

## **8. Efforts to Strengthen Surveillance Activities and Functions**

### **1) Expansion and Strengthening of the Market Surveillance systems**

#### **1. Expansion human Resources**

##### **(1) Staff Increase**

As for the staffing quota in the 2005 SESC year, an increase of 44 positions was approved, following an increase of 23 positions in the 2004 SESC year. As the result, the staffing quota as of the end of 2005 SESC year stood at 307.

In addition, securities transaction surveillance officers (department) at Local Finance Bureaus, etc. were approved for an increase of 16, to 245 as of the end of 2005 SESC year. Combined with the staff quota of the SESC, the total now stands at 552.

##### **(2) Use of Private-Sector Experts**

In order to improve the effectiveness of market surveillance and boost the professional expertise among surveillance officers, the SESC hired a total of 31 private-sector experts, consisting of individuals who are well versed in creating and managing derivatives and investment trusts, as well as lawyers and certified public accountants. As of the end of June 2005, 80 of such professionals were on the payroll.

#### **2. Improvement information gathering and analytical competence**

As a way to analyze complex and massive data on securities transactions and shed light on the factual relationship of these transactions, the SESC has been developing the Securities Comprehensive Analyzing System (SCAN-System) since 1993 in an effort to improve the efficiency of operations. The SCAN-System is a comprehensive computer system that is used widely in the operations of the SESC, including the inspection of securities companies, routine market surveillance and investigation of criminal offenses. Its basic development was complete by the 2001 fiscal year. However, efforts continue on the improvement of various system functions with a focus on further operational efficiency improvement. In the 2004 fiscal year, security features were strengthened to cope with the enforcement of the Personal Information Protection Act

Note: The SCAN-System consists of two parts, the Securities Company Inspection System and the Market Surveillance System. Support systems under the SCAN System are the SCAN-Internet Patrol System (SCAN-IPS) and the SCAN-Surveillance by Technical Analysis of corporation Finance system (SCAN-STAF), as well as the information control system which is meant to process information supplied by the general public efficiently.

### **2) New surveillance functions**

#### **1. Outline**

(1) On December 24, 2003, the First Subcommittee within the Sectional Committee on Financial System of the Financial System Council compiled a report entitled the "Reestablishing the Financial System with the Market Function at its Core." The part of the report that related to the SESC discussed "strengthening of market surveillance function and system." As specific measures to achieve this objective, the adoption of administrative civil money penalty, expansion of the scope of authority delegation for inspections by the FSA to the SESC, and other matters were reported.

Based on the report, the FSA submitted a "Bill to Amend a Part of the Securities

Exchange Law” to the 159th ordinary session of the Diet. The bill passed the Diet on June 2, 2004.

The new administrative civil money penalty (refer to “Chapter 3: Administrative Civil Penalty Investigation”), which was newly introduced by the Securities and Exchange Law that was revised by this bill (hereinafter referred to as the “Revised SEL”), has been enforced since April 1, 2005. The expansion of the scope of inspections delegated to the SESC took effect on July 1 of the same year.

(2) On June 23, 2004, the First Subcommittee within the Sectional Committee on Financial System of the Financial System Council compiled a report entitled the “Establishment of Regulations concerning Foreign Exchange Margin Trading.” The report contained a proposal to revise the Financial Futures Trading Law as a way to regulate foreign exchange margin trading and have the SESC perform inspections of such transactions as regulated activities.

Based on the report, the FSA submitted a “Bill to Amend a Part of the Financial Futures Trading Law” to the 161st extraordinary session of the Diet. The bill passed the Diet on December 1, 2004.

The Financial Futures Trading Law that was revised by this bill (hereinafter referred to as the “Revised FFTL”) has been in force since July 1, 2005.

In the following sections, the three components of the expanded scope of SESC’s authority to inspect are explained. These three components are (1) the unified approach to the inspections of securities companies and others, (2) granting of authority to inspect foreign exchange margin traders, and (3) disclosure-related inspections.

