

Chapter 7

Self-Regulatory Organizations

I. Relationship between the SESC and SROs

SROs (such as securities dealers associations, stock exchanges, financial futures dealers associations and a financial futures exchange) conduct surveillance activities of their members and make self-regulatory rules to ensure the fairness and transparency of the market. These activities determine whether member companies operate appropriately according to laws, regulations and self-regulatory rules. In this manner, the SROs operate hand-in-hand with the SESC.

Nevertheless, the SESC assumes the right to inspect the activities of SROs to determine whether surveillance is conducted appropriately and whether SROs are imposing strict sanctions against members who violate laws, regulations and self-regulatory rules.

The SESC maintains close interactive relationships with SROs.

Following are activities reported by SROs:

Reference

After a series of securities scandals in the summer of 1991, the issue of the function of securities dealers associations and other SROs surfaced. As a result, the need to strengthen these functions was emphasized in a report by the Provisional Council for the Promotion of Administrative Reform (September 1991), a Diet resolution by the House of Representatives (September 1991) and the House of Councilors (October 1991), and a report by the Securities and Exchange Council (January 1992).

The Securities and Exchange Council report points out that securities market regulations should be handled by related parties because of the highly specialized nature of securities transactions and the need to cope with changes.

Based on the opinions described above, the SEL and other regulations were amended to strengthen the function of SROs.

II. Activities of the Japan Securities Dealers Association

The activities of the JSDA during fiscal 1993 (April 1, 1993, to March 31, 1994) were as follows:

1. Entrance of special members

The JSDA revised its charter and made necessary amendments to various rules to enable financial institutions licensed to provide securities services to join the association. This activity corresponded with the amended SEL (which took effect in July 1992), which provides for a self-regulatory system. As a result, 244 certified financial institutions licensed to provide securities services joined the JSDA as special members on April 1, 1994.

The JSDA also entered contracts with six special member groups, such as the Federation of Bankers Association of Japan, delegating to them a part of its self-regulatory authority, including surveillance of special members. In addition, the association made plans to prepare special members for the surveillance system by educating them about the system and dispatching responsible staff from special member groups.

2. Status of surveillance

(1) Primary surveillance topics

Topics of supervision of association members include sales practices, such as accepting transaction orders; compliance with rules related to prohibited acts during securities transactions; management of securities transaction orders; execution, delivery and custody of securities transactions; and internal control systems.

(2) Conduct of surveillance

In general, surveillance is conducted every two years. In fiscal 1993, surveillance was conducted on 130 companies: 105 domestic and 25 foreign securities companies.

Table 5: JSDA Market Surveillance

(Unit: companies)

Classification	Fiscal 1992 April 1, 1992 to March 31, 1993	Fiscal 1993 April 1, 1993 to March 31, 1994
Domestic securities companies	109	105
Foreign securities companies	21	25
Total	130	130

(3) Summary of results

Surveillance during fiscal 1993 uncovered cases of delays in creating customer cards and omissions of necessary items on these cards as well as on registration cards related to insider trading. In addition, some cases involved delays in the collection of confirmation statements, in the delivery and collection of securities depository receipts, and in employee retraining. In these cases, incomplete internal control systems were found, as were violations of regulations on operating activities and customer management.

In cases in which improvement was particularly necessary, in addition to directing member associations the SESC requested that these members report on improvements in the situation.

3. Conducting securities market surveillance

(1) Summary of surveillance

It is the duty of the Over-the-Counter Transaction Management Office, which is responsible for surveillance of securities transactions, to monitor stock prices and trading volume as well as to collect information on members' participation in transactions. When necessary, the office conducts close surveillance when it observes irregularities in securities transactions. Alternatively, the

office investigates when the Operational Division's Over-the-Counter Section reports on information having a wide-ranging influence on stock prices.

The office maintains close relationships with these sections in the area of market surveillance. After the office obtains results of initial surveillance, as necessary it requests that the Surveillance Section conduct further investigation.

(2) Surveillance results

Surveillance was conducted in fiscal 1993 as follows:

Issues surveyed (selected and falling under specific criteria): 1,782 issues

 Manipulation: 858 issues

 Insider trading: 917 issues

 Others: 7 issues

Issues investigated (requiring more detailed investigation based on results of surveillance): 41 issues

 Manipulation: 21 issues

 Insider trading: 18 issues

 Others: 2 issues

In addition to the surveillance activities described above, the office monitored real-time price movements to prevent other inappropriate acts from occurring.

