

Report by the Working Group on Legislative Issues,
The First Subcommittee of the Sectional Committee on
Financial System of the Financial System Council

~Recommendations on the Administrative Monetary Penalty System~

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I . Introduction

In order to make the Japanese financial and capital markets more attractive, and to secure the trend of moving from savings to investment, it is important to enhance the credibility of the Japanese markets by improving the fairness and transparency of the markets. In order to improve the fairness and transparency of the markets, it is necessary to provide sufficient deterrence for violations in the financial and capital markets.

Administrative monetary penalties for market abuse and false statements in offering disclosure documents were introduced by the 2004 amendment of the Securities and Exchange Act, and the administrative monetary penalties for false statements in ongoing disclosure documents were introduced by the 2005 amendment of the same Act.

Twenty nine administrative orders to pay monetary penalties have been issued in the little over two years thereafter (22 cases of insider trading, four cases of false statements in offering disclosure documents, and six cases of false statements in ongoing disclosure documents). Though there cases, public awareness of the administrative monetary penalty system has been increasing, and there is a strong expectation that the system be further utilized.

II . Course of Deliberations, etc.

The supplementary provision of the 2005 amendment of the Securities and Exchange Act states: "The Government, within about two years, shall study the desirable system pertaining to administrative monetary penalty, including the calculation method of the penalty amount, the level of penalty amount and methods monitoring violations, taking into consideration the enforcement status of the administrative monetary penalty system following the amendment of the Act and changes in socioeconomic trends, etc., and take necessary measures based on the study results."

A review of the administrative monetary penalty system is also recommended in the Interim Report on Issues (compiled on June 13, 2007) prepared by the Study Group on the Internationalization of the Japanese Financial and Capital Markets, the First Subcommittee of the Financial System Council, and the 2007 Outline of Economic and Fiscal Policies (approved by the Cabinet on June 19, 2007).

It was decided at the meeting of the First Subcommittee of the Financial System Council held on October 3, 2007 that the review of the administrative monetary penalty system will be discussed by this Working Group. The Working Group deliberated on the desirable system for the administrative monetary penalty on 5 occasions since October 12. During the course of the deliberations, the characterization of the administrative monetary penalty system, the level of penalty amount, the scope of coverage, statute of limitation, and other issues were

studied, based on the attached discussion materials and other information. The results of the studies are reported as follows. It is desired that the authorities will proceed to establish necessary systems based on the ideas set forth in this report.

III . Characterization of the Administrative Monetary Penalty System

Administrative monetary penalties were introduced as an administrative measure to impose a monetary burden from the perspective of adequately deterring violations in the financial and capital markets, and ensuring the effectiveness of regulations.

When introducing the new penalty system, in order to prevent violations profiting from violations, the amount of profit was decided as the level of penalty amount. On this point, it was pointed out that, from the perspective of enhancing the effectiveness of regulations, there is no need to adhere to the profited amount. On the other hand, it was also suggested that because the administrative monetary penalty is not a punishment against antisocial behavior or violation of public moral, the penalty should not completely deviate from the profited amount. Further discussion is anticipated.

It is important to conduct necessary reviews of the nature of the administrative monetary penalty system along the lines indicated below from the perspective of further ensuring the effective deterrence of violations through the use of penalties, while making efforts to enforce the penalty system appropriately.

IV . Scope and Level of Administrative Monetary Penalties

Unfair Trading

1. Insider Trading

The administrative monetary penalty for insider trading should be raised to a more appropriate level from the perspective of ensuring effective deterrence of violations, in view of such facts as that the profit actually gained by the violators exceeded the penalties imposed in some cases in the past. For example, the calculation of the penalty amount is currently based on the closing price of the day after the announcement of material facts. However, a framework that reflects subsequent price fluctuations should be considered.

2. Market Manipulation

The administrative monetary penalty for market manipulation should be raised to a more appropriate level, in order to deter violations effectively. Currently the administrative monetary penalty applies only to market manipulation involving market fluctuation. The penalty should also be applied, for example, to illegal market stabilization and market manipulation involving wash sales.

3. Dissemination of Unfounded Rumors, Trading by Fraudulent Means

The administrative monetary penalty for the dissemination of unfounded rumors and trading by fraudulent means should be raised to a more appropriate level in order to deter

violations effectively.

The current penalty for the dissemination of unfounded rumors and trading by fraudulent means must be calculated based on the market resulting from the fluctuation caused by the rumor or fraudulent means. However, since the market is formed by a composite of various factors, it is very difficult to demonstrate that a certain market resulted from fluctuations caused by certain rumors or fraudulent means, which are only a few of the factors contributing to market formation.

