

## I. Outline

Based on the results of inspections and investigations of criminal offenses, the SESC can, as necessary, send recommendations to the Prime Minister and the Commissioner of the Financial Supervisory Agency, or the Minister of Finance, for disciplinary actions or other appropriate measures (hereinafter referred to as “administrative disciplinary actions”) to ensure securities transaction fairness (Article 18(1) of the Law Establishing the Financial Supervisory Agency). Recommendations are classified as follows:

- [1] Recommendations for administrative disciplinary actions against securities companies for their violations of laws;
- [2] Recommendations for administrative disciplinary actions against SROs, such as securities dealers associations, stock exchanges, etc., that neglected to exercise their authority and take necessary actions though they found violations of laws by securities companies and financial institutions licensed to provide securities services; and
- [3] Recommendations for instructions toward SROs to take appropriate measures when they neglected to exercise their authority and take necessary actions

though they found violations of laws by securities companies and financial institutions licensed to provide securities services.

The Prime Minister, the Commissioner of the Financial Supervisory Agency, and the Minister of Finance must respect recommendations made by the SESC (Article 18(2) of the Law Establishing the Financial Supervisory Agency). The SESC can also request that they report on actions taken based on the SESC’s recommendations (Article 18(3) of the Law Establishing the Financial Supervisory Agency).

After receiving recommendations for administrative disciplinary actions, based on the results of inspections made by the SESC, the Prime Minister, the Commissioner of the Financial Supervisory Agency, or the Minister of Finance hold hearings with the parties involved and take appropriate actions, such as suspending the operations of securities companies when deemed necessary.

Matters concerning the registration of sales representatives, including administrative disciplinary actions against sales representatives, are delegated by the Prime Minister to the JSDA (Article 64–5(1) of the SEL). Based on the SESC’s inspection results, the JSDA holds further hearings with the parties concerned and

takes such measures as revoking the registration of sales representatives or suspending operations as sales representatives.

## II. Status of Recommendations and Actions Taken

In the year under review, the SESC sent 40 recommendations to the Minister of Finance for administrative disciplinary actions against securities companies and directors or employees of securities companies for their grave violations of laws found during inspections and investigations of criminal offenses. These included 14 recommendations for disciplinary actions against securities companies (including directors and employees thereof), and 26 for appropriate actions against directors and employees of securities companies. Disciplinary actions were taken against 84 directors and employees based on the SESC's recommendations. Violations of laws referred to in the recommendations are as follows:

### 1. Violations of laws by Company D

#### *(1) Provision of property gains to compensate for losses*

(Violation of Article 50-3(1)(iii) of the SEL)

Securities Company D, with the involvement of four directors and employees, including the president, committed the following acts in order to compensate for a customer's losses incurred through his securities transactions:

[1] On five occasions between January and June 1995, the company conducted stock purchase transactions on its own account and moved the transactions to the said customer's account with the intention of disguising the original buyer. Through these acts, the company provided a property gain of around ¥47.5 million to the customer.

[2] In March 1995, the company, noting an upward trend in the price of warrants held in its own account, made manipulations so that the said customer seemed to have purchased the warrants before the price rise. The company then immediately bought back the warrants from the said customer. Through these acts, the company provided approximately a ¥2.2 million property gain to the customer.

[3] In March 1995, the company provided a property

gain of ¥320 million by sending the same amount in cash to the customer.

**(2) Conclusion of discretionary trading account transaction contracts**

(Violation of Article 50(1)(iii) of the SEL)

The company concluded a discretionary trading account transaction contract following a request by the customer referred to in (1) above concerning the customer's transactions, then received and executed transaction orders between February 1989 and July 1996. (Out of these acts, ones committed after January 1, 1992, are recognized as violations of laws.)

**(3) Problems with internal controls**

Directors and employees of the company who were involved in illegal acts shown in (1) and (2) above are considered to lack an awareness of the importance of compliance with laws and regulations. At the same time, the following grave insufficiencies in the company's internal control systems are recognized:

[1] In the course of committing violations of laws, directors and employees of different divisions partici-

pated in improper acts, such as falsifying receipt-of-order forms.

