

Message from the Chairman



Chairman: Takeo TAKAHASHI

The Japanese Securities and Exchange Surveillance Commission (SESC) is carrying out its mission of ensuring fair trade in both securities and financial futures markets in Japan and maintaining the confidence of investors in these markets.

The SESC was founded in 1992 and has been in its 5th term (3 years each term) since July 2004.

This annual report covers the SESC's main activities in the 2004 SESC year (July 1, 2004-June 30, 2005).

Recently we have seen markets changing through the appearance of various derivative products, such as the financial products with embedded options, and new types of developed structure, while the globalization of financial transactions and the development of IT have been advancing.

Under such circumstances, it has been getting more important than ever to improve and to strengthen our surveillance activities; therefore, the Securities and Exchange Law was amended in June 2004, and the function of the SESC has been reinforced by the introduction of an administrative civil money penalty system (since April 2005) and expanded its authority delegated to conducting inspections on market intermediaries (since July 2005).

The SESC, while preparing properly for such an environment as the one explained above, endeavors to ensure fairness of transactions and to maintain the confidence of investors in the markets.

This report takes these issues into consideration and summarizes the SESC's activities in the last SESC year for maintaining investors' confidence in the securities markets.

I hope that this report will be useful for market operating in Japanese markets in further enhancing the level of their compliance with laws. In addition, I expect the report to become instrumental to foreign securities and for derivatives regulatory authorities and intermediaries

service providers in having a better understanding of our activities.

November 2005

高橋武生

Takeo Takahashi

Chairman

Securities and Exchange Surveillance Commission

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Introduction of Chairman and Commissioners

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 referred to 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 evidences (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 14 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 investigations 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 the 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) Filing of complaints

In the 2004 SESC year, the SESC conducted compulsory search of the homes and related offices of the suspects and necessary non-compulsory investigations in connection with the suspected criminal offenses.

Based on the results of investigations of the criminal offenses, the SESC filed a total of 11 complaints involving 18 individuals with the public prosecutors on charges of violation of the Securities and Exchange Law. These complaints consisted of 6 cases involving 10 individuals on charges of insider trading, 1 case involving 2 individuals on charges of spreading rumors and use of fraudulent means, 2 cases involving 2 individuals on charges of market manipulation, and 2 cases involving 4 individuals on charges of filing financial statement reports containing false information. The outline of these filed complaints is provided as follows:

(1) Media Lynks Corp. Case (1: Insider Trading)

As the differences arose between the expected figures projected in February and May 2003 in terms of net profit and dividends of Media Lynks Corp. for the fiscal year ended March 2003, the president of Media Lynks Corporation sold the shares of the company prior to the release of the latest projection as of May 2003 in an attempt to avoid a loss.

(2) Media Lynks Corp. Case (2: Dissemination of Rumors and Use of Fraudulent Means)

With the intent to make the stock price of Media Lynks Corp. soar, the company's president released the false information, stating that the total issue amount of the convertible bond that the company decided to issue on the Osaka Stock Exchange was paid in by the payment date when in fact the payment had not been made. Furthermore, he circulated the rumors and employed fraudulent means by announcing on the company's website that the conversion to stock of the bond had been completed partially and its capital was increased when in fact there were no assets added as the result of the bond issue as well as there were no assets to be applied to increase the capital in the event the warrants of the bond were exercised.

(3) Case Involving Stocks of Magara Construction and the Two Additional Stocks (Price Manipulation)

Intending to drive up the bid quotations and prices of stocks of Magara Construction Co., Ltd., Yamatane Corp. and Iwatsu Electric Co., Ltd. and induce active trading among these stocks, the suspect issued numerous buying orders in massive quantities from his home in the city of Kushiro, Hokkaido, through a number of securities companies over the Internet, using his own name at prices that ranged between 1 yen and 4 yen below the best bid in spite of the fact that he had no intention of actually buying these stocks. The suspect generated an appearance of vast buying orders, induced buying orders at high prices, drove up the stock prices, misled investors into believing that the stocks were actively traded, and also arranged to have a series of selling and buying orders executed to cause the price of each of these stocks to change.

(4) Media Lynks Corp. Case (3: Submission of a Financial Statement Report Containing False Information)

The president of Media Lynks Corp. submitted the financial statement reports containing the company's income statement and balance sheet that presented the false information for the fiscal year ended March 2003 in the course of the business operation of the company. That falsification was accomplished by such means of reporting of fictitious sales and purchases.

(5) CSK Communications Corp. Case (Insider Trading)

The executives and other employees of CSK Venture Capital Co., Ltd., which had been hired by CSK Communications Corp. to provide services in connection with the stock exchange listing of the CSK Communications Corp. stock, gained knowledge of CSK Communications Corp.'s decision to become a fully-owned subsidiary of CSK Corp. by exchange the stocks, and purchased the company's shares before the announcement of the plan.

(6) Chinon Industries Inc. Case (Insider Trading)

The suspect, who was an employee of the Ministry of Economy, Trade and Industry,

was engaged in the administration of reviews and approvals relating to corporate restructuring plans that were covered by the Special Measures Law Concerning Industrial Revitalization. He gained knowledge of the decision by Kodak Japan Digital Product Development Corp. to make a takeover bid of Chinon Industries based on the assumption Chinon would receive the application of the law, and bought shares of Chinon prior to the announcement of the decision in an attempt to gain profit.

(7) Nanno Construction Co., Ltd. Case (Insider Trading)

The executive officer of Nanno Construction Co., Ltd., who was also concurrently the director of the Kansai Division and the manager of the Wakayama branch of the company, and other individuals gained knowledge of the decision by the company to issue new shares by way of third party allotments and bought the company's shares with the intent to gain profit from the purchase of the company's shares before the decision was announced.

(8) Seibu Railway Co., Ltd. Case (1: Submission of Financial Statement Reports Containing False Information)

The Chairman of Kokudo Co., Ltd., in conspiracy with the President of Seibu Railway Co., Ltd., submitted the financial statement reports containing false information with respect to the certain material facts, including misrepresentation about Kokudo's ownership percentage of the total outstanding shares of Seibu Railway, which was approximately 43% when in fact it was approximately 65%.

(9) Seibu Railway Co., Ltd. Case (2: Insider Trading)

In the course of performing his job duties, the chairman of Kokudo Co., Ltd. learned of the fact that false information had been presented continually in Seibu Railway's financial statement reports regarding the major shareholder information of Seibu Railway that Kokudo owned, and sold shares that Kokudo owned to other companies in the course of the company's business operation in conspiracy with some Kokudo's employees and others in an attempt to reduce the number of shares owned by selling off part of the holdings prior to the announcement of the fact.

(10) Canon Software Inc. Case (Insider Trading)

The employee of a corporation that had been hired by Canon Software Inc. to provide services relating to legal advertising of a stock split of Canon Software Inc. gained knowledge of the decision by Canon Software Inc. to split its stock. He then purchased the company's shares with intent to gain profit by buying the company's shares before the decision was announced.

(11) Nissin Kogyo Co., Ltd. Case (Price Manipulation)

Between the second half of July 2001 and the first half of August of the same year and in connection with shares of Nissin Kogyo Co., Ltd., which was listed on the Second Section of the Tokyo Stock Exchange, the suspect committed the following acts.

a) In an attempt to boost the price of Nissin Kogyo stock and induce active trading in the stock, the suspect, using his own name and through multiple securities companies, manipulated the price of Nissin Kogyo stock by:

- Purchasing approximately 200,000 shares of the stock by such means as placing successive price limit buy orders to drive up the price while at the same time,
- Selling off approximately 160,000 shares of the stock and holding up the lows by

placing massive buy orders at lower levels. By employing these means, the suspect ordered the purchase of approximately 50,000 shares, making the stock price to surge.

b) With the aim of misleading others to believe that the stock was being traded actively, the suspect bought a total of approximately 100,000 shares of the stock in his own name and sold the same volume of shares at about the same time in separate transactions over the same period of time. These sales and purchases were sham transactions that were not intended for the actual transfer of ownership.

2. Administrative Civil Money Penalty Investigations

1) Purpose of and Authority for Investigations

The administrative civil money penalty system was introduced on April 1, 2005 to achieve administrative goals of curbing such acts of violations as insider trading and ensuring the effectiveness of regulations. It is an administrative measure that imposes monetary burdens on violators of certain provisions of the Securities and Exchange Law.

The Surveillance Commission is granted authority under the Securities and Exchange Law by the Prime Minister and the Commissioner of the Financial Services Agency to conduct investigations of suspects and other involved persons for the purpose of penalty investigation.

The authority for conducting penalty investigations (which do not extend to submissions of financial statement reports containing false statement) is set forth in Article 177 of the Securities and Exchange Law, which grants the Commission the power to

- (1) Question suspects or persons of interest, or demand opinions or reports from such individuals, and
- (2) Enter business offices of suspects and other sites that are necessary for investigation, and inspect accounting documents and other items.

The authority to conduct penalty investigations pertaining to submission of registration statements etc. containing false statement is set forth in Article 26 of the Securities and Exchange Law, which grants the Commission the power to take the following actions when deemed necessary and appropriate for the sake of public interest or investor protection:

- (1) To 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 person who filed a report of treasury share purchase, an underwriter of securities or any other involved party to submit reports or data that are helpful for investigations, and
- (2) To inspect accounting records and other items of the individuals being investigated.

2) Acts Subject to Penalties

Specific acts that are subject to levying of penalties are as follows:

- (1) Submission of a registration statement etc. containing false statement (disclosures relating to subscriptions and sales) (Article 172 of the SEL)
- (2) Dissemination of rumors and use of fraudulent means (Article 173 of the SEL)
- (3) Price manipulation (Article 174 of the SEL)
- (4) Insider trading (Article 175 of the SEL)

Note: Submission of a financial statement report containing false information, etc. on or after December 1, 2005 will be subject to orders for payment of penalties.