Table 6: Market Surveillance by the JSDA

(Unit: issues)

Classification	Fiscal 1992 April 1, 1992 to March 31, 1993		Fiscal 1993 April 1, 1993 to March 31, 1994	
	Surveillance	Investigation	Surveillance	Investigation
Insider trading	654	12	917	18
Others	15	15	7	2
Total	1,114	29	1,782	41

Note: "Surveillance" refers to cases that met certain criteria for conducting surveillance. "Investigation" indicates cases surveyed that required more detailed surveillance.

(3) Summary of surveillance results

When inappropriate securities transactions are uncovered through surveillance, according to its charter the office takes measures against the members involved.

In addition, when securities transactions are suspected, but not proven, to be inappropriate, the office cautions the members involved. The office also provides necessary directions for the acceptance or carrying out of orders that will ensure fairness in over-the-counter price formation.

(4) Summary of measures taken against association members

Measures that the JSDA can take with the approval of its board of directors include cautions, penalties up to ¥100 million, the suspension or limitation of membership for a period not to exceed six months, or the revocation of membership.

After holding hearings for the members concerned, the association can take these measures in cases of violations of laws, regulations or membership rules, or against members whose actions violate the faith of transactions. These actions fall within the purview of Article 25 of the JSDA Charter, based on which the measures are taken. During fiscal 1993, seven penalties, totaling ¥84 million, were imposed according to this article. Five of these penalties, totaling ¥58 million, were imposed in conjunction with disciplinary actions based on SESC recommendations. The two other penalties totaled ¥26 million.

III. Activities of Stock Exchanges

Following are the activities of stock exchanges in fiscal 1993 (April 1, 1993, to March 31, 1994):

1. Status of inspections

(1) Primary inspection topics

Topics of supervision of stock exchange members and special participants include sales practices, such as accepting transaction orders; compliance with rules related to prohibited acts during securities transactions; management of securities transaction orders, deliveries, and custody; and internal control systems.

(2) Conduct of inspections

Inspections are conducted approximately every two years. In fiscal 1993, inspections were made of 72 companies in the TSE (55 domestic securities companies, 11 foreign securities companies and six special member companies), and 19 domestic securities companies in the Osaka Securities Exchange (OSE).

Table 7: Inspections by Stock Exchanges

(Unit: companies)

Classification	TSE		OSE	
	Fiscal 1992	Fiscal 1993	Fiscal 1992	Fiscal 1993
Domestic securities companies	49	55	18	19
Foreign securities companies	13	11	—	—
Special member companies	4	6	—	—
Total	66	72	18	19

(3) Summary of inspection results

The results of inspections carried out by the TSE and OSE in fiscal 1993 reveal many incidents of the following events: commission collection errors and deposit shortages of additional amounts as consignment guarantee money.

According to the results of inspections, stock exchanges requested their members and special participants to submit reports and provided directions as necessary for the improvement of operational disposition and internal control systems in cases of violations of laws and regulations.

2. Conducting securities market surveillance

(1) Summary of surveillance

Taking the TSE as an example, the Department of Market Surveillance and Compliance conducts investigations and surveys of issues selected by examining collected market information, issues notified by the Stock Market Department and Bond Market Department as abnormal in their trading, and issues reported by the Office of Listings Supervision as discharging material information influencing investment decisions. As necessary following these surveys, the TSE requests its Member Firm Inspection Department to undertake special inspections. Thus, the Department of Market Surveillance and Compliance works on market surveillance in close cooperation with these departments.

(2) Surveillance results

The total numbers of issues investigated by the TSE in fiscal 1993 are as follows:

Issues surveyed (selected and falling under specific criteria):	2,104 issues
Manipulation:	265 issues
Insider trading:	1,767 issues
Others:	72 issues
Issues investigated (requiring more detailed investigation based on results of surveillance):	226 issues
Manipulation:	133 issues
Insider trading:	64 issues
Others:	29 issues

In addition, the Stock Market Department and the Bond Market Department also monitor real-time price movements to prevent inappropriate activities from occurring.