[2] Managers and sales managers in the relevant divisions failed to grasp the situation and failed to provide appropriate instructions and directions concerning customer management. Moreover, the business management division, which is responsible for monitoring compliance with laws and regulations, also failed to take appropriate actions.

[3] The staff in the trading control division responsible for helping clarify facts in response to the SESC's investigations made an organized struggle to make it difficult to clarify actual legal violation acts by holding meetings under the participation of directors and employees of different divisions and making them respond in collusion with each other.

**2. Violations of laws by Company A**

**(1) Provision of property gains to compensate for losses or to give customers additional profit**

(Violation of Article 50-3(1)(iii) of the SEL)

Securities Company A, with the involvement of eight directors and employees, including the president, acted to compensate for losses incurred in securities transac-

tions conducted on its customers' accounts or to provide additional profits to the customers. The company conducted on its own account transactions of Nikkei 225 Stock Average Futures on the Singapore International Mercantile Exchange (SIMEX) and made profits. The company moved the transactions to the said customers' accounts with the intention of disguising the original parties of the transactions, and these acts resulted in the following:

[1] Provision of property gains to an individual customer on 32 occasions between December 1994 and January 1995, totaling about ¥107 million.

[2] Provision of property gains to a corporate customer on 76 occasions between November 1994 and March 1995, totaling about ¥316.9 million.

**(2) Conclusion of discretionary trading account transaction contracts**

(Violation of Article 50(1)(iii) of the SEL)

The company, at the request of the customers described in (1) above, concluded discretionary trading account transactions contracts concerning the customers' transactions and did the following:

[1] Acceptance and execution of orders from the individual customer between June 1994 and February 1995.

[2] Acceptance and execution of orders from the corporate customer between April 1993 and June 1995.

**3. Violations of laws by Company B**

• **Provision of property gains to compensate a sokaiya corporate racketeer for his losses**

**(1) Provision of property gains to compensate for losses**

(Violation of Article 50-3(1)(iii) of the SEL)

In order to compensate for losses incurred in securities transactions by a customer, Securities Company B, with the involvement of six directors and employees, including the vice president, committed the following acts:

[1] On five occasions between March and June 1994, the company, noting an upward trend in the price of warrants held in its own account, made manipulations so that the said customer seemed to have purchased the warrants before the price rise. The company then

immediately bought back the warrants from the said customer. Through these acts, the company provided a property gain of around ¥14.5 million to the customer.

[2] In June 1994, the company conducted a purchase transaction, of warrants, on its own account and moved the transaction to the said customer's account. Through this act, the company provided a property gain of around ¥900,000 to the customer.

[3] On 11 occasions between January and December 1995, the company conducted stock purchase transactions on its own account and moved the transactions to the said customer's account with the intention of disguising the original buyer. Through these acts, the company provided property gains of around ¥14.1 million to the customer.

### ***(2) Conclusion of discretionary trading account transaction contracts***

(Violation of Article 50(1)(iii) of the SEL)

The company, at the request of the customer described in (1) above, concluded a discretionary trading account transactions contract concerning the customer's transactions, then accepted and executed transaction orders

using two different accounts. The transactions were conducted between September 1992 and October 1995 on one account and between August 1994 and July 1996 on the other.

### ***(3) Problems with internal controls***

Directors and employees of the company who were involved in illegal acts shown in (1) and (2) above are considered to lack an awareness of the importance of compliance with laws and regulations. At the same time, the following grave insufficiencies in the company's internal control systems are recognized as a source of the above illegal acts:

[1] The person responsible for monitoring internal controls (the manager of the Equities Division (one of the directors at the time)) personally participated in committing violations of laws. Moreover, routine checks by the person responsible for monitoring internal controls as well as internal audits by the business control division were conducted in a superficial manner. For these reasons, the company's internal check systems were not functioning effectively.

