

## 4. Policy Proposals

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### 1) Outline

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Based on inspections or investigations of criminal offenses, the SESC may, if necessary, present policy proposals to the Prime Minister, the FSA Commissioner or the Finance Minister in order to ensure fairness in securities transactions (Article 21 of the FSA Establishment Law).

In the 2002 SESC year, the SESC presented the following two proposals to the FSA Commissioner as a way to ensure fairness in securities trading.

### 2) Implementation of proposals and measures taken based on proposals

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Proposals and measures taken in line with the proposals are as follows.

a) Proposal on marketing methods by securities companies

The SESC's inspections of securities companies showed:

1. At a time when the yields on certain corporate bonds were rising significantly on the secondary market, some securities companies accepted subscriptions from individual investors for new bonds to be floated by the issuer of the corporate bonds without informing them of the sharp rise in bond yields, even though such information was important for assessing the credit risks of the new bonds, and thus the new bonds would be issued disadvantageously to the individual investors under such a circumstance.
2. At a time when prices of stocks linked to certain exchangeable bonds (EBs) were dropping significantly, some securities companies sold such EBs to individual investors without informing them of probable impacts of the reference stock's decline on the EBs, even though issuing terms for the EBs would obviously become disadvantageous for the customers.

Marketing methods employed by the securities companies in the cases mentioned above had serious problems from the viewpoint of offering sincere and fair services to individual customers.

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It is therefore necessary for the securities industry to introduce a set of rules on subscription and sale of new securities products to individual investors by brokerage houses, such as investors being informed adequately, in order to prevent possible lack of information on the side of individual investors as a result of short-term changes in market-moving factors from hurting their investment.

- Measures taken

The FSA revised the Cabinet Office directives that regulate securities company operations. The revised directives say the FSA will need to order securities companies to rectify their business operations if a subsequent situation arises in addition to the ones already confirmed as conditions for remedial orders, and the directives are retroactive. The newly added condition is the situation in which securities companies have failed to inform their individual customers of such important economic developments that could affect their investment judgment which have arisen during the sales or subscription periods for new bonds being campaigned by the securities companies.

Guidelines shown in the revised directives list specific cases where remedial measures become necessary.

b)Proposals on in-house compliance systems by securities companies specializing in Internet trading

Inspections of online securities companies showed:

- 1.Some online brokerage houses which have lacked strict in-house systems to check customers and their trading kept accepting orders that might lead to the formation of an artificial market.
- 2.Some online brokerage houses received customers' orders for selling certain stocks on margin several times in a very short period of time and executed such orders on behalf of the customers although such trading was apparently aimed to dodge price-restricting measures

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applied in short selling.

3. Some online brokerage houses received orders for securities trading from customers whose names appeared to be different from those under which the trading was registered.

The act explained just above probably resulted from Internet trading's nature of a customer and trader not meeting each other during business. The securities companies which engaged in the acts mentioned above were also found to not have internal trade-screening and customer management systems sufficient to detect and reject illegal or dubious orders.

Given the nature of sales methods used for Internet trading, online brokerage houses should build trade-screening and customer management systems that are different from those employed by brokerage houses offering regular over-the-counter, face-to-face services, in order to eliminate illegal or illicit trading. And it is necessary to take adequate steps for online securities houses to build such systems.

- Measures taken

Necessary procedural works are under way at the FSA to revise the Cabinet Office directives that govern securities company operations and guidelines.