Table 8: Market Surveillance by the TSE

(Unit: issues)

Classification	Fiscal 1992 April 1, 1992 to March 31, 1993		Fiscal 1993 April 1, 1993 to March 31, 1994	
	Surveillance	Investigation	Surveillance	Investigation
Insider trading	1,690	52	1,767	64
Others	19	5	72	29
Total	2,543	171	2,104	226

Note: "Surveillance" refers to issues selected that met certain criteria for conducting surveys. "Investigation" indicates issues surveyed that required more detailed surveillance.

(3) Summary of surveillance results

When inappropriate transactions are uncovered through surveillance, stock exchanges impose sanctions against the members involved in view of preventing such transactions.

In addition, when securities transactions are suspected but not proven to be inappropriate, stock exchanges issue cautions to the concerned members.

Furthermore, stock exchanges provide necessary directions for the acceptance of orders that will ensure fairness in price formation.

3. Summary of sanctions against members

If the stock exchange deems that a member has violated laws and regulations or just and equitable principles of trade, the exchange may, after providing the opportunity for a hearing from the member, impose sanctions such as: a fine of up to ¥100 million; censure; suspension from or restriction on transactions in the market of the exchange; suspension of membership for up to six months; and revocation of membership.

Pursuant to the constitution of the stock exchange, if a member undergoes disciplinary actions, such as business suspension, business restriction or license revocation, based on the extent of the above disciplinary actions, the exchange shall suspend or restrict said member's transactions in the market of the exchange or revoke exchange membership.

Sanctions by the TSE in fiscal 1993 included six fines totaling ¥51 million and five cases of restrictions on transactions in the market of the exchange.

Of this total, five fines totaling ¥46 million and five cases of restrictions on transactions in the market of the exchange were imposed based on disciplinary actions following SESC recommendations or inspections. In addition, one fine of ¥5 million was imposed that was not based on disciplinary actions following SESC recommendations or inspections.

Sanctions imposed by the OSE included one fine of ¥5 million and five cases of restrictions on transactions in the market of the exchange. These sanctions were all based on disciplinary actions following SESC recommendations.

IV. Activities of the Financial Futures Dealers Association of Japan

Following are the surveillance activities of the Financial Futures Dealers Association of Japan in fiscal 1993 (April 1, 1993, to March 31, 1994):

(1) *Primary surveillance topics*

Surveillance topics regarding association members include management of acceptances of transaction orders; management of customers' margins; and compliance with rules concerning regulating financial futures transactions.

(2) *Conduct of surveillance*

In fiscal 1993, surveillance activities were carried out on 13 member companies (six banks, three securities companies, four call loan and discount companies and other companies).

(3) *Summary of surveillance results*

The following incidents were discovered during surveillance activities in fiscal 1993: omission of necessary items on customer management cards and insufficient management of agreements to set up transaction accounts. The association advised the members involved to correct these points.

Table 9: Market Surveillance by the Financial Futures Dealers Association of Japan

(Unit: companies)

Classification	Fiscal 1992 April 1, 1992 to March 31, 1993	Fiscal 1993 April 1, 1993 to March 31, 1994
Banks	—	6
Securities companies	—	3
Call loan and discount companies	1	2
Others	—	2
Total	1	13

Note: "Call loan and discount companies" refers to call loan and discount companies and foreign exchange brokers. "Others" includes futures companies and Shinkin banks.

V. Activities of the Financial Futures Exchange

Following are the activities of the Financial Futures Exchange in fiscal 1993 (April 1, 1993, to March 31, 1994):

1. Inspection systems

Regarding inspections of members, the Financial Futures Exchange is currently studying such items as what topics should be covered and how inspections should be carried out under inspection regulations. The exchange plans to establish and launch its inspection system during fiscal 1994.

2. Activities of the Surveillance Section

All transactions of members in the market are monitored by computer software specially developed for exchange surveillance. Hearings for members are held as required.

Chapter 8

Cooperation with Securities Regulatory Authorities Overseas

Along with the increasing internationalization of securities transactions, misconduct regarding fairness in markets around the world have been occurring at the cross-border level. As a result, close ties and international cooperation in legal enforcement have become increasingly important to ensure the fairness of markets.