[2] Employees of the General Affairs Division in charge

of dealing with *sokaiya* corporate racketeers were exceptionally out of the company's internal controls.

[3] Input of stock transaction data into the company's computer, including the input of the data on whether the transaction is on the company's own account or on customers' accounts, was expected to be completed after the transaction's completion. However, the system was operated inappropriately, such as intentionally changing the account the transaction is ascribed to.

- **Provision of property gains to give other customers additional profit**

- (1) Provision of property gains to give customers additional profit**

(Violation of Article 50-3(1)(iii) of the SEL)

With the involvement of two directors, including the vice president, Securities Company B committed the following acts in order to provide additional profits to other customers than mentioned above:

[1] On six occasions between October 1995 and June 1996, the company conducted transactions of stocks on its own account and made profits. The company moved the transactions to a customer's account.

Through these acts, the company provided property gains of around ¥6.8 million to the customer.

[2] On 19 occasions between November 1995 and June 1996, the company conducted stock purchase transactions on its own account and moved the transactions to a customer's account. Through these acts, the company provided property gains of around ¥22.3 million to the customer.

- (2) Conclusion of discretionary trading account transaction contract**

(Violation of Article 50(1)(iii) of the SEL)

The company, at the request of the customers described in (1) above, concluded a discretionary trading account transaction contract concerning the customers' transactions, then accepted and executed transaction orders between October 1995 and March 1997.

#### **4. Violations of laws by Company C**

- (1) Provision of property gains to compensate for losses**

(Violation of Article 50-3(1)(iii) of the SEL)

With the involvement of seven directors and employ-

ees, including the vice president, Securities Company C committed the following acts in order to compensate for a customer's losses through securities transactions:

[1] On 107 occasions between November 1992 and December 1995, the company conducted stock purchase transactions on its own account and moved the transactions to the said customer's account with the intention of disguising the original buyer. Through these acts, the company provided property gains of around ¥318.2 million to the customer.

[2] On 12 occasions between January and December 1995, the company conducted transactions of stocks on its own account and made profits. The company moved the transactions to the said customer's account with the intention of disguising the original party of the transactions. Through these acts, the company provided property gains of around ¥36.6 million to the customer.

## ***(2) Conclusion of discretionary trading account transaction contracts***

(Violation of Article 50(1)(iii) of the SEL)

The company, at the request of the customer described in (1) above, concluded a discretionary trading account

transaction contract concerning the customer's transactions, then accepted and executed transaction orders using two different accounts. The transactions were conducted between September 1992 and May 1996 on one account and between January 1994 and June 1996 on the other.

## ***(3) Problems with internal control systems***

Directors and employees of the company who were involved in illegal acts shown in (1) and (2) above are considered to lack an awareness of the importance of compliance with laws and regulations. At the same time, the following grave insufficiencies in the company's internal control systems are recognized as a source of the above illegal acts:

[1] The person responsible for monitoring internal controls (vice president at the time) himself was deeply involved in violations of laws. Moreover, despite being aware of various unnatural events, the internal control division failed to take strong measures.

[2] The data of orders should have been input into the company's computer immediately after the orders were placed in the market, but this was intentionally

delayed. After the market closed, transactions on the company's own account were moved to the customer's account. In these ways, improper operations were conducted.

[3] Upon being investigated by the SESC, the person responsible for monitoring internal controls himself took the initiative in making related persons respond in collusion with each other. Thus, an organized struggle was made to prevent the truth from being uncovered.

## 5. Violations of laws by Company A

### *(1) Solicitation with promise to compensate for losses*

(Violation of Article 50(1)(iii) of the SEL before the revision of 1991 (put into force on April 1, 1992))

With the involvement of four directors and employees, including a managing director, the company solicited transactions of securities by guaranteeing a return on the securities for a certain period of time. Such solicitations were made to 86 customers between May 1989 and September 1991.