3. Inspections towards regulated market intermediaries

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 market intermediaries entities to check their compliance with laws and regulations for ensuring fairness in securities and financial futures 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). Specifically, securities companies are inspected in connection with provisions concerning prohibited acts of securities companies and those of their executives or employees. Such prohibited acts include a series of securities transactions carried out with intent to create an artificial market that does not reflect the actual market, representation of false statement concerning securities trading or misleading statement with respect to material matter concerning securities trading, and solicitation of securities trading with special profit guarantee.

2. Inspections with respect to confirming customers' identity

(1) Objectives and scope of SESC inspections

Under the authority entrusted by the Prime Minister and the FSA Commissioner based on the Law on Customer Identification and Retention of Records by Financial Institutions and prevention of unlawful use of Deposit (LCIRR), the SESC conducts on-site inspections of securities companies and related market intermediaries entities to check if these companies are taking adequate measures to confirm their customers' identity and maintain their transaction records.

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

(2) Scope of inspections

Based on the authority to inspect securities companies and order to produce documents, which is prescribed under the LCIRR, the SESC conducts inspections of securities companies to check if they have confirmed 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 falsifying his or her name, address and date of birth (in the case of a corporate entity, the corporate name and location of the head office and main offices). Under such circumstances, the SESC also conducts inspections of the securities companies to check if they have prepared documents after the verification and have kept these documents (Article 4 of the PIVL).

2) Basic inspection policy and Basic Inspection Plan

Inspections are planned and executed on a one-year cycle. Each SESC year begins on July 1 and ends on June 30 of the following year.

At the beginning of each SESC year, the SESC establishes a basic inspection policy and

a basic inspection plan of the year to ensure that inspections conducted by the SESC and Local Finance Bureau Chiefs are managed and implemented smoothly and efficiently.

The basic policy determines priority items and other basic matters for inspections for the year, while the basic plan specifies the number and types of companies which will become subject to inspections for the year among domestic brokerage houses, foreign securities companies and other financial institutions registered for securities business.

3) Results of inspections

1. Outline of conducted inspections

During the 2004 SESC year, inspections were initiated of 96 domestic securities companies, 17 foreign securities companies and 27 financial institutions registered for securities business.

2. Outline of securities company inspection results

During the 2004 SESC year, inspections of 118 securities companies were completed. Problems were found in 55 of these companies, representing 47% of all the companies inspected. In 45 of these companies, violations of market rules, etc. were found. In addition, a number of problems concerning the way these companies have conducted business and those relating to their internal control systems were identified. In particular, some securities companies were found to have concluded into discretionary account trading contract in the 2004 SESC year in spite of the fact that this violation had been pointed out multiple times in previous inspections. The SESC therefore made recommendations of taking administrative disciplinary measures against these companies to the Prime Minister and the Commissioner of the FSA.

(Note: Problems were found among 52% of the companies inspected in the 2003 SESC year, 58% in the 2002 SESC year and 63% in the 2001 SESC year.)

3. Outline of registered financial institution inspection results

During the 2004 SESC year, inspections of 28 financial institutions registered for securities operations were completed. Inspections of registered financial institutions were conducted in essentially the same areas as those for securities companies, namely, compliance with market rules, the ways of their business such as solicitation of investment, and internal control systems. The inspections revealed the following problems with some of the registered financial institutions:

- (i) Representation of misleading statement with respect to material matters in the course of handling private placement of securities.
- (ii) Handling private placement on a condition of granting credit.
- (iii) Failures to confirm the identity of customers in transactions in which there was a possibility that the customers assumed the identity of others [in violation of Section 1, Article 3 of the LCIRR].

4. Inspections of Financial Futures Traders

Inspections of financial futures traders were carried out concurrently with the inspections of securities companies. Their compliance with market rules was checked and inspectors identified the ways that they solicit customers to invest in financial futures. The inspections found no particular problems.

5. Inspections of Self-Regulatory Organizations

Generally, the SESC together with the Inspection Bureau of the FSA conducts their inspections of Self-regulatory organizations simultaneously, aiming to comprehensively examine the business operations and financial management of the securities exchanges, recognizing the trend among the securities exchanges to become stock companies and the growing importance of the Self-regulatory operations.

In May 2004, the SESC conducted an inspection of the Nagoya Stock Exchange and completed the inspection in July 2004 by issuing the notice of inspection results.

4. Recommendations

1) Outline

Based on the results of the inspections or the investigations of criminal offenses, the SESC may, if deemed necessary, present recommendations to the Prime Minister and the FSA Commissioner on administrative disciplinary actions and other necessary measures intended to ensure fairness in securities transactions (Article 20, Paragraph 1 of the FSA Establishment Law).

Specifically, recommendations by the SESC include proposing that administrative disciplinary measures be taken against securities companies and other entities if they are found to be violating laws and proposing that self-regulatory organizations take punitive measures against executives or employees of securities companies for such violation.

The SESC can ask the Prime Minister and the FSA Commissioner for a report on the measures taken based on the SESC's recommendations (Article 20, Paragraph 2 of the FSA Establishment Law).

Following the receipt of the recommendations by the SESC, the Prime Minister or the FSA Commissioner will hear from the securities companies concerned on the transactions in question, based on the results of the SESC inspections. If deemed necessary, the Prime Minister or the FSA Commissioner will take administrative disciplinary measures against the securities companies, including depriving the securities companies of their business registration license and ordering the suspension of their business operations.

Disciplinary measures against the registered securities traders of the securities companies are to be taken by the Japan Securities Dealers Association, which is entrusted by the Prime Minister to do clerical work on such measures (Article 64-7, Paragraph 1 of the SEL). The Japan Securities Dealers Association will hear from the registered securities traders concerned on the transactions in question, based on the results of the SESC inspections. If deemed necessary, the association will deprive the registered traders of their business registration license or order the suspension of their business activities.

Upon receipt of a recommendation for an order to pay penalties, the Prime Minister and the Commissioner of the FSA decide to initiate a hearing procedure. A hearing examiner drafts a decision on the case, following the hearing procedure. The Commissioner of the FSA (with delegation by the Prime Minister) makes a decision to order payment of a penalty, based on the draft decision.

2) Recommendations and measures taken based on recommendations

Based on the results of the inspections of securities companies and registered financial institutions, as well as those of the investigations of criminal offenses, the SESC made recommendations to the Prime Minister and the FSA Commissioner for administrative disciplinary measures against 17 companies that were found to have violated laws or regulations. (These included 12 cases that were revealed by inspections conducted by the chief of the Local Finance Bureau.)

13 recommendations were in 12 companies to take administrative disciplinary measures against securities companies. Two recommendation in one institution were against registered financial institution, and 18 recommendation for 32 people were against executives or

employees of securities companies or registered financial institutions.

Note: In 12 of these cases, administrative disciplinary measures were sought against both securities companies and their executives or employees. In one other case, administrative disciplinary measure was sought against both a registered financial institution and its executives or employees. Furthermore, there were cases in which multiple violations were pointed out against one company. As a result, the total number of cases are not consistent with the number of recommendations, which is 17.

1. Violations of laws and regulations by securities companies

(1) A Senior Vice President & Manager and an employee of Japanese Government Bonds division of Cantor Fitzgerald Shoken Kaisha Ltd, from May 2002 to July 2003 and from July 2002 to August 2002, respectively, had, in the course of business, executed several customers' orders by acting as a broker and at the same time as a principal for several times.

The aforementioned act of the two persons mentioned above is acknowledged to fall under the act of "acting as a principal and at the same time as a broker of the other party in consummating sale or purchase of securities" prescribed in Article 39 of the Securities and Exchange Law, which is applied to Paragraph 1 of Article 14 of the Law on Foreign Securities Firms.

Six other employees had, in pursuing their business, also executed customers' orders with their own accounts. The act of eight persons in total is considered to be that of the company, thus, Cantor Fitzgerald as a company is also acknowledged to amount to the violation of Paragraph 1 of Article 14 of the Law on Foreign Securities Firms.

- Date of Recommendation: September 10, 2004

- Administrative Disciplinary Action: A business improvement order.

* The recommendation also sought disciplinary measures against two registered representatives.

(2) The Act of Concluding Contracts for Discretionary-Account Trading [Violation of Item 5, Paragraph 1, Article 42 of the SEL]

- The assistant manager of the Sales Department at the head office and another employee of **Chuo Securities Co., Ltd.** concluded discretionary-account trading contracts with their respective clients in the course of their business operations. These contracts gave them full authority over the execution of stock trading on behalf of their clients with complete discretion as to whether to sell or buy, and which stocks to trade, as well as how many shares and at what prices to trade, without the clients' consent on individual transactions. They then accepted orders and executed transactions.

- Date of Recommendation: November 16, 2004

- Administrative Disciplinary Measures: Suspension of stock brokerage services of the Sales Department at the head office for two days, and an order for business improvement.

* The recommendation also sought disciplinary measures against one registered securities representatives.

Note: The disciplinary measures described above include disciplinary measures relating to the prohibited Act of representing Misleading Statements about Material matters in Connection with Securities Trading and Other Transactions described under 3), which was subjected to recommendations along with the violation described above.

- A director of **Iizuka Nakagawa Securities Co., Ltd.** concluded discretionary-account trading contracts with his clients in the course of the company's business operation. These contracts gave the director full authority over the execution of stock trading on behalf of his clients with complete discretion as to whether to sell or buy, and which stocks to trade, as well as how many shares and at what prices to trade, without the clients' consent on individual transactions. He then accepted the orders and executed transactions.

- **Date of Recommendation: February 23, 2005**

- **Administrative Disciplinary Measures: Suspension of stock and bond brokerage services of Sales Department at the head office for one day, and an order for business improvement.**

* The recommendation also sought disciplinary measures against one registered representatives.

- The (then) head of the Oyama branch of **Meiwa Securities Co., Ltd.** concluded discretionary-account trading contracts with his clients in the course of the company's business operation. These contracts gave the branch manager full authority over the execution of stock trading on behalf of his clients with complete discretion as to whether to sell or buy, and which stocks to trade, as well as how many shares and at what prices to trade, without the clients' consent on individual transactions. He then accepted orders and executed transactions.

