

3. Recommendations

1) Outline

Based on the results of inspections, the SESC issued 30 recommendations (19 cases of them were based on inspections by local Finance Bureau chiefs) to the Prime Minister and the FSA Commissioner in the year under review, calling for disciplinary actions to be taken against securities companies and their employees (registered securities traders) who had violated laws. Of the 30 cases, 14 were administrative disciplinary measures against an identical number of securities companies and 23 cases were disciplinary measures against 39 individual traders.

(Note)Of the 30 cases, 7 involved administrative disciplinary measures against both securities companies and individual traders.

2) Recommendations and steps taken

The following are specific cases of violations that led to FSA recommendations explained in terms of who violated a law and which law they violated and administrative disciplinary measures taken by the FSA Commissioner.

1. Violations of laws by securities companies

- a) Act of concluding contracts for discretionary-account trading (violation of Article 42, Paragraph 1, item 5 of the SEL)

Three employees of Aizawa Securities Co., including a trader working at its Oi branch under a performance-based pay system, concluded discretionary-account trading contracts with their clients, in which the clients agreed to enable the employees to trade stocks on behalf of the clients without their consent on all aspects of trading, whether buy or sell and which stocks to be traded, in what amount, and at which prices. Based on the contracts, the employees in question accepted orders from the clients and executed them.

The securities company had been found to have engaged in discretionary-account trading in the previous inspections.

- Recommendation date: November 15, 2002
- Disciplinary measures: A two-day suspension of stock brokerage services and business improvement order

(Note) The recommendation called for disciplinary measures against the three employees as well.

An identical trading practice was also detected at the following securities company.

- Marusan Securities Co.
- Recommendation date: March 11, 2003
- Disciplinary measures: Suspension of stock brokerage services for two to four days and business improvement order

(Note) The recommendation called for disciplinary measures against three securities traders involved as well.

- b) Act of making false or misleading statements about important matters in securities and other securities transactions (violation of Article 4, item 1 of the Cabinet Office directives, based on Article 42, Paragraph 1, item 9 of the SEL)

Miki Securities Co. sold more than one issue of exchangeable bonds (EBs) between June and October in 2000 after the initially set subscription period for the issues had passed, although the market value of the EB issues had already slipped as a result of drops in the prices of the reference shares. In selling the EBs to numerous customers, Miki offered prices that did not reflect the actual market value of the EBs by providing prices equal to the initial subscription prices. This action caused the customers to develop the misunderstanding that the prices Miki offered them were appropriate, although such prices were higher than levels deemed appropriate.

- Recommendation date: December 10, 2002

-
- Disciplinary measures: business improvement order

c) Act of soliciting business with promise to provide special benefits (violation of Article 4, item 2 of the Cabinet Office directives, based on Article 42, Paragraph 1, item 9 of the SEL)

In January 1998, ING Securities (Japan) Ltd. solicited business from a certain corporate customer who had held a note of almost no redemption value immediately before maturity, with a promise to enable the customer to delay realizing losses, by presenting a scheme in which the customer would acquire a new note into which the losses would be transferred and simultaneously purchase a different note to bear the expenses arising from the issuance of the new note, for the sole purpose of keeping the losses unrealized.

- Recommendation date: December 19, 2002
- Disciplinary measures: suspension of business for three days and business improvement order

In addition, an identical violation was detected at the following company.

- Credit Agricole Indosuez Securities (Japan) Ltd.
- Recommendation date: June 24, 2003
- Disciplinary measures: Suspension of stock brokerage services for two days and business improvement order

(Note) Although the violation resulted from a request filed on the part of the customers, the act by this company still constituted "solicitation" as defined under the relevant law.

d) Act of making a series of securities transactions to create an artificial market that does not reflect the actual state of the market (violation of Article 4, item 3 of the Cabinet Office directives, based on Article 42, Paragraph 1, item 9 of the SEL, Article 14, Paragraph 1 of the LFSF applied)

In relation to corporate bonds with a clause to exchange them for shares of a listed company other than the bond issuer company, or exchangeable bonds (hereinafter referred to as "EB"), the Tokyo branch of Banc of America Securities-Japan, Inc, with the involvement of the (then) head of the equity financial products department's trading section and others, placed a series of large market-on-the-close limit orders to sell the reference shares at a lower price (¥174) than the EB's strike price (¥175). This created a situation in which the closing price of the reference shares would not equal or exceed the strike price unless all the orders were consummated during the last minute of trading time for the day, from 14:59 until the end of the day's trading, on December 5, 2001, which was the valuation date when the EB redemption method, as to whether by payment of cash equal to the EB's principal amount or by delivery of the reference shares, was to be decided based upon the day's closing price for the reference shares. This was intended to make the reference price lower than the strike price so that the EB would be redeemed by delivery of the shares in order to enable the Banc of America Securities' parent corporation to avoid risks that might have arisen from its status as a holder of the reference shares that had been held in preparation for the redemption.

