

The Minister of Finance must seek the opinions of the SESC regarding inspection plans and basic matters. (MFEL, Article 21 (1)) This provision also obliges the Minister of Finance to ask for SESC advice and enables the SESC to make necessary proposals regarding the policies of inspecting financial institutions, foreign currency exchange and securities companies (financial soundness). Proposals, made in view of the value of objective opinions by nonadministrative personnel, include judgments on which points to emphasize, as

well as on the basic plans of inspections, including the number of inspections to be conducted.

The Minister of Finance must also report to the SESC on a quarterly basis on the manner in which inspections are carried out. If necessary, the SESC can make proposals to the Minister of Finance concerning the operation and policies of inspections of financial institutions. (MFEL, Article 21 (3))

In SESC year 1994, no cases were acknowledged of problems on inspection operations that required proposals.

I. Relationship between the SESC and SROs

SROs (such as securities dealers associations, stock exchanges, financial futures dealers associations and a financial futures exchange) conduct surveillance activities of their members and make self-regulatory rules to ensure the fairness and transparency of the market. These activities determine whether member companies operate appropriately according to laws, regulations and self-regulatory rules. In this manner, the SROs operate hand-in-hand with the SESC.

Nevertheless, the SESC assumes the right to examine the activities of SROs to determine whether surveillance is conducted appropriately and whether SROs are imposing strict sanctions against members who violate laws, regulations and self-regulatory rules.

The SESC maintains close interactive relationships with SROs, with which it holds hearings on such matters as the status of surveillance.

Following are activities reported by SROs:

II. Activities of the Japan Securities Dealers Association

The activities of the JSDA during fiscal 1994 (April 1, 1994, to March 31, 1995) were as follows:

1. Status of surveillance of association members

(1) Main surveillance items

Items of surveillance of association members include management of securities transaction orders; compliance with rules related to prohibited acts during securities transactions; management of the implementation, delivery and custody of securities transaction orders; and management related to the processing of securities transactions.

(2) Conduct of surveillance

In fiscal 1994, surveillance was conducted on 130 companies: 110 domestic and 20 foreign securities companies.

Table 5: Inspections by the JSDA

(1) Regular Members

(Unit: companies)

<i>Classification</i>	<i>Fiscal 1992 April 1, 1992, to March 31, 1993</i>	<i>Fiscal 1993 April 1, 1993, to March 31, 1994</i>	<i>Fiscal 1994 April 1, 1994, to March 31, 1995</i>
Domestic securities companies	109	105	110
Foreign securities companies	21	25	20
Total	130	130	130

(2) Special Members

(Unit: companies)

<i>Classification</i>	<i>Fiscal 1994 April 1, 1994, to March 31, 1995</i>
City Banks	2
Regional Banks	3
Regional Banks II	4
<i>Shinkin</i> Banks	2
Life Insurance Companies	2
Non-Life Insurance Companies	1
Others	1
Total	15

Note: "City Banks" refers to city banks, long-term credit banks, trust banks and government financial institutions. "Shinkin Banks" includes *shinkin* banks and The Zenshinren Bank, and "Others" includes call loan and discount companies and foreign banks.

(3) Summary of results

Surveillance during fiscal 1994 uncovered cases of delays in preparing customer cards and omissions of necessary items on these cards as well as on registration cards related to insider trading. In addition, some cases involved delays in the collection of confirmation statements, in the delivery and collection of securities depository receipts, and in conducting retraining for sales staff.

In cases in which improvement was particularly necessary, in addition to directing member associations the JSDA requested that these members report on improvements in the situation.

2. Status of surveillance of special members

(1) Commencement of surveillance

Financial institutions licensed to provide securities services have been able to join the JSDA as special members since April 1994, and the JSDA commenced surveillance of these special members in December 1994.

Surveillance of special members is primarily delegated by the JSDA to the associations regularly organized by said special members (six in total), such as the Federation of Bankers Association of Japan. These associations implement surveillance with personnel designated by the JSDA.

(2) Main surveillance items

Items of surveillance of special members include management of securities transaction orders; compliance with rules related to prohibited acts during securities transactions; management of the implementation, delivery and custody of securities transaction orders; and management related to the processing of securities transactions.

(3) Conduct of surveillance

In fiscal 1994, surveillance was conducted on 15 financial institutions: nine banks, two *shinkin* banks, three insurance companies and one call loan and discount company. No violations of regulations or other problems were acknowledged in particular as a result of this surveillance.

3. Conducting securities market surveillance

(1) Summary of surveillance

It is the duty of the OTC Stock Watching Department, which is responsible for investigation of securities transactions, to monitor stock prices and trading volume as well as to collect information on members' participation in transactions. When necessary, the office conducts close surveillance when it observes irregularities in securities transactions. Alternatively, the office investigates when the OTC Stock Market

Department of the Securities Business Division reports on information having a wide-ranging influence on stock prices.