- **Date of Recommendation: June 3, 2005**

- **Administrative Disciplinary Measures: Suspension of stock brokerage services at Oyama Branch for four days, and an order for business improvement.**

* The recommendation also sought disciplinary measures against one registered representatives.

- The (then) managing executive officer and manager of Corporate Department and other fourteen employees of **Maruhachi Securities Co., Ltd.** concluded discretionary-account trading contracts with their clients in the course of the company's business operations. These contracts gave them authority over the execution of stock trading on behalf of their clients with complete or partial discretion as to whether to sell or buy, and which stocks to trade, as well as how many shares and at what prices to trade, without the clients' consent on individual transactions. He then accepted and executed transactions.

- **Date of Recommendation: June 21, 2005**

- **Administrative Disciplinary Measures: Suspension of stock brokerage services for two days, and an order for business improvement.**

* The recommendation also sought disciplinary measures against eight registered representatives.

(3) The Act of Representation of False, or Misleading Statements with Respect to Material Facts, in Connection with Securities Trading and Other Transactions [Violation of Item 1, Article 4 of the Ordinance of Cabinet Office concerning Regulations, etc. of Conducts of Securities Company, based on Item 9, Paragraph 1, Article 42 of the SEL prior to its amendment by Law No. 97 of 2004]

- Between January 1989 and August 2004, the president and another employee of **Niigata Securities Co., Ltd.** represented a false statement to a number of clients regarding trading of discount bank debentures in the course of their business operations. They informed the clients that they intended to have the clients acquire such debentures when in fact they had no such intentions. Furthermore, they made a false representation when they furnished trade reports and securities receipts containing false information when in fact there was no acquisition made.

- Date of Recommendation: December 22, 2004

- Administrative Disciplinary Measures: Suspension of the entire securities operations for one month, and an order for business improvement.

* The recommendation also sought disciplinary measures against one registered representatives.

Note: The disciplinary measures described above include disciplinary measures pertaining to violations of laws and regulations that were revealed by an inspection by the Commissioner of the FSA.

- While soliciting a number of customers to purchase shares of multiple stocks between August 31, 2001 and March 12, 2003, the (then) manager of the Head Office Sales Planning Department, the (then) head of Narita branch, and the (then) head of Toshin branch of **Chuo Securities Co., Ltd.** made a representation that can mislead the clients to believe that they would receive a fixed amount of dividends yearly in the future in an advertisement that stressed such shareholder benefits as dividends and preferential treatment of shareholders.

- Date of Recommendation: November 16, 2004

- Administrative Disciplinary Measures: Suspension of stock brokerage services of the Sales Department at the head office for two days, and an order for business improvement.

* The recommendation also sought disciplinary measures against three registered representatives.

Note: The disciplinary measures described above include disciplinary measures relating to the Act of Concluding Contracts for Discretionary-Account Trading that are described under 2) and were subjected to recommendations along with the violation described above.

(4) The Act of Making a Series of Securities Transactions to Create an Artificial Market that Does Not Reflect the Actual Market or the Act of Accepting a Series of Securities Brokerage Orders Knowing that Tradings Would Create an Artificial Market That Does Not Reflect the Actual [Violation of Item 3, Article 4 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conducts of Securities Company, based on Item 9, Paragraph 1, Article 42 of the SEL prior to its amendment by Law No. 97 of 2004]

- Between March and September 2003, in the course of business operations, a senior dealer of the Second Dealing Team of **Jujiya Securities Co., Ltd.** carried out a series of transactions in connection with shares of multiple listed stocks with the intention of moving the prices of the stocks in his favor. He did this by driving up the prices of the stocks by buying shares of the stocks, using either market or limit orders, followed by orders to buy at the best bid or a price below the best bid.
- Date of Recommendation: October 8, 2004
 - Administrative Disciplinary Measures: Suspension of stock dealing operations for 15 days, and an order for business improvement.
 - * The recommendation also sought disciplinary measures against one registered representative.
- Between, April and October 2003, in the course of business operations, a dealer of Dealing Department of **Aizawa Securities Co., Ltd.** placed a series of limit orders to buy shares of a number of stocks with the intention of moving the prices of the stocks in his favor by inducing orders from other market participants even though he had no intention of actually having his orders executed.
 - Between July and August 2002, in the course of business operations, the (then) head of Mishima branch and the assistant sales manager at the same branch of **Aizawa Securities Co., Ltd.** accepted and executed a series of client's buying orders for shares of certain listed stocks even though they were aware that their client was carrying out a series of securities buying and selling transactions by using limit orders, etc. with the intention of driving up the prices of the stocks.
- Date of Recommendation: February 23, 2005
 - Administrative Disciplinary Measures: Suspension of dealing in stocks for ten days, suspension of stock brokerage by Mishima Branch for five days, and an order for business improvement.
 - * The recommendation also sought disciplinary measures against three registered representatives.
- (5) The Act of Engaging in Business Operations that Create a Situation in Which Explanations are Not Provided to Clients with Respect to Material Facts Relating to Switching Investment Trust Beneficiary Securities when Soliciting Clients to Switching Investment Trust Beneficiary Securities [Violation of Paragraph 8, Article 10 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conducts of Securities Company, based on Paragraph 2, Article 43 of the SEL]
- The executive director and another individual of **Ichiyoshi Securities Co., Ltd.** failed to provide proper guidance to the company's sales people in the course of the company's business operations, and as a result created a situation in which the company's sales people failed to explain to customers about a redemption switch preferential treatment program, a material fact concerning such switches, when they solicited their customers to switch their investment trust beneficiary certificates that are redeemed prematurely. In addition, the two failed to construct an internal control system to ensure that internal records of such explanations are created and retained, and that the status of such explanations is monitored. As a result, they carried out their operations without their customers being provided

with explanations of certain material facts relating to the switches when they solicited the customers to switch their investment trust beneficiary certificates.

- Date of Recommendation: June 3, 2005

- Administrative Disciplinary Measure: A business improvement order.

* The recommendation also sought disciplinary measures against one registered representative.

- The manager-director of Sales Division and the (then) managing director of **World Nichiei Frontier Securities Co., Ltd.** failed to provide proper guidance to the company's sales people in the course of business operations, and as a result created a situation in which the company's sales people failed to explain to customers about a redemption rollover preferential treatment program, a material fact concerning such rollovers, when they solicited their customers to roll over their investment trust beneficiary certificates that are redeemed prematurely. In addition, by failing to make the company's internal control system to function effectively to ensure that internal records of such explanations were created and retained and that the status of such explanations was monitored, the individuals let their business operations to go on without their customers being provided with explanations of certain material facts relating to the rollovers when they solicited the customers to roll over their investment trust beneficiary certificates.

- Date of Recommendation: June 23, 2005

- Administrative Disciplinary Measure: A business improvement order.

* The recommendation also sought disciplinary measures against two registered representatives.

(6) Prohibition of market manipulative [Violation of Items 4 and 5, Paragraph 1, Article 159 of the SEL]

- Between 4 and 20 June 2001, **UFJ Tsubasa Securities Co., Ltd.** colluded with another party to engage in collusion to trade a total of 355 thousand shares of Cats Corporation over a period of 12 business days on the Tokyo Stock Exchange. UFJ Tsubasa Securities Co., Ltd. made an arrangement in advance to have the other party simultaneously buy or sell the shares that UFJ Tsubasa sold or bought at the same price, and executed the collusion sales and purchases of the stock.

- Date of Recommendation: January 7, 2005

- Administrative Disciplinary Measures: Suspension of dealing in stocks for ten days, and an order for business improvement.

(7) The Act of Failing to Perform Personal Identity Confirmation when Trading or Brokering Securities, and the Act of Failing to Create Records of Personal Identity Confirmation [Violation of Paragraphs 1 and 2, Article 3 and that of Paragraph 1, Article 4 of the LCIRR]

- Between February 26, 2003 and January 21, 2005, a director and another individual of **Credit Agricole Indosuez Securities (Japan) Ltd.** let some corporate clients open accounts either without performing the required confirmation of the identity of such corporate clients or that of the natural persons who were engaged in such

transactions or without creating any records of such identity confirmation in the course of the company's business operations.

- Date of Recommendation: June 17, 2005

- Administrative Disciplinary Measure: An order for remedial measures.

* The recommendation also sought disciplinary measures against one registered representative.

2. Violations of laws or regulations by executives and other employees of securities companies

The following types of violations of laws or regulations were found to have been committed by executives and other employees (registered representative) of securities firms. (The descriptions contain only the disciplinary actions that are recommended strictly against executives and employees. Violations that involved concurrent recommendations of disciplinary actions against corporations are excluded.)

(1) The Acts of Concluding into Contracts for Discretionary-Account Trading [Violation of Item 5, Paragraph 1, Article 42 of the SEL]

(Recommendations were issued against four individuals at four corporations)

(2) Securities Trading Intended for Executives and Other Employees of Securities Companies to Pursue Speculative Profits [Violation of Item 5, Article 4 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conducts of Securities Company, based on Item 10, Paragraph 1, Article 42 of the SEL (or Item 9, Paragraph 1, Article 42 of the SEL prior to its amendment by Law No. 97 of 2004 for acts committed on or prior to March 31, 2005)]

(Recommendations were issued against one individual at one corporation.)

3. Violations of laws or regulations by Registered Financial Institutions

(1) The Act of Presenting Misleading Statements with Respect to Material Facts in Connection with the Handling of Private Placement of Securities [Violation of Item 1, Article 21 of the Ordinance of Cabinet Office concerning Securities Operations of Financial Institutions, based on Item 9, Paragraph 1, Article 42 of the SEL prior to its amendment by Law No. 97 of 2004. Provisions of Paragraph 5, Article 65-2 of the SEL are relied upon.]

- In connection with private placement of structured bonds (which are bonds issued with various conditions attached to meet the investment objectives of individual clients) in the course of their business operations, two vice presidents of the Second Sales Dept. at the **Marunouchi Branch of Citibank, N.A.** made statements that are bound to mislead investors with respect to certain material facts by distributing to multiple clients certain solicitation materials that do not properly describe the product features of the notes.