### *(2) Solicitation with promise of special profit*

(Violation of a Ministerial Ordinance, Article 50(1)(V)

of the SEL before the revision of 1991 (put into force on April 1, 1992))

With the involvement of four directors and employees, including a managing director, the company solicited the purchase of securities, based on promises that the company would buy back the securities after a certain period at prices much higher than market prices. Such solicitations were made to six customers between September 1988 and July 1991.

### *(3) Provision of property gains to compensate for losses or to give customers additional profit*

(Violation of Article 50–2(1)(i) (acts referred to in (1)) and Article 50–2(1)(iii) (acts referred to in (2) and (3)) of the SEL before the revision of 1992 (put into force on April 1, 1993))

With the involvement of four directors, including the chairman, the company committed the following acts:

[1] On January 30, 1992, the company made a promise to one customer to guarantee a return on securities transactions after a certain period. On March 18 of the same year, the company made similar promises to seven customers, including the above-mentioned customer. The seven customers had already entrusted



securities transactions to the company, concluding discretionary trading account transaction contracts.

[2] In order to compensate for losses or provide additional profit in relation to securities transactions, the company committed the following acts:

(a) On January 31, 1992, the company acted on behalf of a customer to whom it had already guaranteed returns after a certain period. In order to compensate for unrealized losses on securities held by the customer, the company made its affiliated company buy back the securities via a third party at a price significantly higher than market prices. Through these acts, the company provided property gains of around ¥24.8 billion to the customer.

(b) On March 19, 1992, the company acted on behalf of a customer who had purchased stocks under a repurchase agreement. In order to compensate for unrealized losses on securities held by the customer, the company made its affiliated company buy back securities from the customer via a third party at a price significantly higher than the market price. Through these acts, the company provided property gains of around ¥14.0 billion to the customer.

(c) On October 28, 1992, the company acted on behalf of a customer to whom it had already guaranteed returns after a certain period. In order to compensate for unrealized losses on securities held by the customer, the company made its related company purchase the securities at a price significantly higher than the market price. Through these acts, the company provided property gains of around ¥8.5 billion to the customer.

[3] In order to partially compensate for losses to its customer incurred in securities trading, the company acted on behalf of the customer to whom it had already guaranteed returns after a certain period with the conclusion of a discretionary trading account transaction contract. The company made its own affiliated company purchase bonds from an affiliated company of the customer at the book price. Due to advance interest payments, the value of the bonds had fallen significantly below the book price. Through these acts, Company A provided property gains of around ¥4.6 billion to the customer.

#### ***(4) Conclusion of discretionary trading account transaction contracts***

(Violation of Article 50(1)(iii) of the SEL)

[1] In January 1992, the company, at the request of eight customers described in [1] and [3] of (3) (pages 26–27), concluded discretionary trading account transaction contracts. The contracts allowed the company to make decisions without the customers' consent for specific transactions in all aspects of their securities transactions, such as whether to buy or sell, selection of issues, number of securities transacted, and prices. Between February 1992 and October 1993, the company accepted and executed transaction orders on behalf of four of the eight customers.

[2] Between March 1992 and February 1997, on several occasions the company concluded discretionary trading account transaction contracts for transactions of options on stock price indices at the request of certain customers. The contracts allowed the company to make decisions without the customers' consent for specific transactions in all aspects of their option transactions, such as whether to buy or sell, selection of issues, number of units transacted, and premium amounts. The company then accepted and executed transaction orders between August 1992 and April 1997.

## 6. Other violations of laws by companies (including those by directors and employees)

### (1) *Counter-bucketing and bucketing*

(Violations of Articles 47 and 129(1) of the SEL)

- On April 26, 1995, Securities Company E solicited its customers to purchase stocks of a certain listed issue. Although such solicitations were rejected, the company, predicting a price increase after the opening of the market, purchased the stocks with the expectation of the customers' later purchase orders. Responding to subsequent purchase orders from the said customers, the company sold the stocks directly to the customers without placing orders in the securities market.