## **2. Expanded scope of authority to inspect**

(1) In July 2005, in an effort to further improve the effectiveness and efficiency of inspections directed at securities companies and others, the SESC was newly delegated with the authority to conduct inspections of the financial soundness of securities companies, etc., which had been the responsibility of the Inspection Bureau of the FSA. At the same time, the SESC was newly delegated with the authority to inspect investment trust companies, investment consulting companies, specific purpose corporations, none of which had been subjected to inspection by the SESC.

Furthermore, the companies that are engaged in foreign exchange margin trading began to be subjected to inspections as financial futures trading companies, and Japan Post, which was newly permitted to sell investment trust products, became subject to inspections as registered financial institutions.

The “Guidelines on the Supervision of Financial Conglomerates,” released by the Supervisory Bureau of the FSA, stresses the importance of cooperation between the Supervisory Bureau and the Inspection Bureau in order to realize effective supervision of financial conglomerates while respecting each other’s independence, and seeks to determine the actual conditions by inspections.

As these changes show, the authority of the SESC has been expanded in terms of both the organizations that are subjected to inspections and the inspection items. This necessitates more efficient and effective inspections than in the past. To meet the new expectations, the SESC is reviewing the techniques and procedures of inspections in an effort to conduct inspections properly.

The SESC also publishes the “Basic Guidelines concerning Securities Inspections” on its website in an effort to achieve improved transparency of its inspection work and greater understanding of its work by the general public.

(2) In July 2005, the authority to inspect and demand reports in connection with submission of financial statement reports etc. containing false statements was transferred from the FSA to

the SESC as a way to make the disclosure system credible. Consequently, the SESC can now order a person who filed a registration statement, a person who filed a shelf registration document, a person who filed a financial statement report, a takeover bidder, a person who filed a report of large ownership, etc. to submit reports and data and can conduct inspections of these persons pursuant to the provisions of Articles 26, Article 27-22-1 and -2, and Article 27-30, etc. of the SEL.

In the event that an inspection reveals false statements with respect to material facts, etc. in such disclosed documents as financial statement reports, the SESC recommends to the Prime Minister and the Commissioner of the FSA to issue an order to submit a report of corrections or pay administrative civil money penalty (refer to “2. Administrative Civil Penalty Investigation”).

### 3) Efforts to communicate with investors

The SESC strives to devise ways to enhance both individual investors’ understanding about the SESC and their confidence in the securities markets by holding lectures and providing information on its activities over the Internet. In addition, the SESC communicates with individual investors by using posters, newspaper ads, radio broadcast, CS broadcast, electronic billboard advertisements, and mobile terminal advertisements to encourage them to send in as many tips as they can to provide meaningful starting points for the SESC’s activities.

### 4) Cooperation with FSA and SROs

The SESC has been stepping up cooperation with the FSA, including sharing of information on a daily basis. In order to make inspection operations effective, the SESC and the FSA’s Inspection Bureau conduct joint inspections of the same securities companies at the same time as well as promoting daily exchange of information each other.

Self-regulatory organizations (SROs) such as the Japan Securities Dealers Association and stock exchanges across Japan are also conducting surveillance of day-to-day trading and of securities companies. The SESC has joined forces with these organizations in monitoring securities markets while exchanging information.

### 5) Cooperation with Foreign Regulators

#### **1. Participation in the International Organization of Securities Commissions (IOSCO)**

The IOSCO is an international organization whose objective is to establish international harmony of securities regulations and mutual cooperation among regulatory authorities. The SESC joined the IOSCO in October 1993. The Chairman and other members of the SESC participate in IOSCO’s annual general meetings where the chairman level officials from various countries gather, as well as biannual meetings of the Asia Pacific Regional Committee (APRC), which is the regional framework within the IOSCO. In addition, the SESC participates in the meetings on law enforcement in the Asia-Pacific region and strives to strengthen cooperation with foreign authorities.