- Date of Recommendation: September 14, 2004

- Administrative Disciplinary Measure: A business improvement order.

* The recommendation also sought disciplinary measures against two registered securities traders.

Note: The disciplinary measure described above includes disciplinary measures relating to the **Act of Handling Private**

Placement as a Condition for Granting Credit, described under 2), which was subjected to recommendations along with the violation described above.

(2) **The Act of Handling Private Placement on a Condition for Granting Credit**

[Violation of Item 6, Article 21 of the Ordinance of Cabinet Office concerning Securities Operations of Financial Institutions, based on Item 9, Paragraph 1, Article 42 of the SEL prior to its amendment by Law No. 97 of 2004. Provisions of Paragraph 5, Article 65-2 of the SEL were relied upon.]

- **The Marunouchi Branch of Citibank, N.A.** in its private banking operations, handled private placement on a condition for granting credit by soliciting specific clients to apply for the purchase of structured bonds while concurrently offering to lend money to the clients for the purchase of the notes. By having the clients acquire the bonds as a condition for the loan, the bank handled private placement as a condition for granting credit.

- Date of Recommendation: September 14, 2004

- Administrative Disciplinary Measure: A business improvement order.

Note 1: The disciplinary measure described above includes disciplinary measure relating to the Act of Presenting Misleading Statements with Respect to Material Facts in Connection with the Handling of Private Placement of Securities described under1), which was subjected to recommendations along with the violation described above.

Note 2:

The FSA took an administrative disciplinary action against the Japan Branch of Citibank, NA on September 17, 2004, based on the provisions of the SEL. As of the same date, the FSA also took an administrative disciplinary action against the same branch in accordance with the provisions of the Banking Law. (The reason for the disciplinary measure was the discovery of fundamental problems in the branch office's system of compliance with laws and regulations and its governance system. In particular, a number of transactions by the bank's Private Banking Division (the Marunouchi Branch and the offices in Nagoya, Osaka, and Fukuoka) were found to be injurious to the public interest, in material violation of laws and regulations, or extremely improper, which led the FSA to conclude that continued business operation of the division would be inappropriate. In addition, the Individual Finance Division was found to have an inadequate internal control system over its foreign currency deposit operations and deemed to be in need of concentrating its efforts on improving its operations.) Subsequently, the Private Banking division of the branch was shut down.

5. Policy Proposals

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

Policy proposals are put forward by the SESC after its comprehensive analysis of the results it obtained through the inspections and investigations. Such proposals are intended to clarify the SESC's view on laws, regulations and self-regulatory trading rules and have it reflected in policy measures being taken by other government agencies and self-regulatory organizations. Proposals by the SESC serve as important yardsticks for relevant government authorities in formulating certain policies.

The SESC has proposed reviewing or revising existing laws or regulations on securities trading and related matters, and self-regulatory rules, when such rules and laws are found unfit to deal with issues found in actual transactions. The SESC has also pointed out problems inherent in the current legal framework for securities transactions and specific areas to be studied and reviewed from the viewpoint of ensuring fairness in trading.

During the period reviewed for this report, the inspections, etc. of securities companies resulted in discovery of no issues that required policy proposals.

6. Market Surveillance

1) Outline

1. Outline of market surveillance

The SESC conducts market surveillance on a broad range of securities transactions on a daily basis, including unfair securities deals, such as manipulation of stock prices and insider trading, as well as inspections of securities companies and investigations of criminal-offense cases.

Specifically, the SESC takes out stocks showing irregular movements, as the samples below show, based on the day-to-day surveillance of market movements and information obtained from various sources, and asks securities companies or SRO's that have engaged in the securities transactions in question to prepare detailed reports on the trading or submit relevant data.

Subject to market surveillance are the following:

- (1) stocks whose prices surged or plunged during a short period of time;
- (2) stocks about which important incidents that would significantly affect investors' investment judgment occurred, etc.

In addition, the SESC checks if securities companies involved in these dubious deals have committed acts that constitute violations of laws.

If the initial surveillance found problems in the securities transactions in questions, the cases will be reported to relevant SESC sections to be made clear.

2. Legal basis

To conduct market surveillance, the SESC is authorized to ask securities companies or SROs to submit reports and data on particular securities transactions if doing so is deemed necessary and appropriate from the viewpoint of maintaining fairness in trading and protecting investors' interests. Such authority delegated to the SESC and the scope of that authority are prescribed under the SEL, LFSF, FFTL and ordinances as with the SESC's authority on inspections.

3. Cooperation with self-regulatory organizations

Daily market surveillance as done by the SESC is also conducted by self-regulatory organizations such as stock exchanges and the Japan Securities Dealers Association. Their surveillance has the important function of checking if market participants are executing their business duties in an appropriate manner. The SESC keeps close cooperation with market-surveillance sections of self-regulatory organizations by exchanging necessary information on regular and extraordinary bases, and also by making mutual inquiries about data and facts on transactions.

2) Summary of surveillance results

In the 2004 SESC year, consisting of four teams, as shown below, with each given specific operational areas, they conducted surveillance in an efficient and flexible manner while maintaining the policy of taking prompt initial action for the early settlement of cases.

- a) Stock-price team
surveillance of stock-price manipulation and formation of artificial markets
- b) Insider trading team
surveillance of insider trading cases
- c) General affairs team
surveillance of socially topical cases needing quick action
- d) Information team
surveillance of suspected spreading of rumors on stock markets via the Internet, collection of market information, and information management

In the 2004 SESC year, broad-based surveillance was conducted with particular emphasis on the following concerns that had been expressed in the Committee Chairman's Policies (released on July 20, 2004):

- Products that are not easily understood by individual investors, such as variously-structured option trading products, are sold to individual investors in massive quantities in recent years. In the market where these new products and new modes of trading are emerging and where information technology is being employed increasingly widely, a watchful eye must be kept on unfair trading and illegal solicitation activities that are conducted by brokers.

- As financial trading becomes increasingly global and the application of information technology continues to expand, trading activities by such non-resident market operators as overseas investment funds in the Japanese market must be monitored to ensure that they do not violate Japanese laws and regulations.

The number of surveillance cases conducted by the SESC and Local Finance Bureaus are shown below:

Number of surveillance cases	SESC Year 2004	SESC Year 2003
Total	674	687
SESC	367	382
Local Finance Bureaus	307	305
(Breakdown of surveillance contents)		
Stock-price manipulation	153	154
Surges in stock prices	106	105
Pegging of stock prices at certain levels, etc.	47	49
Insider trading	506	500
Downward revision of corporate earnings	96	86
Upward revision of corporate earnings	68	56
New share issues, etc.	30	63
Others	312	295
Others	15	33
Spreading of rumors on markets	8	6
Others	7	27

7. Gathering of Information from the General Public

Information furnished by the general public reflects the raw voices of investors in the market. Such information is highly useful as it often leads the SESC to launch investigations into criminal offenses and administrative civil money penalties, as well as inspections and market surveillance. In some cases, information received served to provide a starting point for the issues that were eventually raised in the inspections of securities companies. At other times, received information played a critical role in market surveillance. In yet other instances, unearthing of the truth in criminal offense investigations was triggered by such information.

For this reason, the SESC uses a variety of media, including telephone, mail, personal visits and the Internet, to receive information from as many people as possible.

In the 2004 SESC year, 4,669 pieces of information were collected from the general public including investors. This was an approximately 40% increase over the preceding SESC year and the highest number of collection since the SESC was established in 1992.

In particular, the number of contacts made over the Internet exceeded 3,000 for the first time and much information continues to flow in. A look at the breakdown of the means employed in information gathering reveals that the Internet and telephone account for over 80% of the total cases of information supplied. The exact breakdown was 3,251 contacts via the Internet, 787 by phone, 408 in writing, 80 by personal visits, and 143 contacts that were referrals from the Local Finance Bureaus.

In terms of information content, 3,339 cases related to specific stocks, 620 cases were about sales practices of securities companies and the remaining 710 cases were opinions on other matters.

Suspicious of stock price manipulation ranked the highest among the cases relating to specific stocks. They accounted for approximately 30% (1,435 cases) of all cases. This figure is indicative of widespread doubts among investors about the way prices are formed in the market.

The second-largest group was related to the suspicious spreading of rumors on stock markets, representing approximately 20% (1,029 cases) of all cases. The majority of such information was about postings on Internet bulletin boards. This suggests the fact that unfounded rumors and investment analyses flood the Internet while tips from investors who read them are also increasing.

Information concerning suspected insider trading and that about suspected false claims made in securities reports, etc. has also dramatically increased.

A various types of information about securities companies' sales tactics and practices, including trading without customers' prior consent, discretionary-account trading and improper solicitations to take advantage of the customers' lack of knowledge, were also received.

Number of information items received

	July 2000-June 2001	July 2001-June 2002	July 2002-June 2003	July 2003-June 2004	July 2004-June 2005
Internet	606	1,282	1,804	2,061	3,251
Telephone	390	408	749	616	787
Mail	205	291	290	287	408
Personal visits	64	58	50	75	80
Forwarded from local Finance Bureaus	91	142	163	178	143
Total	1,356	2,181	3,056	3,217	4,669

(Note) Receipt of information via Internet started in April 1999.

Breakdown of information received

	July 2000 -June 2001	July 2001 -June 2002	July 2002 -June 2003	July 2003 -June 2004	July 2004 -June 2005
Information on specifics	671	1,208	1,848	2,015	3,339
Suspected stock-price manipulation	317	601	759	680	1,435
Suspected spreading of rumors	124	294	576	787	1,029
Suspected insider trading	122	195	271	282	510
Submission of false securities reports	28	48	73	67	142
Profit guarantees, compensation of investment losses	8	9	13	18	9
Subscription without submission	57	42	29	34	24
Others	15	19	127	147	190
Marketing methods and practices by securities companies	356	498	573	655	620
Trading without customers' consent	35	65	88	66	63
Solicitations with decisive predictions	35	49	30	27	19
Improper solicitations to take advantage of customers' lack of knowledge	17	13	29	31	28
Conclusion of discretionary-account contracts	49	27	15	22	40
Large-volume recommendation sale	5	1	6	3	2
Others	215	343	405	506	468
Other opinions	329	475	635	547	710
Total	1,356	2,181	3,056	3,217	4,669

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.