- On October 31, 1995, Securities Company F solicited its customers to purchase stocks of a certain listed issue after purchasing the stocks by itself, expecting later purchase orders from them. Responding to actual purchase orders from the customers, the company sold the stocks directly to the customers without placing orders in the securities market.

This act was committed under the instructions from the manager of the Sales Division of the head office to his subordinates.

- On January 25, 1996, Securities Company G accepted an order for so-called profit-taking cross transactions. However, later stock price movements prevented the completion of the counter-transactions at the same price, leaving some stocks not being sold back. The company sold these stocks directly to the customers without placing orders in the securities market.

- In August 1997, Securities Company H (a foreign securities company) accepted an order from a customer for stocks of listed issues, but sold the stocks directly to the customer without placing orders in the securities market. In addition, the company accepted an order from a customer for over-the-counter stocks of an issue, but sold the stocks directly to the customer.

- On November 14 and December 25, 1997, Securities Company I placed sell orders for stocks of a certain listed issue via a securities exchange member company with the expectation of its customers' later sell orders. The transactions concerning the company's sell orders were settled soon. The company received sell orders from its customers after the transactions, but instead of transferring the orders to a securities exchange member

company, the company just moved transactions on the company's own account to the customers' accounts.

These acts were committed under instructions from the manager of the Corporate Division (one of the directors) to the company's branches.

***(2) Failure to submit transaction reports or submission of falsified reports to customers***

(Violations of Articles 37(3) and 17(1) of the LFSF)

- The Tokyo branch of Securities Company H (a foreign securities company), with the involvement of directors and employees, neglected to send its customers transaction reports containing correct information despite realizing that reports already having been submitted to the customers contained prices that differed from actual contract prices on securities exchanges because of mistakes in registering transaction contents. The company also intentionally submitted falsified transaction reports containing prices that differed from actual contract prices on securities exchanges to satisfy its customers' request.

***(3) Conclusion of discretionary trading account transaction contracts***

(Violation of Article 50(1)(iii) of the SEL)

• Between March 1993 and January 1997, a commission sales representative of Securities Company E received orders from a customer and conducted transactions of stocks and options on securities after concluding, on several occasions, contracts that allowed the sales representative to make decisions concerning all the items or part of them in conducting transactions in response to the customer's orders so that good chances would not be missed. The items were whether the customer's order is for buying or selling (i.e., for buying or selling options concerning transactions of options; same hereinafter), selection of issue, number of stocks or units transacted, and price (premium as for options; same hereinafter).

(Number of transactions: 1,524; number of stocks traded: around 2.1 million)

Between June 1995 and January 1997, another commission sales representative of the company received orders from his customers and conducted transactions of stocks after concluding, on several occasions, contracts that allowed the sales representative to determine transaction prices, though other items (whether the order is for selling or buying, selection of issue, and number of stocks transacted) were left to the customers' decision.

(Number of transactions: 245; number of stocks traded: 434,000)

***(4) Continued acceptance of securities transaction orders knowing that such actions will have a manipulative effect on the market***

(Violation of a Ministerial Ordinance, Article 50(1)(vi) of the SEL)

Between 2:49 p.m. and 2:52 p.m. on October 31, 1997, Securities Company B, presenting low limit prices, made a series of limit sell transactions of stocks of an issue on its own account, thus causing the price of the stocks to decline to a predetermined level. This was done with the intention of settling a transaction at the said predetermined price by letting the company's selling orders meet its customer's buying orders.

This act was committed by the manager of the Over-the-Counter Stock Section of the Equities Division of the company's head office.

***(5) Visits to customers accompanied by directors and employees of parent bank without the customers' requests***

(Violation of a Ministerial Ordinance, Article 50-2(iii) of the SEL)

On April 11, 1997, the manager of the Underwriting Division of a branch of Securities Company J visited the company's customers accompanied by an employee of the company's parent bank, despite not being asked to do so by the customers.