To discuss major regulatory issues that face the international market and propose practical solutions to such issues, the IOSCO has established Technical Committee that is made up of authorities of major countries and regions. Under Technical Committee there are five Standing Committees (SCs). The SESC is a member of the Fourth Standing Committee (SC4), which deals with enforcement and exchange of information. The SC4 holds discussions on information exchange and cooperation among securities regulators from

different countries to respond to international securities crimes. Recently, discussions have centered on trends of securities crimes and the systems of property protection in respective countries. In addition, the SESC participated in the meeting of the Screening Group (SG) that verifies applications to join the multilateral Memorandum of Understanding (MOU) concerning Consultation and Cooperation, and Exchange of Information, which had been adopted at the May 2002 annual general meeting of IOSCO.

## **2. Bilateral Information Sharing and Exchange with Foreign Securities Regulatory Authorities**

The SESC has also promoted active information sharing and exchange with foreign securities regulators on a bilateral basis through both formal and informal channels outside of international conferences in an effort to construct cooperative relationships with them.

Specifically, the SESC has exchanged information with the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) of the United States, the Financial Services Authority (FSA) of the United Kingdom, the Monetary Authority of Singapore (MAS), the Securities and Futures Commission (SFC) of Hong Kong, Autorité des Marchés Financiers (AMF) of France, and the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) of Germany regarding compliance by securities companies that operate internationally with the regulations on their operations. When unfair trading practices are suspected, the SESC strives to gather information through such channels as bilateral agreements on information sharing too.

In addition, the SESC has exchanged opinions with the top officials of foreign securities regulatory authorities. In the 2004 SESC year, the SESC Chairman met with Mr. Lucy, the Chairman of the Australian Securities and Investments Commission (ASIC) during his visit to Japan in July 2004 to exchange opinions. In November of the same year, Commissioner of the SESC member who attended the APRC meeting exchanged opinions with Mr. Tregillis, Deputy Managing Director of the MAS. The SESC Chairman and other Commissioner also exchanged opinions with Mr. Guskov, Deputy Secretary of the Russian Federal Financial Market Agency during his visit to Japan in February 2005, and with Mr. Campos, Commissioner of the US SEC during his visit to Japan in June 2005. In addition, opinions were exchanged with the UK FSA.

## **3. Memoranda of Understanding (MOU) concerning Information Exchange**

With a rise in the number of cross-border securities transactions, the fairness of trading in individual countries' markets might be undermined. Exchange of information among securities regulators is thus indispensable. In order to exchange information smoothly with foreign securities regulators, the FSA of Japan has signed Memoranda of Understanding concerning information exchange with the following foreign securities regulatory authorities:

- March 1997                      China Securities Regulatory Commission (CSRC)
- December 2001                MAS
- May 2002                        US SEC and CFTC
- September 2004                ASIC
- May 2005                        HK SFC

The SESC cooperates with foreign securities regulatory authorities by using such mechanisms as the above-mentioned MOUs. In October 2004, the MAS took civil penalty enforcement action on an employee of the Government of Singapore Investment Corporation

(GIC) for breaches of insider trading regulations of Singapore involving Japanese securities market. This was a result of a request of assistance with the inquiry made by the SESC to the MAS under the MOU that had been signed between the FSA of Japan and the Singapore government.

#### **4. Training Program for Officials of Foreign Securities Regulators**

In December 2004, The SESC held the “4th Tokyo Enforcement Seminar,” inviting twenty-eight security law enforcement officers from Asian and other emerging economies. The annual seminars are taught by the SESC staff and guest lecturers, who are experienced officials from Japanese SROs and securities regulatory authorities in the Asia-Pacific region. The objective of the seminar is to introduce to the trainees the investigations of criminal offenses, investigations of administrative civil money penalties, inspections, market surveillance practices that are conducted by the SESC, and assist emerging Asian economies to develop human resources, thus contributing to the development of their securities administration and markets.