Supplements

Basic Principle

– On the Start of New Regime (July 2004) –

《Mission of Securities and Exchange Surveillance Commission (SESC)》

- To ensure fair trading in securities and financial future markets
- To maintain the confidence of investors in these markets

《Objective under the New Regime》

The most important objective of the SESC under the new regime is

to protect individual investors with all our force

, as former regime did.

《Main Targets》

Main targets of SESC in order to achieve the above objective include:

- (1) Sweep out criminal activities which hamper the fairness of markets
Sweep out criminal activities, including market manipulations and insider trading, which deceive investors and hamper the fairness of markets. The SESC aims to, for instance, thoroughly detect the large-scale market manipulation by speculators.
- (2) Detect the violations of laws or regulations by market intermediaries
Strictly detect the act of violating laws or regulations by market intermediaries including securities firms and their managements and employees who try to make profits at the expenses of investors.
- (3) Detect false statements on securities reports
Exhaustively detect the issuers of securities reports with false information who try to raise funds in favor of themselves by deceiving investors.

《Priority Matters》

The SESC will put emphasis on the following activities:

(1) Proper implementation of investigation for imposing new administrative civil penalty

Administrative civil money penalty system will be introduced in April 2005 against unfair trading (e.g. insider trading) and the submission of financial statements containing false information, and the SESC will be granted the authority of conducting the investigation for imposing the penalty. The SESC will arrange our organizational and procedural structure for implementing this new authority properly.

(2) Appropriate response to integrated inspection

Further inspection authorities will be delegated from the Financial Services Agency to the SESC in July 2005. The SESC will prepare for exercising the newly integrated inspection authorities in an accurate way, and implement efficient and intensive inspection.

(3) Response to recent developments in the markets

New products that cannot be easily grasped by individual investors, such as complicated option trading, have recently been sold in a large quantity to individual investors. The SESC will implement surveillance and inspection timely to see whether there exist unfair trading and/or illegal solicitation by market intermediaries in such a new market environment where the new products and forms of trading mechanism have been emerged and Information Technology has been advanced.

The SESC will also respond appropriately once the inspection authority on foreign exchange margin transaction is granted.

(4) Response to cross-border transactions

As the globalization of financial transactions and the development of Information Technology are advanced, suspicious activities involving non-residents including foreign investment funds that may violate the laws or regulations have been found in the Japanese markets. The SESC will strengthen the detection of such activities and coordinate with foreign authorities in a closer manner than before.

(5) Reinforcement of human resources

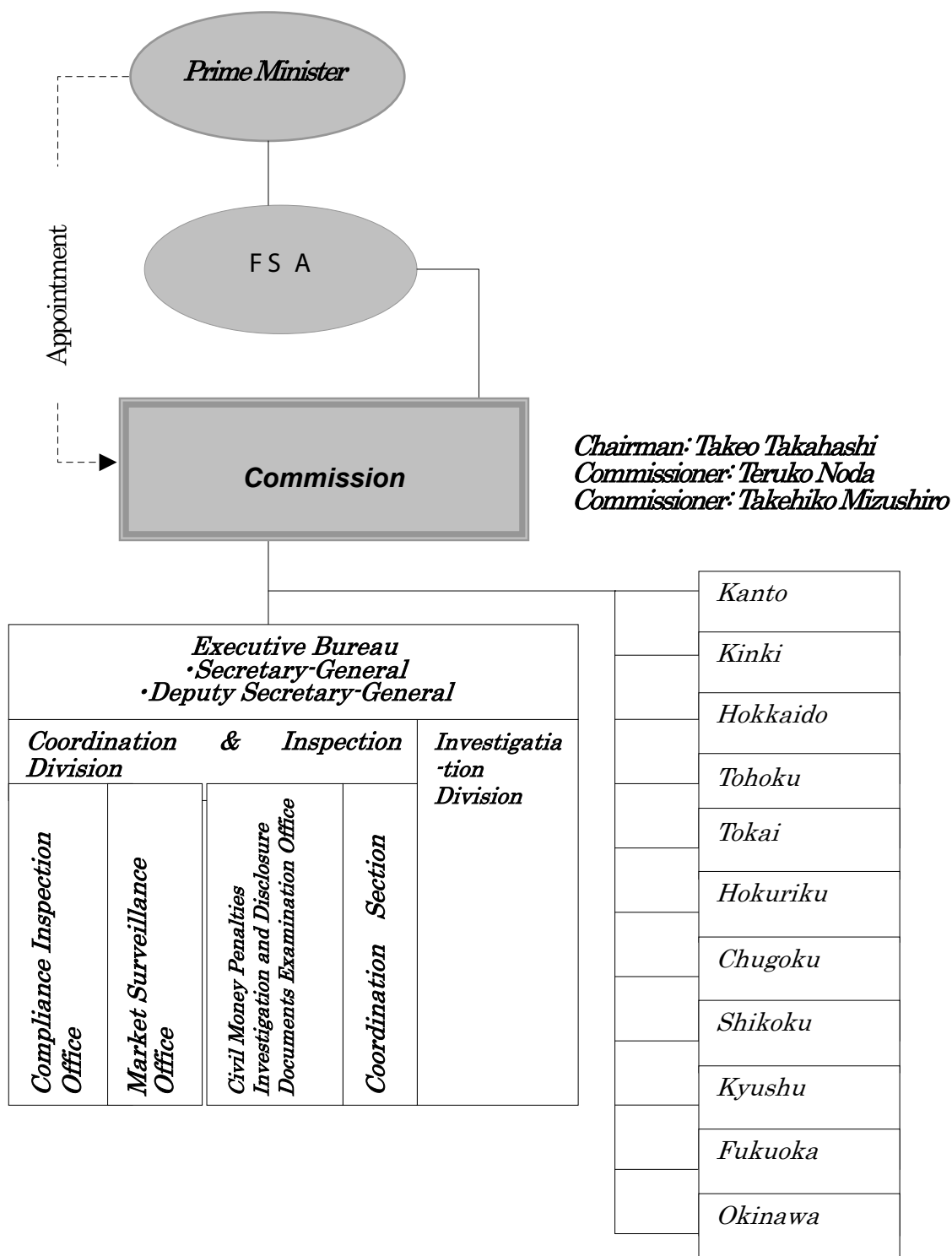
Further increase in human resources is needed in implementing the above targets, thus, the SESC continues trying to keep the necessary level of human resources in coordination with the authorities on the increase.

(6) Promotion of the presence of SESC

The SESC tries to increase its presence in the markets so that the existence of the SESC itself will serve as deterrence against unfair practices. The SESC also tries to further increase the credibility of the SESC, and consequently, of the securities markets, from investors. The SESC will thus make an effort to achieve higher performance in detecting criminal offences, as well as inform more people of the activities of the SESC through our website and seminars.

Table 1

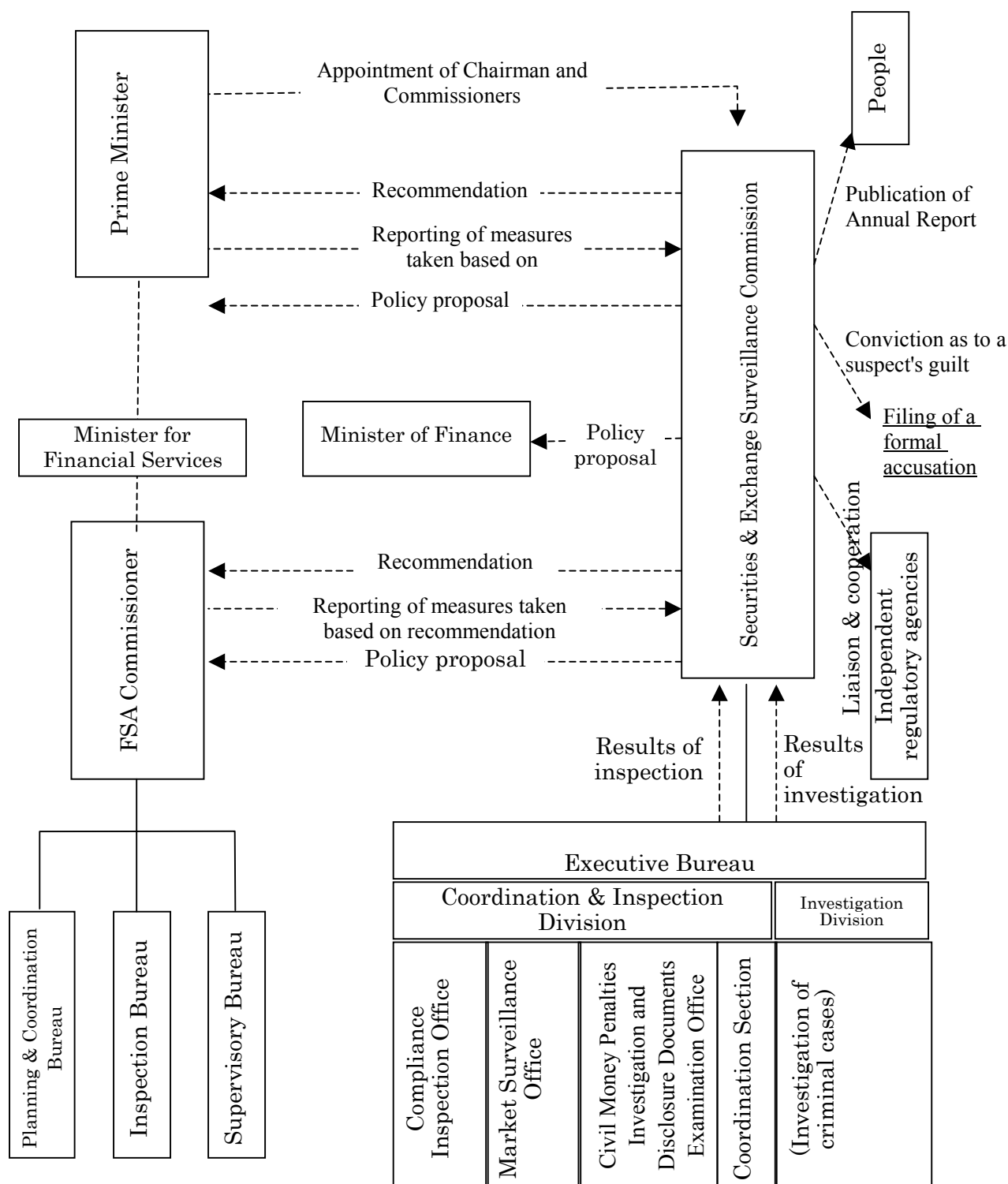
Organization of the SESC



Note: Local offices were established under the Local Finance Bureaus of the Ministry of Finance to carry out SESC surveillance activities. The directors general of Local Finance Bureaus conduct inspections and market surveillance under the authority delegated by the SESC and investigations of criminal offenses under the direct supervision of the SESC (see Table 3).