In order to ensure flexible application of the system, the penalty should be calculated based on the market that was affected by the rumors or fraudulent means, and not the market resulting from the fluctuation caused by the violation.

4. Market Abuse on Others' Account

Under the current system, administrative monetary penalties on market abuse are applicable to violations committed on one's own account.

Market abuse is a violation that damages market discipline regardless of whose account it is committed on, and should be adequately deterred. Of the market abuse committed on the account of others, those that may be effectively deterred by imposing penalties should be subject to the administrative monetary penalties.

Violations of Disclosure Regulations

5. False Statements in Offering Disclosure Documents and Ongoing Disclosure Documents

The administrative monetary penalty for false statements in offering disclosure documents and ongoing disclosure documents should be raised to more appropriate levels, in order to deter violations effectively.

In the event that there are false statements in both an ongoing disclosure document and its amendment report, the false statements presumably pertain to different matters. Because there are adjustment provisions in the current system, the total amount of the penalty imposed for the two violations will be adjusted to be equal to the penalty for one violation. However, the adjustment provisions should be revised to enable the imposition of additional penalty for the false statement in the amendment report.

6. Failure to Submit Offering Disclosure Documents

As is the case for false statements, failure to submit offering disclosure documents for public offerings is a material violation involving financing through the deception of investors, and should be subject to administrative monetary penalty.

7. Failure to Submit Ongoing Disclosure Documents

Failure to submit ongoing disclosure documents is a violation where the issuer fails to provide necessary information to the financial and capital markets while utilizing said markets for financing. As such, this violation should also be subject to administrative

monetary penalty.

8. False Statements in and Failure to Submit Tender Offer Disclosure Document and Large Shareholding Disclosure Document

With the increase in the number and the diversification of cases of corporate mergers and acquisitions in recent years, it is becoming increasingly important that tender offer disclosure documents and large shareholding disclosure documents are submitted properly.

In view of the foregoing situation, false statements in and failure to submit tender offer disclosure documents and large shareholder disclosure documents should be subject to administrative monetary penalty.

V. Other Issues Concerning the Administrative Monetary Penalty System, etc.

1. Introduction of Systems for Increased and Reduced Administrative Monetary Penalties

From the perspective of adequately deterring violations a framework for increasing the amount of penalty should be implemented, for example, with respect to those who commit violations repeatedly.

As regards the administrative monetary penalty for violations by companies, it is important to encourage companies to establish a system for preventing and detecting violations internally on their own and to prevent repeating the violations in the future. Reduction measures should be implemented for violations that are likely to be repeated (e.g., insider trading involving treasury stock and false statements in offering disclosure documents and ongoing disclosure documents), in limited cases where the violating company detects the violation at an early stage and reports to the authorities.

2. Other Types of Violations

There is an issue as to whether violations of conduct of business regulations by financial instruments firms should be subject to administrative monetary penalty. Careful studies are further required regarding this point, in view of such matters as the characterization of the administrative monetary penalty system in Japan and consistency with administrative measures against violations of business regulations under other laws.

There is also an issue as to whether violations of Article 157 of the Financial Instruments and Exchange Act, which sets forth a comprehensive prohibition of market abuse, should be subject to administrative monetary penalty. The Japanese administrative monetary penalty system stipulates the calculation method for the penalty amount based on a clear definition of the violation subject to the penalty. Further, market manipulation, dissemination of unfounded rumors and trading by fraudulent means are already subject to administrative monetary penalty, and it is important that these penalties be utilized first. Based on the foregoing, careful studies are further required for including in the scope of penalties violations of Article 157 of the Financial Instruments and Exchange Act.

3. Statute of Limitation

From the perspective of enhancing effective deterrence by imposing penalties on past violations that have been identified, the statute of limitation should be extended from the current 3 years to, for example, 5 years.

4. Sanction Hearing Procedures

Sanction hearing procedures continue to play a significant role, as they provide the accused with the opportunity to explain themselves and enable the authorities to exercise caution in imposing penalty. As such, from the perspective of smooth and appropriate implementation of sanction hearing procedures, necessary reviews should be considered including, for example, requiring the accused to file notification of the address to which documents should be delivered in order to ensure that the authorities can determine the whereabouts of the accused.

5. Reinforcement of Investigation of Violation

In addition to the systemic reviews encompassing penalty levels and the scope covered by the administrative monetary penalty system, in order to deter violations, investigations by the Securities and Exchange Surveillance Commission, etc., should be reinforced to be more effective, and it should be ensured that such systems are fully utilized. From this perspective, efforts are being made, and should continue to be made, to reinforce the investigation and inspection systems of the Securities and Exchange Surveillance Commission pertaining to administrative monetary penalty cases and disclosure documents.