

1. Investigations of Criminal Offenses and Filing of Complaints

1) Outline

1. Authority to investigate criminal offenses

The authority to investigate criminal offences on securities transactions is given to the SESC under the Securities and Exchange Law (SEL), the Law on Foreign Securities Firms (LFSF) and the Financial Futures Trading Law (FFTL). The SESC's scope of investigations under that authority is not limited to securities companies, but reaches all parties involved in securities transactions, including the investors themselves. With the SEL being applied similarly, the SESC is also given the authority to investigate criminal offences under the Personal Identity Verification Law (PIVL).

Noncompulsory investigations conducted by the SESC on criminal offenses include making inquiries about suspects of criminal acts or related parties (hereinafter referenced jointly as "suspects"), inspection of materials in the possession of or left behind by suspects, and confiscation of materials supplied by suspects on a voluntary basis or left behind by them (Article 210 of the SEL, Article 53 of the LFSF, Article 106 of the FFTL and Article 18 of the PIVL). Compulsory investigations conducted by the SESC with warrants from judges include visiting and searching the premises of suspects and seizing related evidence (Article 211 of the SEL, Article 53 of the LFSF, Article 107 of the FFTL and Article 18 of the PIVL).

2. Scope of criminal offenses and others

Criminal offenses are defined as hampering fair securities trading, and their scope is prescribed under cabinet orders (Article 45 of the SEL Enforcement Order, Article 23 of the LFSF Enforcement Order and Article 11 of the FFTL Enforcement Order). Main offences include securities companies providing benefits to select clients to compensate for trading losses, issuing companies submitting securities statements and reports containing false information, insider trading, the spreading of rumors and the manipulation of prices.

Criminal offenses subject to investigation under the PIVL include customer acts of covering up their real names and addresses when the securities company verifies their identity.

SESC investigators report the results of criminal investigations to the SESC (Article 223 of the SEL, Article 53 of the LFSF, Article 119 of the FFTL and Article 18 of the PIVL). When convinced of a suspect's guilt, the SESC files a complaint with public prosecutors and sends the evidence it gathered in its probe, including materials left behind by the suspect and seized materials (Article 226 of the SEL, Article 53 of the LFSF, Article 122 of the FFTL and Article 18 of the PIVL).

2) Investigations of criminal offenses and filing of complaints

1. Investigations of criminal offenses

In the 2003 SESC year, the SESC conducted compulsory investigations into four cases of transactions, including price manipulations involving shares of Cats, by searching the homes and related offices of the suspects as well as conducted necessary noncompulsory investigations into cases.

2. Filing of complaints

Based on the results of investigations the SESC filed a total of 10 complaints involving 28 people with public prosecutors on charges of violating the SEL: six complaints involving eight people on charges of insider trading, two complaints involving 10 people on charges of manipulating prices and two complaints involving 10 people on charges of submitting

securities reports containing false information. The outline of these complaints is explained below.

(1) Sotec Case (Insider Trading)

The suspect, an employee of Sotec Co., gained knowledge of the company's decision to acquire its own shares in line with rules set under Article 210 of the Commercial Code and its decision to form a business partnership with Active Investment Partners Ltd., an investment management company. The suspect then bought shares of Sotec before the announcement of the decisions in an attempt to make a profit.

(2) OSE Case (Price Manipulation)

The Osaka Securities Exchange Vice President and the President of Japan Electronic Securities Co. conspired with each other in an attempt to mislead investors by making the trading of stock options listed on the OSE appear to be drawing more popularity than it actually was.

- a) The OSE Vice President, in connection with the exchange's business duty, engaged in fake stock options trading that is not intended for actual sale and acquisitions of options, and so-called coordinated stock options trading in which buying orders for stock options and selling orders for the options are coordinated in advance with the other party so that their prices are made equal.
- b) The President of Japan Electronic Securities engaged in fake stock options trading and coordinated stock options trading in connection with the company's business duty.

(3) Nichimen Infinity Case (Insider Trading)

When a securities company concluded an agent contract with Nichimen Corp. on its takeover bid plan, a corporate finance division chief at the securities company gained knowledge that the target of Nichimen's takeover bid was Nichimen Infinity Inc. before the company announced the plan. The division chief bought shares of Nichimen Infinity before the announcement of the takeover bid in an attempt to reap profit.

(4) Aichi Corp. Case (Insider Trading)

The suspect gained knowledge of Aichi Corp.'s decision to conclude a business partnership and capital affiliation agreement with Toyota Industries Corp. through the suspect's adopted son employed by Toyota Industries before Aichi announced the decision. The suspect bought shares of Aichi before the announcement of the business partnership and capital affiliation agreement in an attempt to reap profit.

(5) Cats Case (Case 1: Price Manipulation)

Six suspects, including the President of Cats Inc., conducted the following transactions.

- a) With the aim of pushing up the pest control company's share prices and making investments in the stock look attractive to investors, they manipulated the stock's prices. The six suspects, under the name of a company run by one of the six, placed successive market orders and limit orders for Cats shares-buy orders for a total of about 2.45 million shares and sell orders for a total of 1.47 million shares-via a securities firm so that its price would bid up. The six also placed massive buy orders for Cats shares-a total of about 210,000 shares-via a securities company in order to prevent the stock's prices from dropping below a specified level. These conducts led to surges in the stock price, amounting to so-called stock price manipulation.