Table 2

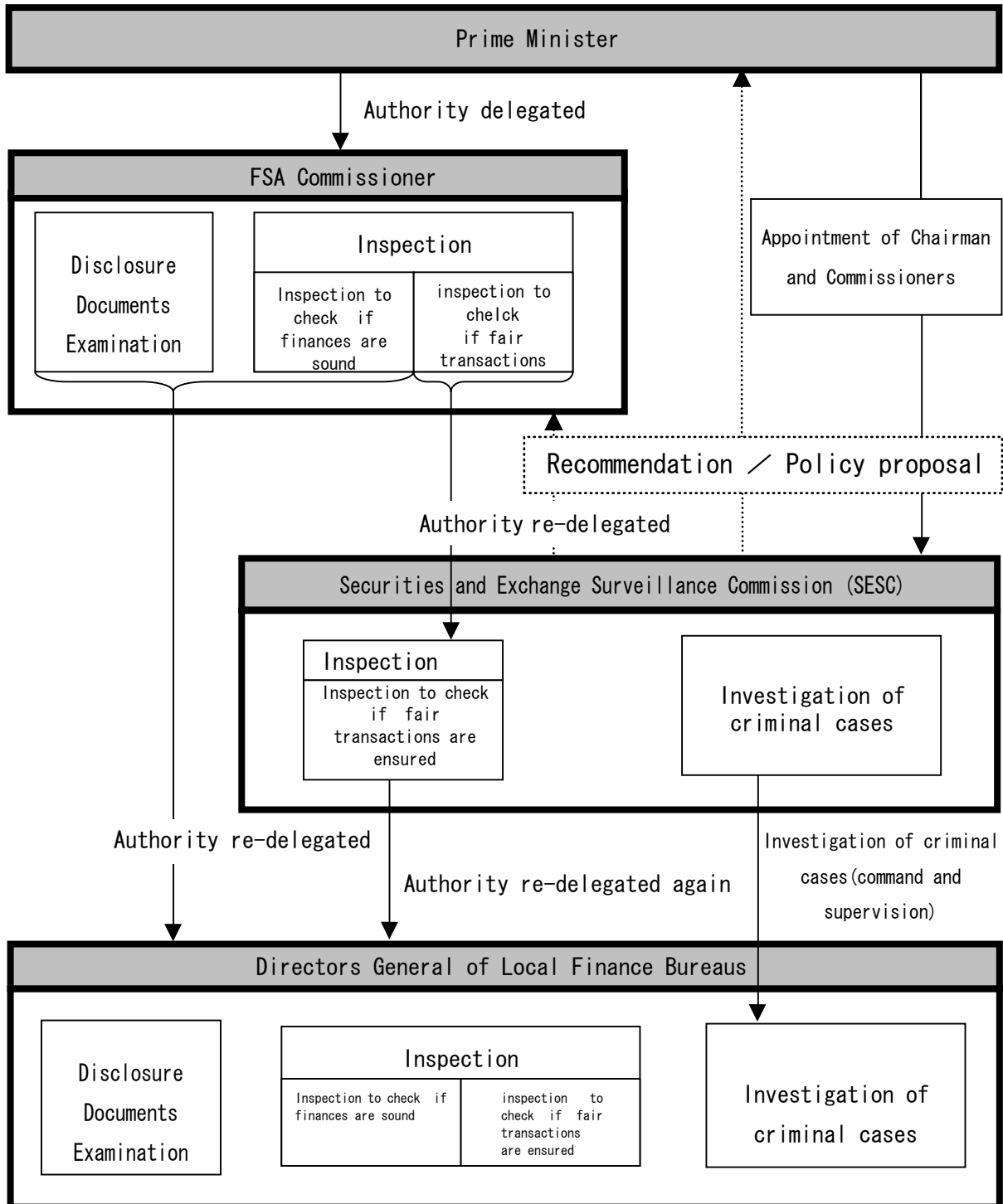
Conceptual Chart for Supervision of Securities Transactions



Note: Recommendations can be filed with the Prime Minister or the FSA Commissioner. Policy proposals can be filed with the Prime Minister, the FSA Commissioner or the Minister of Finance (Articles 20 and 21 of the Establishment Law).

Table3-1

Conceptual Chart of Relationship among the Prime Minister, FSA Commissioner, SESC, and Directors General of Local Finance Bureaus
 (~March 31,2005)



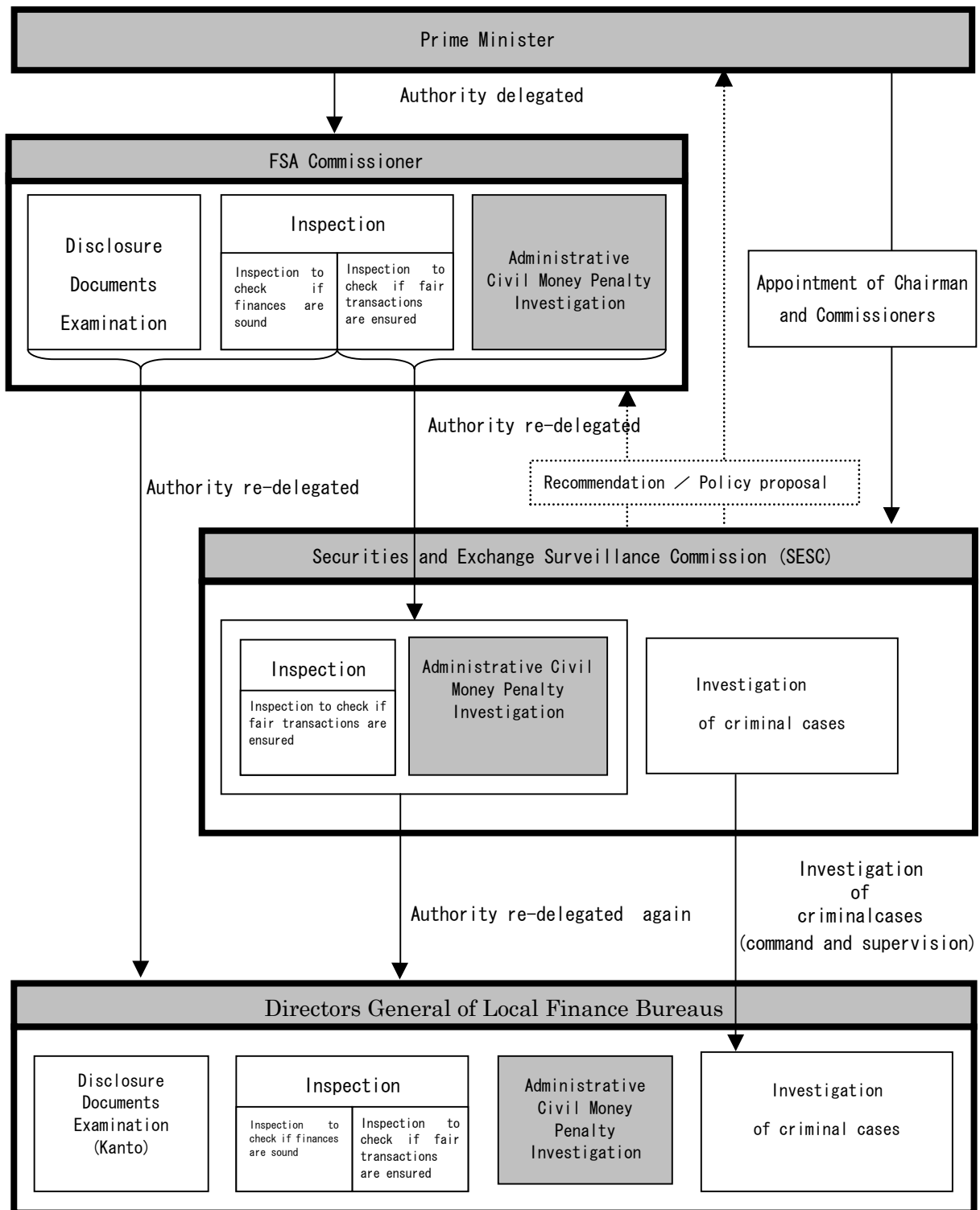
(Note 1) SESC officials have the authority to investigate criminal cases.

- Authority to conduct noncompulsory investigation of criminal cases (Article 210 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 106 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)
- Authority to conduct compulsory investigation of criminal cases
- (Article 211 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 107 of the Financial Futures Trading Law, Article 18 of the Personal Identification Verification Law)

(Note 2) FSA Commissioner shall exercise part of delegated his powers. SESC shall exercise all powers delegated.