The office maintains close relationships with these departments in the area of market surveillance. After the office obtains results of initial surveillance, if

necessary it requests that the Member Firm Inspection Department conduct further investigation.

(2) Surveillance results

Surveillance was conducted in fiscal 1994 as follows:

Issues surveyed (selected because they fall under specific criteria):	2,051 issues
Manipulation	1,292 issues
Insider trading	745 issues
Others	14 issues
Issues investigated (requiring more detailed investigation based on results of surveillance):	48 issues
Manipulation	14 issues
Insider trading	25 issues
Others	9 issues

In addition to the surveillance activities described above, the office monitored real-time price movements

to prevent other inappropriate acts from occurring.

Table 6: Market Surveillance by the JSDA

(Unit: issues)

Classification	Fiscal 1992 April 1, 1992, to March 31, 1993		Fiscal 1993 April 1, 1993, to March 31, 1994		Fiscal 1994 April 1, 1994, to March 31, 1995	
	Surveillance		Surveillance		Surveillance	
		Investigation		Investigation		Investigation
Manipulation	445	2	858	21	1,292	14
Insider trading	654	12	917	18	745	25
Others	15	15	7	2	14	9
Total	1,114	29	1,782	41	2,051	48

- Notes: 1. "Surveillance" refers to issues selected that met certain criteria for conducting surveys.
2. "Investigation" indicates issues surveyed that required more detailed surveillance.

(3) Summary of surveillance results

When inappropriate securities transactions are uncovered through surveillance, according to its charter the office takes disciplinary measures against the members involved.

In addition, when securities transactions are suspected, but not proven, to be inappropriate, the office cautions the members involved. The office also provides necessary directions for the acceptance or carrying

out of orders to ensure fairness in over-the-counter price formation.

(4) Summary of penalization of association members

Disciplinary actions that the JSDA can take with the resolution of its Board of Directors include reprimands, the imposing of negligence penalties up to ¥100 million, the suspension or restriction of membership for a

period not to exceed six months, or the revocation of membership.

Pursuant to Article 25 of the JSDA Charter, allowing the opportunity for a satisfactory explanation, the association can take these disciplinary actions against members in cases of violations of laws or regulations, or against members that act in violation of the principles of fair and equitable trade. These actions fall within the purview of Article 25 of the JSDA Charter, based on which disciplinary actions are taken.

During fiscal 1994, one penalty, totaling ¥36 million, was imposed according to Article 25 of the JSDA Charter. This penalty was imposed in conjunction with disciplinary actions based on SESC recommendations.

III. Activities of Stock Exchanges

Following are the activities of stock exchanges in fiscal 1994 (April 1, 1994, to March 31, 1995):

1. Status of inspections

(1) Main inspection items

Items of inspection of stock exchange members and special participants include sales practices,

such as accepting transaction orders; compliance with rules related to prohibited acts during securities transactions; management of securities transaction orders, deliveries, and custody; and internal control systems.

Note: "Special participants" refers to financial institutions other than members that are certified to participate directly in financial futures transactions on stocks listed on stock exchanges.

(2) Conduct of inspections

In fiscal 1994, inspections were made of 65 companies on the TSE (46 domestic securities companies, 13 foreign securities companies and six special participant companies), and 20 domestic securities companies on the Osaka Securities Exchange (OSE).

Table 7: Inspections by Stock Exchange

(Unit: companies)

Classification	TSE			OSE		
	Fiscal 1992	Fiscal 1993	Fiscal 1994	Fiscal 1992	Fiscal 1993	Fiscal 1994
Domestic securities companies	49	55	46	18	19	20
Foreign securities companies	13	11	13	—	—	—
Special member companies	4	6	6	—	—	—
Total	66	72	65	18	19	20

(3) Summary of inspection results

The results of inspections carried out by the TSE and OSE in fiscal 1994 revealed many incidents of the following events: commission collection errors; advances of purchase amounts for margin transactions and loss amounts for transaction settlements; and deposit shortages of additional amounts as consignment guarantee money.

According to the results of inspections, stock exchanges requested their members and special participants to submit reports and provided directions as necessary for the improvement of operational disposition.

2. Conducting securities market surveillance

(1) Summary of surveillance

Taking the TSE as an example, the Department of Market Surveillance and Compliance conducts investigations and surveys of issues selected by examining collected market information, issues notified by the Stock Market Department and Bond Market Department as abnormal in their trading, and issues reported by the Office of Listings Supervision as discharging material information influencing investment decisions. Thus, the Department of Market Surveillance and Compliance works on market surveillance in close cooperation with these departments.