Given this situation, in October 1993 the SESC joined the International Organization of Securities Commissions (IOSCO), members of which cooperate together to ensure better regulation of markets, on the domestic as well as the international level, in order to maintain just and efficient markets, and exchange information on their respective experience in order to promote the development of domestic markets. In October 1993, the SESC attended the 18th annual conference of IOSCO, held in Mexico City. In October 1994, the SESC, together with the Securities Bureau of the Ministry of Finance, will host the 19th annual conference in Tokyo.

Note: IOSCO membership comprises 110 institutions from 68 countries, provinces and regions worldwide.

In November 1993, the SESC, together with the Securities Bureau of the Ministry of Finance, attended the regular meeting with the U.S. Securities and Exchange Commission (SEC) in Washington, D.C. In April 1994, the SESC participated in a trilateral meeting attended by Japan (SESC and the Securities Bureau of the Ministry of Finance), the United States (SEC) and the United Kingdom (HM Treasury and the Securities and Investments Board).

The SESC will continue to exchange information and opinions with IOSCO members and at bilateral or multilateral meetings with overseas regulatory authorities.

Chapter 9

Other Activities

I. Receiving Information from the General Public

1. Information receiving system

Visits by and telephone calls and letters from the general public are useful sources of information for inspections, market surveillance activities and investigations of criminal offences. Therefore, since its establishment the SESC has actively sought information from the general public. The SESC is also establishing a system for receiving such information.

2. Status of information receipt

The SESC received 403 items of information from the general public in SESC year 1993 (234 telephone calls, 123 letters and 46 visits).

Information is diverse and includes that related to problems in transactions with securities companies, stocks for which manipulation is suspected, and opinions directed toward the SESC and the Ministry of Finance. Information can generally be classified as follows:

Concerning specific stocks:	134 items
Concerning the sales practices of securities companies:	183 items
Opinions and inquiries about the SESC and the Ministry of Finance:	86 items

Information received is used in conducting inspections, market surveillance activities and investigations of criminal offences. Concerning information on problems between securities companies and investors, when concrete resolutions are requested, the SESC on occasion takes measures such as introducing matters to the Office of Security Complaint Consultation of the JSDA, where a system of claim management has been established.

Reference

The SESC received 497 items of information from the general public in SESC year 1992 (317 telephone calls, 148 letters and 32 visits).

Information can generally be classified as follows:

Concerning specific stocks:	149 items
Concerning the sales practices of securities companies:	190 items
Opinions and inquiries about the SESC and the Ministry of Finance:	158 items

II. Staff Training

Since its establishment in 1992, the SESC has striven to foster the expertise and improve the quality of its staff through seminars and on-the job training (OJT). Concerning staff education, the SESC holds intensive seminars immediately following personnel changes as well as seminars designed especially for managers. The SESC also sends staff to seminars of the SEC and Commodity Futures Trading Commission (CFTC) to learn surveillance skills overseas.

As part of this policy, under the budget for SESC year 1994 two investigators for securities and exchange are to be added to the Executive Bureau, while directors are to join the Kanto Finance Bureau (Tokyo) and Kinki Finance Bureau (Osaka). With these personnel, the SESC will be seeking to further strengthen its systems of surveillance.

Appendix

Organization and Functions of the Securities and Exchange Surveillance Commission

1. Background of Establishment

Following a series of securities and financial scandals in the summer of 1991, various arguments took place regarding systems of surveillance, especially for securities companies and the securities market.

Given this situation, the Prime Minister consulted with his Provisional Council for the Promotion of Administrative Reform about measures for the surveillance and appropriate functioning of the securities market. The council drafted the "Report of Basic Countermeasures for Unfair Securities and Financial Transactions" in September 1991, which referred to the necessity of establishing an independent commission as the organization responsible for surveillance according to Article 8 of the National Administration Organization Law. Proposals were also made concerning securities administration, based on the overall policy of "achieving a free, fair, transparent and sound securities market."

Considering from the viewpoint of the report and through opinions from various sectors, the Ministry of Finance examined methods of inspection and how a surveillance system should work in securities transactions. As a result, the Ministry of Finance introduced a bill entitled "Amendment to the SEL to Ensure Fair Securities Transactions" in February 1992. This amendment emphasized the foundation of a surveillance commission.