Table3-2

(April 1, 2005~June 30, 2005)

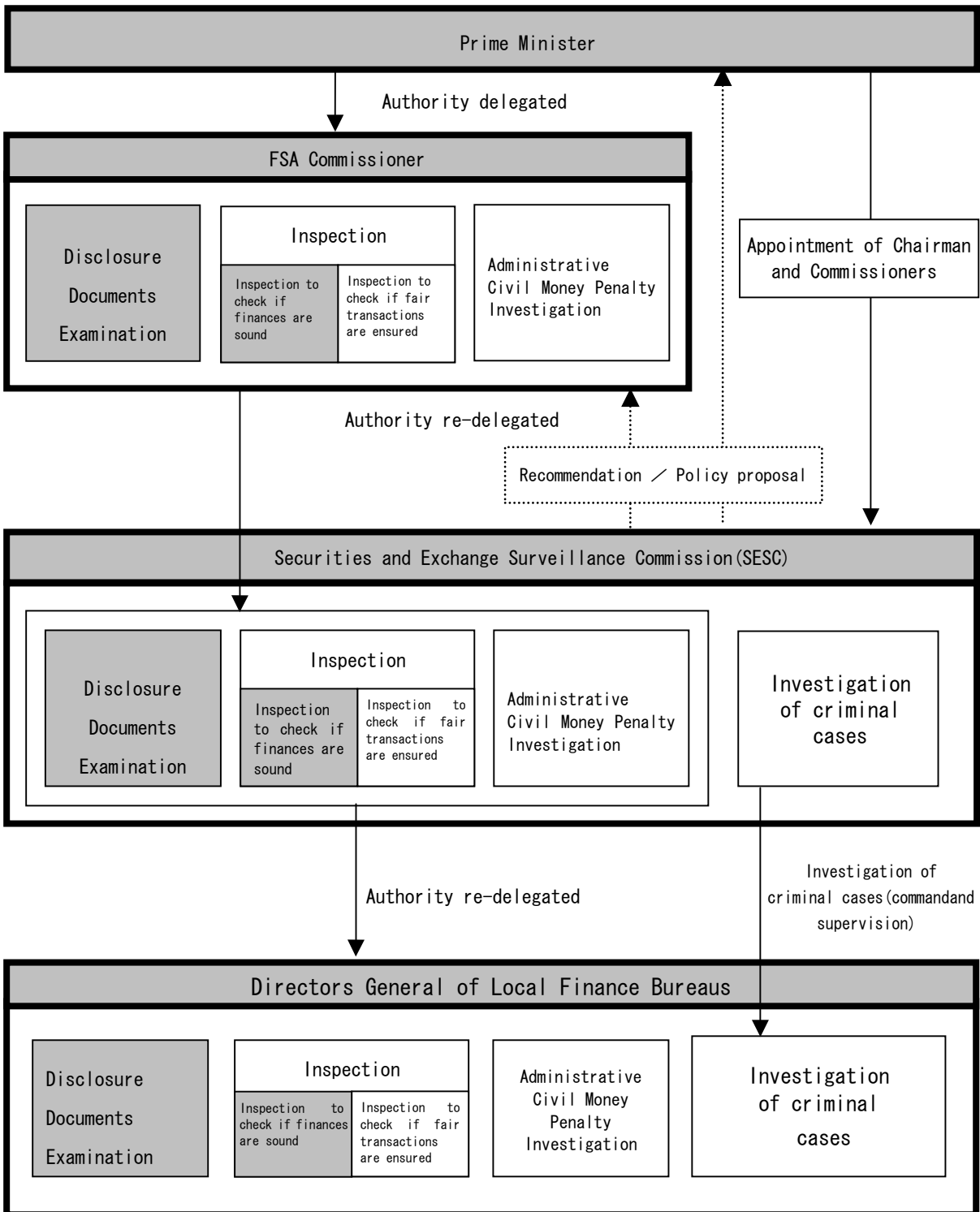


(Note1) SESC officials have the authority to investigate criminal cases.

- Authority to conduct noncompulsory investigation of criminal cases (Article 210 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 106 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)
- Authority to conduct compulsory investigation of criminal cases (Article 211 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 107 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)

(Note2) FSA Commissioner shall exercise part of delegated his powers. SESC shall exercise all powers delegated.

Table3-3
(July 1, 2005~)



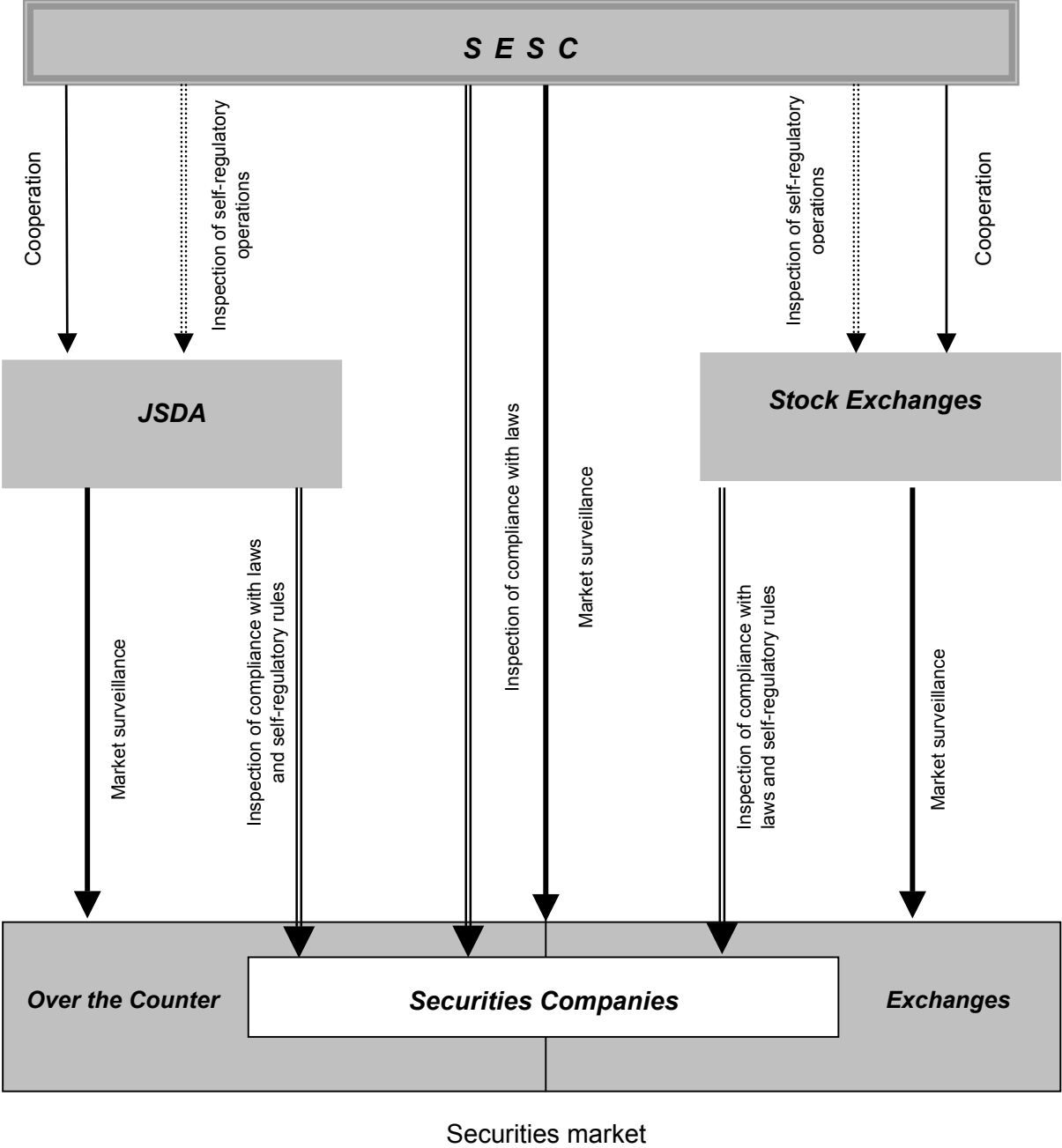
(Note1) SESC officials have the authority to investigate criminal cases.

- Authority to conduct noncompulsory investigation of criminal cases (Article 210 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 106 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)
- Authority to conduct compulsory investigation of criminal cases (Article 211 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 107 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)

(Note2) FSA Commissioner shall exercise part of delegated his powers. SESC shall exercise all powers delegated.

Table 4

Relationship to Self-Regulatory Organizations



Note: The same system applies to financial futures.

**Outline of Main Cases for which Recommendations
were Issued in the 2004 SESC Year**

Summary of Major Cases of Recommendations in the 2004 SESC Year

Date of Recommendation Month/Day/Year (Category)	Description of Violations of Laws or Regulations That Led to Recommendations	Description of Administrative Disciplinary Measures, etc.
September 14, 2004 (Inspection)	<p>◎ The Act of Making Misleading Statements with Respect to Material Facts in Connection with the Handling of Private Placement of Securities</p> <p>In connection with private placement of structured notes (which are notes issued with various conditions attached to meet the investment objectives of individual clients) in the course of their business operations, two vice presidents of the Second Sales Dept. at the Marunouchi Branch of Citibank, N.A. made statements that are bound to mislead investors with respect to certain material facts by distributing to multiple clients certain solicitation materials that do not properly describe the product features of the notes.</p> <p>○The Act of Handling Private Placement as a Condition for Granting Credit</p> <p>The Marunouchi Branch of Citibank, N.A. in its private banking operations, handled private placement as a condition for granting credit by soliciting specific clients to apply for the purchase of structured notes while concurrently offering to lend money to the clients for the purchase of the notes. By having the clients acquire the notes as a condition for the loan, the bank handled private placement as a condition for granting credit.</p>	<p>Disciplinary Measures Taken Against the Company Business Improvement Order</p> <ul style="list-style-type: none"> • To expand and strengthen the internal control system • To establish and implement recurrence prevention measures, and clearly define responsibilities • To expand and strengthen the compliance system • To fundamentally reexamine and construct the system to ensure proper investment solicitation (including an expansion and strengthening of a system to review advertisement, etc.) <p>• To submit improvement plans concerning the foregoing and promptly implement them.</p> <p>To provide a quarterly report on the progress and implementation of the plan and the status of improvement.</p> <p>Disciplinary Measures Taken Against Officers and Employees (Registered Securities Traders)</p> <ul style="list-style-type: none"> • Two vice presidents of the Second Sales Dept., at the Marunouchi Branch A three-week suspension from work

○ Supporting Facts for the Recommendations concerning Citibank, N.A. Tokyo
Branch

1. The Act of Making Misleading Statements with Respect to Material Facts in Connection with the Handling of Private Placement of Securities

The Marunouchi Branch of the said registered financial institution handles private placement of structured bonds, which are issued with various conditions attached to meet the investment objectives of individual clients. In connection with the handling of such private placement, the following situations were found, which constitute an act of making misleading statements with respect to material facts:

(Case 1)

During the course of solicitation for structured notes between June 4, 2003 and August 28 of the same year, Vice President A of the Second Sales Dept. at the branch made misleading statements to two clients by furnishing solicitation literature and led the clients to believe, incorrectly, that the structured notes could be sold at any time at an approximate set price before they reach maturity, even though the bonds actually had low liquidity and were difficult to sell at a set price before their maturity.