As a result of this, the price of the reference shares closed below the strike price, and the parent corporation succeeded in avoiding risks that might have arisen from its status as a holder of the reference shares.

- Recommendation date: September 10, 2002
- Disciplinary measures: business improvement order

(Note 1) In the case in question, the sell orders mentioned above were not executed. But even under such a condition, the act of Banc of America Securities amounted to "securities transactions" as defined under the relevant law.

(Note 2) Administrative disciplinary measures were not sought against the individuals involved because the (then) head of the trading section of the equity financial product department of the Tokyo branch had already had his name taken from a list of registered securities traders.

An identical violation was detected at the following companies.

- BNP PARIBAS Securities (Japan) Ltd.
- Recommendation date: November 29, 2002
- Disciplinary measures: Suspension of stock trading business for 10 days and business improvement order

(Note)The order was executed over a multiple time of transactions. Even the act of a single-time order constitutes "a series of securities transactions" as defined under the relevant law.

- J.P. Morgan Securities Asia Pte. Ltd.
- Recommendation date: February 25, 2003
- Disciplinary measures: Suspension of stock trading business for 10 days and business improvement order

(Note)Under this recommendation, disciplinary measures were also sought against one registered securities trader.

Nikko Salomon Smith Barney Ltd. concluded a contract with a certain customer to purchase a large quantity of shares of numerous listed stocks that the customer held and establish investment trust funds linked to stock price indexes, or exchange-traded funds (ETFs), based on the purchased shares. Under the contract, the amount of money to be paid to the customer for Nikko Salomon's purchase of the shares would be determined by deducting the aggregate prices of additional shares that were necessary to complete the composition of the ETFs ("complementary shares"), which were calculated on the basis of their closing prices on certain days on the Tokyo Stock Exchange (TSE), from the total market value of the ETFs.

On July 18, 2002, the Managing Director at the Program Trading Desk of the Nikko Salomon Smith Barney Equity Department deliberately raised the closing prices of the complementary shares at the TSE when procuring the shares in large volumes. The action

was taken under circumstances where profits to be generated at Nikko Salomon Smith Barney would be maximized if, on certain days, an abundance of the closing prices of the complementary shares would be greatly above the average cost at which the securities house procured the complementary shares. Nikko Salomon Smith Barney raised the closing price of each of the stocks at the TSE:

- (1) by placing with the TSE, from around 14:59 to the day's closing, market orders or limit-at-the-close orders to purchase more than one issue of stocks in such extremely large volumes as would make it possible for one to expect the prices of the stocks to almost certainly rise with the execution of the orders, and
 - (2) by placing with the TSE, from around 14:56 to the day's closing, a series of small-lot market buy orders involving more than one issue of stocks mainly traded at the Osaka Securities Exchange (OSE), utilizing an account of an affiliated company abroad, as well as a series of limit orders to mainly purchase these OSE-traded stocks at a price which is a certain percentage added to their immediately preceding prices in trading at the OSE, with the added margin rising toward the close of the day's trading.
- Recommendation date: March 7, 2003
 - Disciplinary measures: Suspension of stock trading business for 20 days and business improvement order

(Note) Under this recommendation, disciplinary measures were also sought against one registered securities trader.

From June 2002 to March 2003, the manager at the Tokai Tokyo Securities Co. Equities Trading Department placed a series of limit buy or sell orders in large quantities for numerous listed stocks without any intention of executing these shares, with the aim of making the stock prices move in favor of Tokai Tokyo Securities (making the prices rise in the case of long positions or making the stock prices fall in the case of short positions) by inducing market participants to place buy or sell orders for the stocks after Tokai Tokyo

executed its buy or sell orders on its own account.