- b) With the aim of misleading investors regarding trading in Cats shares by making such trading appear to be drawing popularity, they engaged in fake trading and coordinated trading. One of the suspects engaged in fake transactions that were not designed for an actual stock ownership transfer by placing sell orders for a total of about 580,000 Cats shares and immediately offsetting the selling with buy orders for the same amount of the stock. Moreover, two of the suspects engaged in coordinated trading in which selling orders for a total of about 350,000 shares and corresponding buying orders for an equal amount of shares were coordinated in advance between the two so that their prices would be equal.

(6) Dai Nippon Construction Case (Insider Trading)

When the suspect, an employee of temporary staffing agency Pastora, was dispatched to Gifu Bank under a business consignment contract between the agency and the regional bank, the suspect gained knowledge of a decision by Dai Nippon Construction Co. to file for court protection from creditors under the Civil Rehabilitation Law before the construction firm announced the decision. The suspect then placed margin selling orders under the name of the suspect's acquaintance for shares of Dai Nippon Construction before the announcement of the decision in an attempt to reap profit.

(7) Cats (Case 2: Submission of Securities Report Containing False Information)

Two executives of Cats Inc., including the President, a public accountant in charge of auditing the pest control company's accounting situation and an executive of a consulting house conspired to falsify Cats' official securities report.

- a) For the first half (January-June) of the business year through December 2002, the suspects prepared a securities report that included a balance sheet in which money actually lent by Cats to the President was described as deposits entrusted with a corporate merger fund company based on a contract stipulating that the deposited money would be eventually returned, and submitted the report to relevant financial authorities.
- b) For the business year through December 2002, the suspects prepared a securities report that included a balance sheet in which the company's acquisition of First Mile shares was described as a ¥6 billion deal although actual acquisition prices were a maximum ¥650 million, and submitted the report to relevant financial authorities.

(8) Digital Electronics Corp. Case (Insider Trading)

The suspect gained knowledge of a decision by Digital Electronics Corp. and Schneider Electric S.A. to conclude a capital affiliation agreement before the announcement of the plan. The suspect then bought shares of Digital Electronics Corp. before the announcement of the plan in an attempt to generate profit.

(9) Morimoto Corp. Case (Submission of Securities Reports Containing False Information)

Four executives of Morimoto Corp., including the President, in connection with its business duty, conspired to produce securities reports for three business years—from the year ended in March 2001 through the year ended in March 2003—that included profit-loss statements and balance sheets in which part of the construction costs was intentionally excluded with the aim of accounting them in the following years even though such costs should have been listed in the years in question, and submitted the securities reports to relevant financial authorities.

(10) Iseki Poly-Tech Case (Insider Trading)

A board director of Iseki Poly-Tech Inc. gained knowledge of a decision by the company to file for court protection from creditors under the Civil Rehabilitation Law before the company announced the decision. The director conspired with two other suspects and sold shares of Iseki Poly-Tech under the name of a company in which one of the suspects sat as a board member before the announcement of the plan in an attempt to avoid capital losses that might arise from holding the shares.

2. Inspections

1) Outline

1. Inspections to ensure fair trading

(1) Objectives and scope of SESC inspections

The SESC conducts on-site inspections of securities companies and other entities to check their compliance with laws and regulations for ensuring fairness in securities transactions. The inspections are conducted under the authority delegated to the SESC by the Prime Minister and the FSA Commissioner, as prescribed under the SEL, LFSF and FFTL.

(2) Scope of Inspections

The scope of inspections is prescribed under cabinet orders (Article 38 of the SEL Enforcement Order, Article 20 of the LFSF Enforcement Order and Article 9 of the FFTL Enforcement Order). Subject to inspection are acts by securities companies, their executives or other employees that are prohibited in (for example, securities trading meant to create an artificial market that does not reflect the actual state of the market, false statements about securities trading, misleading statements about important investment factors and the act of soliciting business with promises to provide special benefits) and other violations of securities laws and regulations, including the guaranteeing of the repayment of investment losses, reimbursement of investment losses, price manipulation and insider trading.

2. Inspections with respect to verifying traders' identity

(1) Objectives and scope of SESC inspections

Under the authority entrusted by the Prime Minister and the FSA Commissioner based on the Personal Identity Verification Law, the SESC conducts on-site inspections of securities companies and related entities to check if these companies are taking adequate measures to verify their customers' identity and maintain their transaction records.

The inspections are mainly aimed to encourage securities companies to improve their customer management system.

(2) Scope of inspections

Based on the authority to inspect securities companies and order to produce documents, which is prescribed under the Personal Identity Verification Law (PIVL), the SESC conducts inspections of securities companies to check if they have verified the identity of a customer (Article 3 of the PIVL) when there is suspicion that the customer is receiving securities brokerage services from the securities companies by pretending to be other person whose name is registered for the transaction or that the customer is