

September 28, 2023

OSE Imposes Disciplinary Actions against Chibagin Securities Co., Ltd.

Osaka Exchange, Inc. (OSE) has taken disciplinary action against Chibagin Securities Co., Ltd. (hereinafter "the Company"), as indicated below, pursuant to the provisions of Rule 42, Paragraph 1, Item (10) of the Trading Participant Regulations and has requested the Company to submit a business improvement report pursuant to the provisions of Rule 17, Paragraph 1, Item (1) of the same Regulations. The above measures were determined based on the results of the deliberations by Japan Exchange Regulation.

1. Disciplinary Action

- Censure

2. Reason

The Company has concluded business cooperation contracts for financial instruments intermediary services (hereinafter referred to "Intermediary Contracts") with its parent company The Chiba Bank, Ltd. (hereinafter "Chiba Bank") and The Musashino Bank, Ltd., which has an alliance agreement with Chiba Bank, allowing these banks to introduce their customers to the Company. As the revenue from customers introduced by banks is a high percentage of the total revenue of the Company, and the revenue from the collaborative operations with banks is the main source of its revenue, the following situations were found:

(1) Solicitations in violation of the suitability principle were continuously conducted for a long time

- a) The Company was deemed to have continuously solicited many customers to purchase complex structured bonds for a long time without knowing the customers' investment policies, their investment experience, and other customer attributes in a timely, and appropriate manner as described below:

- i. Cases where customers' investment policies differ from the Company's knowledge

The Company recorded that of 8,424 customers who held structured bonds as of June 30, 2022, 8,168 were "aggressively value-oriented," an investment policy with the highest risk tolerance that would allow them to purchase complex structured

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bonds. However, out of said 8,168, 2,424 customers' actual investment policy was not "aggressively value-oriented" but rather a less risk-tolerant one.

ii. Cases where customers' investment experience differs from the Company's knowledge

Of 80 customers who were introduced by the banks and bought structured bonds after the Company checked their investment experience, 34 had no investment experience in financial products or did not have investment experience that would allow them to purchase complex structured bonds at the Company.

- b) In soliciting purchases of complex structured bonds, the Company did not provide explanations to at least three customers about reasons why they might incur losses due to fluctuations in reference indices of structured bonds and other information in a manner and to the extent necessary for ensuring that the customers understand the matters relevant to their attributes.

(2) Insufficient system to comply with the suitability principle

Although the Company had problems complying with the suitability principle because of banks providing product explanations beyond the scope of the Intermediary Contracts to introduce customers and other factors, it did not take appropriate steps to understand the actual situation in order to eliminate the problems. In addition, the Company rapidly expanded the solicitation of purchases for complex structured bonds without ensuring that its sales representatives thoroughly understand how to properly assess the suitability of customer attributes such as investment policies and investment experience.

As a result, the Company received a number of complaints from customers who had purchased structured bonds, some of which indicated problems with the Company's compliance with the suitability principle, such as the fact that customers' investment policies that the Company was aware of did not match those stated by the customers. Since the Company processed the majority of complaints as "one-sided requests," it overlooked them without properly identifying and analyzing problems with compliance with the suitability principle contained in the complaints and failed to properly utilize the complaints to improve its business operations. In addition, the Company failed to resolve the situation in which it continuously received many complaints, and consequently the Japan Securities Dealers Association (hereinafter "JSDA"), a self-regulatory organization, cautioned the Company three times regarding the Company's compliance with the suitability principle.

In response to concerns raised by JSDA regarding the matter, the Company established a committee, attended by the president, with the aim of implementing company-wide, drastic

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measures to address such complaints. However, the Company did not take sufficient measures to prevent and improve the solicitation of purchases in violation of the suitability principle, such as identifying the actual situation regarding the solicitation of purchases in violation of the suitability principle and establishing an effective framework based on that.

As described above, the Company sold structured bonds as a tool to increase commission revenue, rather than soliciting investments in the true interests of customers, due to a lack of understanding of the suitability principle and awareness of the importance of compliance among other factors, and the Company's system for ensuring compliance with the suitability principle was insufficient. Therefore, the Company was unable to prevent the inappropriate solicitation of purchases in violation of the suitability principle.

The acts aforementioned in (1), b) are deemed to fall under case described in Article 117, Paragraph 1, Item 1 of the Cabinet Office Ordinance on Financial Instruments Business pursuant to the provisions of Article 38, Item 9 of the Financial Instruments and Exchange Act (hereinafter "FIEA") which states "an act to conclude a Contract for Financial Instruments Transaction, without having provided a customer with an explanation upon the delivery of a Document for Delivery Prior to Conclusion of Contract, in a manner and to the extent necessary for ensuring that the customer understands, in light of the customer's knowledge, experience, the status of the customer's properties and in light of the purpose of concluding the Contract for Financial Instruments Transaction."

The situations aforementioned in (1) and (2) are deemed to indicate that the Company was continuously conducting business operations that violate the suitability principle, and the Company's solicitation of purchases of structured bonds falls under Article 40, Item 1 of FIEA which states that "issuance of a solicitation which is found to be inappropriate in light of customer knowledge, customer experience, the state of customer assets, or the purpose for which a financial instruments transaction contract is concluded, results in or is likely to result in insufficient investor protection."

The above situations are deemed to have been caused by a lack of proper understanding from the management of the Company about the problems that had arisen in the collaborative operations with the banks, as well as their inadequate understanding of the suitability principle and awareness of the importance of compliance.

Contact:

Trading Participants Office, Market Operations Department, Osaka Exchange, Inc.

Tel: +81-(0)50-3377-8024

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