(2) Surveillance results

The total numbers of issues investigated by the TSE in fiscal 1994 are as follows:

Issues surveyed (selected because they fall under specific criteria):	1,809 issues
Manipulation	138 issues
Insider trading	1,625 issues
Others	46 issues
Issues investigated (requiring more detailed investigation based on results of surveillance):	126 issues
Manipulation	57 issues
Insider trading	63 issues
Others	6 issues

In addition, the Stock Market Department and the Bond Market Department also monitor real-time price movements to prevent inappropriate activities from occurring.

Table 8: Market Surveillance by the TSE

(Unit: issues)

Classification	Fiscal 1992 April 1, 1992, to March 31, 1993		Fiscal 1993 April 1, 1993, to March 31, 1994		Fiscal 1994 April 1, 1994, to March 31, 1995	
	Surveillance		Surveillance		Surveillance	
		Investigation		Investigation		Investigation
Manipulation	834	114	265	133	138	57
Insider trading	1,690	52	1,767	64	1,625	63
Others	19	5	72	29	46	6
Total	2,543	171	2,104	226	1,809	126

- Notes:
1. "Surveillance" refers to issues selected that met criteria for conducting surveys.
 2. "Investigation" indicates issues surveyed that required more detailed surveillance.

(3) Summary of surveillance results

When inappropriate transactions are uncovered through investigations, stock exchanges impose sanctions against the members involved in view of preventing such transactions.

In addition, when securities transactions are suspected but not proven to be inappropriate, stock exchanges issue cautions to the concerned members.

Furthermore, stock exchanges provide necessary directions for the acceptance of orders that will ensure fairness in price formation.

3. Summary of sanctions against members

Pursuant to Article 50 of the TSE Charter, if the stock exchange deems that a member has violated laws, regulations, its charter, or just and equitable principles of trade, the exchange may, after providing the opportunity for a hearing from the member, impose sanctions such as: fines of up to ¥100 million; censure; suspension from or restriction on transactions in the market of the exchange; suspension of membership for up to six months; and revocation of membership.

Pursuant to Article 55 of the TSE Charter, if a member undergoes disciplinary actions, such as business suspension, business restriction or license revocation, based on the extent of the above disciplinary actions, the exchange shall suspend or restrict said

member's transactions in the market of the exchange or revoke exchange membership.

Sanctions by the TSE in fiscal 1994 included three penalties totaling ¥21 million. These fines were imposed based on disciplinary actions following SESC recommendations or inspections. There were no cases of restrictions on transactions in the market of the exchange in fiscal 1994.

In addition, under Articles 50 and 55 of its charter, the OSE imposed neither sanctions nor restrictions on transactions in the market of the exchange in fiscal 1994.

IV. Activities of the Financial Futures Dealers Association of Japan

Following are the surveillance activities of the Financial Futures Dealers Association of Japan in fiscal 1994 (April 1, 1994, to March 31, 1995):

(1) Main surveillance items

Items of surveillance of association members include management of financial futures transaction orders, management of customers' margin, and compliance with rules concerning regulating financial futures transactions.

(2) Conduct of surveillance

In fiscal 1994, surveillance activities were carried out on 18 member companies (eight banks, seven securities companies, and three companies in the call loan and discount and other business fields).

(3) Summary of surveillance results

The following incidents were discovered during surveillance activities in fiscal 1994: omission of necessary

items on customer management cards and order forms, and insufficient management of agreements to set up transaction accounts. The association advised the members involved to correct these points.

Table 9: Market Surveillance by the Financial Dealers Association of Japan

(Unit: companies)

Category	Fiscal 1992 April 1, 1992, to March 31, 1993	Fiscal 1993 April 1, 1993, to March 31, 1994	Fiscal 1994 April 1, 1994, to March 31, 1995
Banks	—	6	8
Securities companies	—	3	7
Call loan and discount companies	1	2	2
Others	—	2	1
Total	1	13	18

Notes: 1. "Call loan and discount companies" refers to call loan and discount companies and foreign exchange brokers.
2. "Others" indicates futures companies and *shinkin* banks.

V. Activities of the Financial

Futures Exchange

Following are the activities of the Financial Futures Exchange in fiscal 1994 (April 1, 1994, to March 31, 1995):

1. Inspection systems

(1) Commencement of inspections

Regarding inspections of members, the Financial Futures Exchange has been studying the implementation of inspections of members. The exchange established an inspection department in January 1995 and commenced inspections in March 1995.

(2) Main inspection items

Items of inspection of exchange members include management of financial futures transaction orders,

compliance with rules related to prohibited acts during financial futures transactions, and management of internal control systems.

(3) Conduct of inspections

In fiscal 1994, an inspection was carried out of one member company (a bank). As a result of this investigation, insufficient storage was acknowledged for some business forms. The exchange is currently instructing said company regarding this problem.

2. Activities of the Surveillance Section

Regarding transaction surveillance, because all transactions are systematized, surveillance software has been specially developed to regularly monitor transactions. Also, as required hearings are held for members.