXX)	()
	Total		()	(XXX)	()
Beneficiary Certificates		()	()	()	
Other	Of which: listed securities investment trusts		()	()	()
	Share Option Certificates		()	()	()
	Commercial Papers		()	()	()
	Other		()	()	()
	Total		()	()	()

• Parentheses indicate foreign securities (Included in the total)
 • For each product category, see Form No. 12 of the Cabinet Office Order

(i) It shows entrusted transaction volume of stocks.

It is supposed to be linked with the amount of entrustment fees for stocks (commissions).

*Transaction volume × Rate of entrustment fee = Entrustment fee

(ii) Proprietary transactions of stocks (Parentheses indicate those of foreign stocks). Linked to profit/loss of stock certificate trading.

(iii) It shows the volume of proprietary transactions of bonds. Note that all government, local, and special bonds are domestic; foreign bonds including TBs and corporate bonds are all included in the calculation of "corporate bond certificates," and therefore, the figures in the parentheses above (Parts that show XXX) are the total foreign bonds. Linked to profit/loss of bond trading.

(iv) While it says Beneficiary Certificates, entrusted transactions do not include intermediated orders for ETF (sales of general publicly offered investment trusts).

Accordingly, it is supposed to be linked to the amount of entrustment fees for stocks (in cases where ETFs are handled in the same way as stocks).

*Sales volume × Rate of entrustment fee = Entrustment fee

3. Financial Analysis (2) Analysis of Changes in Profit/Loss Items (Relevance to the Business Report)

(vi) Underwriting and secondary distributions, and sales solicitations to Professional Investors etc. of securities, as well as the handling of public offering, secondary distribution, private placement, and sales solicitations to Professional Investors etc. of securities

		Underwritten volume	Secondary distribution volume	Total amount of sales solicitations to Professional Investors etc.	Volume of public offering handled	Volume of secondary distribution handled	Volume of private placements handled	Volume of sales solicitations to Professional Investors handled
Stock	No of stocks	()	()	()	()	()	()	()
	Amount	()	()	()	()	()	()	()
Bond	Government bond certificates	/	/	/	/	/	/	/
	Local government bond certificates	/	/	/	/	/	/	/
	Special bond certificates	/	/	/	/	/	/	/
	Corporate bond certificates	()	()	()	()	()	()	()
	Total	()	()	()	()	()	()	()
Beneficiary certificates	/	/	/	()	()	()	()	()
Other	()	()	()	()	()	()	()	()

(v) They show handled volumes of underwriting/public offerings of stocks and bonds. Accordingly, they are supposed to be linked with fees for underwriting/secondary distributions and those for public offering/secondary distributions.

(vi) They show the handled volume of public offerings of investment trusts (sales volume of general publicly offered investment trusts). Accordingly, they are supposed to be linked with fees for public offerings/secondary distributions
 $\text{*Sales volume} \times \text{Rate of sales fee} = \text{Fee for public offerings/secondary distribution.}$

Thank you