Incidentally, after the stock prices rose or fell, the manager placed additional sell or buy orders to offset the initially taken long or short positions. The manager, upon having the additional orders executed at prices in favor of Tokai Tokyo, then cancelled the limit buy or sell orders.

- Recommendation date: June 23, 2003
- Disciplinary measures: Suspension of stock trading business for 10 days and business improvement order

(Note) Under this recommendation, disciplinary measures were also sought against one registered securities trader.

An identical violation was detected at the following company.

- Retela Crea Securities Co.
- Recommendation date: June 23, 2003
- Disciplinary measures: Suspension of stock trading business for 10 days and business improvement order

(Note) Under this recommendation, disciplinary measures were also sought against four registered securities traders.

e) Act of failing to inform customers that funds being raised through securities issuance would be used to finance the repayment of debt owed by the issuer's parent company (violation of Article 12, Paragraph 1, item 1 of the Cabinet Office directives, based on Article 45, item 3 of the SEL)

Norinchukin Securities Co., Ltd., from November 2000 to December 2002, underwrote securities issued by an entity which had borrowings from Norinchukin Securities' parent company and knowingly sold them to customers without informing them that there was an extremely high possibility that proceeds being raised from the issuance of the securities would be used by the issuing entity to finance the repayment of its borrowings.

-
- Recommendation date: March 14, 2003
 - Disciplinary measures: business improvement order

(Note) Given the situation in which the securities company knew there was an extremely high possibility that proceeds being raised from the issuance of the securities would be used by the issuing entity to finance the repayment of its borrowings, the securities company's selling the securities to the customers was judged as having been done with "knowledge" as defined under the relevant law.

f) Act of obtaining undisclosed information on a customer from a parent company and others or providing such information to a parent company and others (violation of Article 12, Paragraph 1, item 7 of the Cabinet Office directives, based on Article 45, item 3 of the SEL)

In June 2001, the President and Representative Board Director of Shinkin Securities Co. issued an in-house instruction to employees that they obtain, from its parent company, undisclosed customer information that came to the knowledge of the parent company's directors and employees in the course of business with the customers, and from July 2001 onward obtained such information from the parent company on a monthly basis without the consent of the customers. In May 2003, the Managing Director and the General Manager at the Bond Business Division provided information on customer securities trading orders to the parent company without the consent of the customers.

- Recommendation date: June 30, 2003
- Disciplinary measures: business improvement order

(Note) Under this recommendation, disciplinary measures were also sought against three registered securities traders.

g) Act of failing to verify the identity of customers who are suspected of engaging in trading by pretending to be the persons whose names are registered for the trading in violation of law (violation of Article 3, item 1 of the Personal Identity Verification Law)

Kabu.com Securities Co. launched a probe to check if any of the same customers used

different accounts at the securities company, by referring to the mobile phone numbers given by them. The probe showed that there were many accounts for online trading which were opened by persons with different names or home addresses, but with the same mobile phone numbers. Despite its suspicion that some customers must have placed orders under the accounts whose registered names were different from those of the customers, Kabu.com Securities Co. had accepted some of such orders since January 6, 2003 and executed them without verifying the customers' real identity.

The SESC's investigation into the dubious transactions showed:

- (1) The name for one account was found to be fake.
 - (2) There were three accounts whose registered names' identity could not be verified, as the persons under these names could not be reached. This indicates the customers must have engaged in securities trading by pretending to be the persons.
- Recommendation date: March 28, 2003
 - Disciplinary measures: order for remedial measures

2. Violations of laws by executives and employees of securities companies

Following are violations of laws committed by executives and employees of securities companies for which the SESC issued recommendations.

a) Securities trading intended for executives and employees of securities companies to pursue speculative profits (violation of Article 4, item 5 of the Cabinet Office directives, based on Article 42, Paragraph 1, item 9 of the SEL)

(Recommendations issued against seven individuals at seven companies)

b) Grossly improper acts by securities traders concerning their business duty (violation of Article 64-5, Paragraph 1, item 2 of the SEL)

(Recommendations issued against two individuals at two companies)

c) Act of providing a series of securities brokerage services despite the knowledge that accepting the request for such services would create an artificial market that does not reflect the actual state of the market (violation of Article 4, item 3 of the Cabinet Office directives, based on Article 42, Paragraph 1, item 9 of the SEL)

(Recommendations issued against one individual at one company)