***(6) Solicitation with promise to compensate for losses***

(Violation of Article 50(1)(iii) of the SEL before the revision of 1991 (put into force on April 1, 1992))

A branch manager (one of the directors) of Securities Company K was requested by a customer to complete the transaction of stocks of a listed issue through which the customer was expected to incur losses. However, receiving the information that a prominent speculator had not yet placed sell orders for the issue, the director came to believe that buying orders would come in once again. Based on this prospect, on October 4, 1991, the director solicited the said customer to continue the transaction with the promise to bear all possible losses.

***(7) Provision of property gains to compensate for losses***

(Violation of Article 50-2(1)(iii) of the SEL before the revision of 1992 (put into force on April 1, 1993))

A customer of a branch manager (one of the directors) of Securities Company K incurred losses at the time of settlement of margin transactions of stocks of an issue due to continued declines in the stock price. In order to compensate for the customer's entire losses incurred in securities and other transactions, on April 2, 1992, the director gave up his claim for the loan previously made to the said customer and also remitted his own money into the customer's bank account, thus providing property gains (approximately ¥6.8 million in compensation).

Moreover, in order to partially compensate for the customer's losses incurred in securities and other transactions, on December 10, 1992, the director gave up his claim for the loan previously made to the customer, thus providing property gains (approximately ¥840,000 in compensation).

A sales representative of the company's branch received requests from a customer to compensate for heavy losses incurred in securities and other transactions. In order to partially compensate for the losses, on January 16, 1992, the sales representative remitted his own money into the customer's bank account, thus providing property gains (approximately ¥450,000 in compensation).

***(8) Sale of securities on the company's own account without owning the securities***

(Violation of Article 162(1)(i) of the SEL)

Between May and December 1997, the Tokyo branch of Securities Company L (a foreign securities company) sold securities that it did not own on securities markets on its own account (hereinafter referred to as "short-selling"). In 70 cases of these, the branch did not make it clear to sell the securities without owning them (including one case concerning over-the-counter stocks). In 17 cases, securities were sold at prices below the most recent market prices.

**7. Violations of laws by directors and employees**

In the year under review, the SESC made recommendations against directors and employees of securities companies concerning the following violations of laws:

***(1) Conclusion of discretionary trading account transaction contracts***

(Violation of Article 50(1)(iii) of the SEL)

At the request of customers or in order to increase sales performance, sales representatives concluded contracts that gave themselves discretionary powers to make decisions concerning all or some items in stock and other transactions, namely, whether to buy or sell, selection of issues, number of stocks to be bought or sold, and price, without consent from customers in each individual transaction, and actually received orders and conducted transactions. (Recommendations made against 25 individuals of 18 companies.)

***(2) Continued acceptance of securities transaction orders knowing that such actions will have a manipulative effect on the market***

(Violation of a Ministerial Ordinance, Article 50(1)(vi) of the SEL)

A sales representative, presenting low limit prices, made a series of limit sell transactions of stocks of an issue for a customer, causing the price of the issue to decline to a predetermined level. While knowing that the said customer was acting to conduct stock transactions at a predetermined price, the sales representative accepted and executed a series of sell orders. (Recommendation made against one individual of a company.)

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*(3) Securities transactions for speculative profit*

(Violation of a Ministerial Ordinance, Article 50(1)(vi) of the SEL)

Sales representatives, for the purpose of increasing their companies' income from commissions on stock transactions and of pursuing personal profit, used customers' accounts and made transactions themselves on numerous occasions. (Recommendations made against 11 individuals of 10 companies.)

*(4) Provision of property gains to compensate for losses*

(Violation of Article 50-3(1)(iii) of the SEL)

Sales representatives, responding to repeated requests from customers to compensate for their losses incurred in transactions of issues recommended by the sales representatives, provided property gains by remitting to the customers' bank accounts in order to partially compensate for the customers' losses. (Recommendations made against five individuals of four companies.)