(Case 2)

During the course of solicitation for structured notes on July 4, 2003, Vice President B of the Second Sales Dept. at the branch made misleading statements to one client by furnishing solicitation literature and led the client to believe, incorrectly, that he was assured of the full value of the principal and interest payments when in fact there was a risk of the principal becoming impaired and interest payments being halted, due to foreign exchange rate fluctuations.

2. The Act of Handling Private Placement as a Condition for Granting Credit

- At the Marunouchi Branch of the said registered financial institution, the following case was found, which was an act of handling private placement as a condition for granting credit:

In April 2003, a salesman in the First Sales Department at the branch solicited a client who had wanted for a loan for an overseas investment applicable to acquire structured notes while at the same time proposing to increase the loan amount to cover the cost of acquiring the said structured notes. By so doing, he had the client acquire the structured notes as a condition for the loan.

Date of Recommendation Month/Day/Year (Category)	Violation of Laws or Regulations that Led to Recommendation	Description of Administrative Disciplinary Measures, etc.
October 8, 2004 (Inspection) (Kanto)	<p>③ The Act of carrying out a series of securities transactions to form an artificial market that does not reflect the true market trends.</p> <p>Between March 2003 and September of the same year and in the course of business operations, a senior dealer of the Second Dealing Team of Jujiya Securities Co., Ltd. carried out a series of buying and selling transactions in connection with shares of multiple listed stocks with the intention of moving the prices of the stocks in his favor. He did this by driving up the prices of the stocks by buying shares of the stocks, using either market or limit orders, followed by orders to buy at the best bid or a price below the best bid.</p>	<p>Disciplinary Measures Taken Against the Company</p> <p>Business Suspension Order</p> <ul style="list-style-type: none"> • A 15-day suspension of stock dealings. <p>Business Improvement Order</p> <ul style="list-style-type: none"> • To expand and strengthen the internal control system, and clearly define responsibilities. • To establish "recurrence prevention measures," such as an expansion and strengthening of the trading control system, and ensure that officers and employees are thoroughly informed of the measures. • To ensure that all employees are fully aware of the importance of compliance with laws and regulations by such means as seminars. • To provide a written report on the status of actions taken to the foregoing, and furnish a quarterly written report of their implementation status <p>Disciplinary Measures Taken Against Officers and Employees (Registered Securities Traders)</p> <ul style="list-style-type: none"> • A nine-week suspension from work

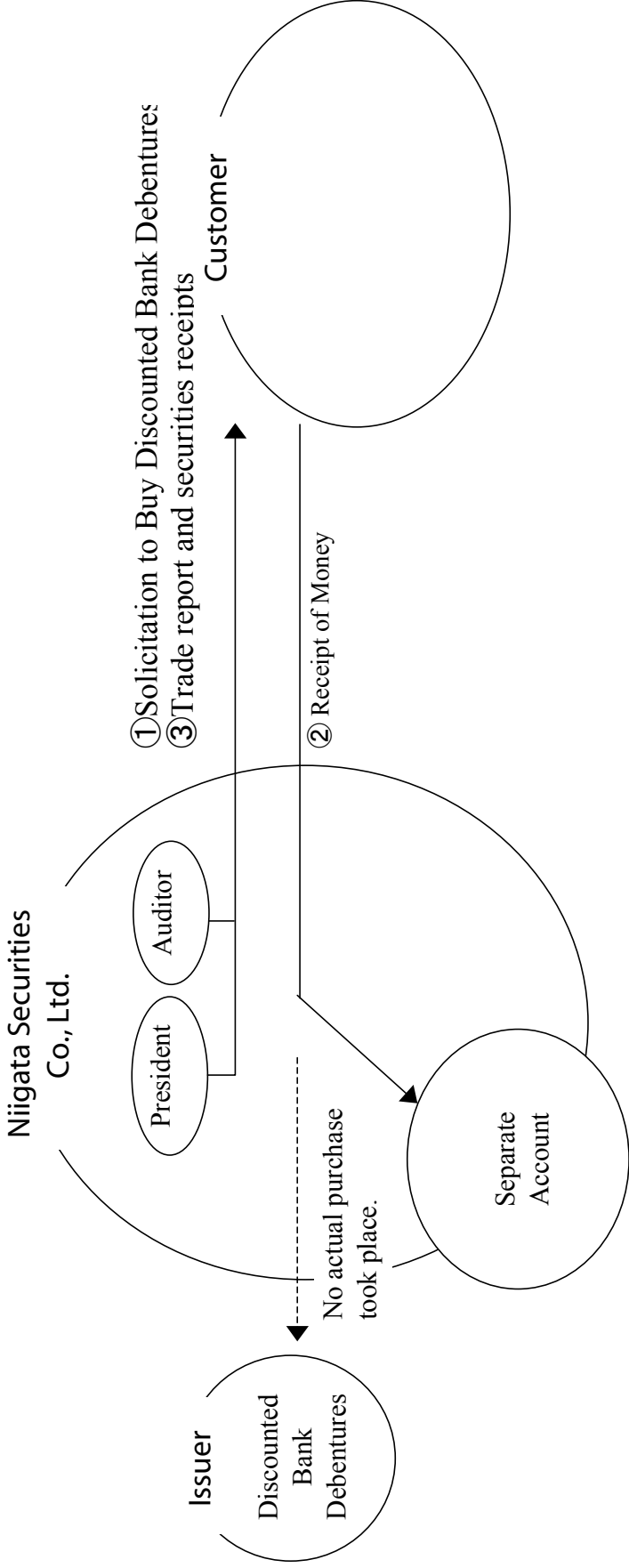
○ Supporting Facts for the Recommendations concerning Jujiya Securities Co., Ltd.

Jujiya Securities Co., Ltd. employed roughly the following trading techniques to carry out a series of buying and selling transactions in an attempt to create an artificial market that did not reflect the true market trends so as to gain profits by driving up the prices of four stocks and selling the positions that the company built for its own accounts at prices that were advantageous to the company:

- (1) The company bid up the price of the stocks by placing limit buy orders at high prices that exceeded the market or the most recent quoted prices.
- (2) After driving up the price by the method described in (1) above, the company placed sizable buy orders at or below the most favorable bid price at that point in time.
- (3) When buy orders began to be placed by other market participants at prices above the most favorable bid price, the company sold its acquired positions in sequence.
- (4) Once the positions it had acquired were completely sold, the company canceled all its yet-to-be executed buy orders referred to in (2) above.

Date of Recommendation Month/Day/Year	Violation of Laws or Regulations that Led to Recommendation	Description of Administrative Disciplinary Measures, etc.
December 22, 2004 (Inspection) (Kanto)	<p>© The act of making false statements in connection with securities trading or other types of transactions.</p> <p>Between January 1989 and August 2004, the president and another individual of Niigata Securities Co., Ltd. made a false statement to a number of clients regarding trading of discount bank debentures in the course of their business operations. They informed the clients that they intended to have the clients acquire such debentures when in fact they had no such intentions. Furthermore, they made a misrepresentation when they furnished trade reports and securities receipts containing false information when in fact there was no acquisition made.</p>	<p>Disciplinary Measures Taken Against the Company</p> <p>Business Suspension Order</p> <ul style="list-style-type: none"> • One-month suspension of entire securities operations at all offices. <p>Business Improvement Order</p> <ul style="list-style-type: none"> • To act properly in dealing with customers so as to protect investors. • To clearly define responsibilities and establish a responsible governance system. • To strengthen the checking function by the board of directors and the board of auditors and the internal control system, and establish "recurrence prevention measures" so as to eliminate violations of laws and regulations through such means as the construction of a proper audit system that includes external audits. • To ensure that all officers and employees are thoroughly aware of compliance with laws and regulations by providing training even during the period of business suspension at all offices. • To provide a written report of the actions taken with respect to the above, and furnish a quarterly written report of their implementation status. <p>Disciplinary Measures Taken Against Officers and Employees (Registered Securities Traders)</p> <ul style="list-style-type: none"> • Nullification of securities traders' registration

○ Supporting Facts for Recommendations concerning Niigata Securities Co., Ltd.



Introduction of Chairman and Commissioners



Chairman Takeo Takahashi

Before his appointment as commissioner of the SESC (1998), Mr. Takahashi served as chief prosecutor of the Tokyo District Public Prosecutors Office (1995–1997) and superintending public prosecutor of the Fukuoka High Public Prosecutors Office (1997–1998). In July 2001, he was appointed chairman of the SESC.



Commissioner Teruko Noda

Ms. Noda was appointed commissioner of the SESC in July 2001. Before being appointed to the commission, she served as a partner of Chuo Audit Corporation (now Chuo-Aoyama Audit Corporation).



Commissioner Takehiko Mizushiro

Mr. Mizushiro was appointed commissioner of the SESC in July 2004. Before being appointed to the commission, he served as a senior commentator of Japan Broadcasting Corporation.