Following its submission to the 123rd regular Diet session, the bill passed both houses on May 29, 1992. Along with this bill's taking effect, the SESC was created on July 20, 1992.

2. Organization

The SESC was founded based on Ministry of Finance Establishment Law to survey securities transactions.

① Chairman and commissioners

The SESC comprises a chairman and two commissioners, and topics of proceedings are resolved by votes among the three members.

The chairman and commissioners have equal power and can exercise their authority independently.

The chairman and commissioners are appointed by the Minister of Finance with the consent of the Diet.

According to the law, on July 20, 1992, Toshihiro Mizuhara was appointed chairman, and Hidetaka Mihara and Masamichi Narita were named commissioners following the approval of the House of Representatives, on June 18, 1992, and the House of Councilors, on June 19, 1992.

The terms of the chairman and commissioners are three years, and they can run for reelection. In addition, they cannot be dismissed against their will except if certain judicial reasons exist.

Meetings of the SESC are held twice a week, in principle.

② Executive Bureau

The Executive Bureau comprises two divisions, the Coordination & Inspection Division and the Investigation Division, which are headed by the secretary-general and deputy secretary-general of the Executive Bureau. The number of personnel in the bureau is 86. Two investigators for securities and exchange were added under the 1994 budget.

- A. *The Coordination & Inspection Division comprises three sections: the Inspection, Market Surveillance and Coordination sections.*
- a. The Inspection Section is in charge of inspecting securities companies and financial institutions.
 - b. The Market Surveillance Section is responsible for watching over and analyzing market transactions.
 - c. The Coordination Section handles the general affairs of the SESC, including the creation of recommendations and proposals.
- B. *The Investigation Division is authorized to probe into suspected cases of criminal offences.*

③ Regional organization

Regional operations of the SESC are entrusted to the directors-general of regional finance bureaus. The directors-general conduct inspections and market surveillance mandated by the SESC. These officials also conduct investigations of criminal offences under the direction and supervision of the SESC.

In this situation, 118 staff are allocated to regional finance bureaus, including directors responsible for surveillance of securities and exchange.

Also, in the 1994 budget two directors were allocated, one to the Kanto Finance Bureau (Tokyo) and one to the Kinki Finance Bureau (Osaka). These directors have strengthened the surveillance system at regional finance bureaus.

Note: The SESC delegates its authorities of inspection and materials collection to the directors-general of regional finance bureaus, except in the case of securities companies and financial institutions licensed to provide securities services supervised by the Ministry of Finance. (However, if necessary the SESC can exercise its authority to inspect or collect materials from any institution under its authority.)

3. Outline of SESC Functions

① Surveillance activities

The activities of the SESC comprise inspections, market surveillance and investigations of criminal offences.

A. *Inspections*

To ensure fairness in both securities and financial futures trading, the SESC can inspect securities companies, financial institutions and SROs, such as stock exchanges and the JSDA.

B. *Market surveillance*

Together with stock exchanges and the JSDA, which also supervises the OTC market, the SESC watches over and analyzes daily securities transactions. In the event of a drastic rise or drop in a stock's price, for instance, the SESC will analyze the cause and check for any improper activities.

C. Investigations of criminal offences

The SESC can investigate suspected criminal offences, including insider trading, market manipulation, loss compensation or guarantees, and violations of disclosure regulations. In an investigation, the SESC may obtain legal warrants to search the target premises and seize evidence.

② Recommendations and proposals

A. Recommendations

Based on the results of inspections and criminal investigations, when the SESC has evidence that a company is conducting improper activities, it can recommend the Minister of Finance to take disciplinary actions against the company. The Minister of Finance is obligated to respect this recommendation and, on request, to report back to the SESC on any disciplinary measures taken.

B. Proposals

Based on the results of inspections and investigations of criminal offences, the SESC can propose policies to the Minister of Finance if the SESC finds them necessary to ensure fair trading in securities and financial futures.

③ Accusations

Based on the results of inspections and investigations of criminal offences, if the SESC believes that a crime has been committed, it will make accusations about the suspect to the Public Prosecutor's Office.

④ Operations concerning inspections conducted by the Minister of Finance

From the standpoint of a neutral third party, the SESC handles the following matters:

A. Opinions for annual policies and other basic points in conducting inspections of the Ministry of Finance

B. Receiving quarterly reports concerning the conduct of inspections

C. Proposals concerning the operation of inspections and other policies

⑤ Reports of activities

The SESC publicizes its activities in an annual report.

Diagram 1

SESC Organization Chart

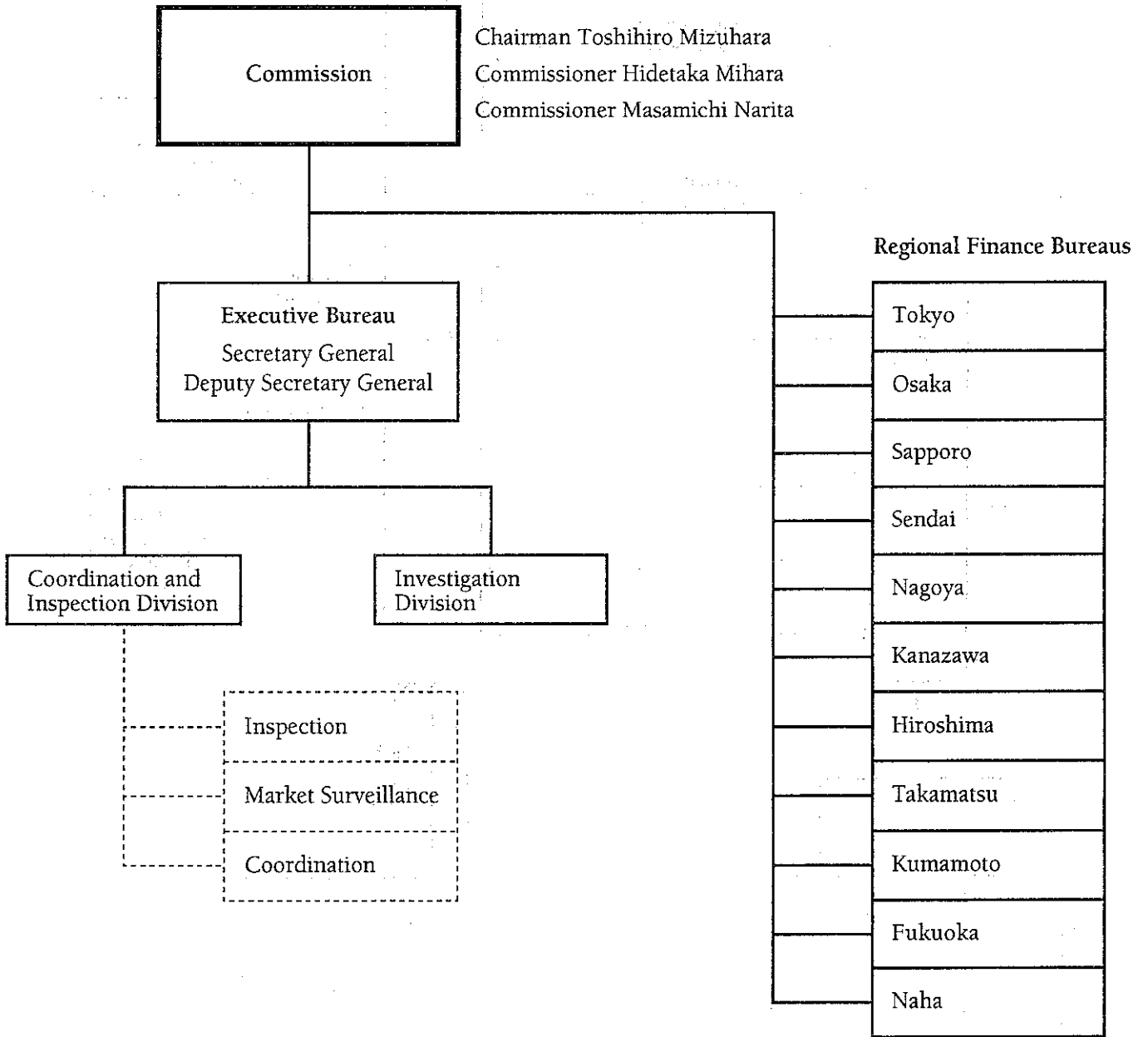


Diagram 2

Relationship between the Minister of Finance and the SESC

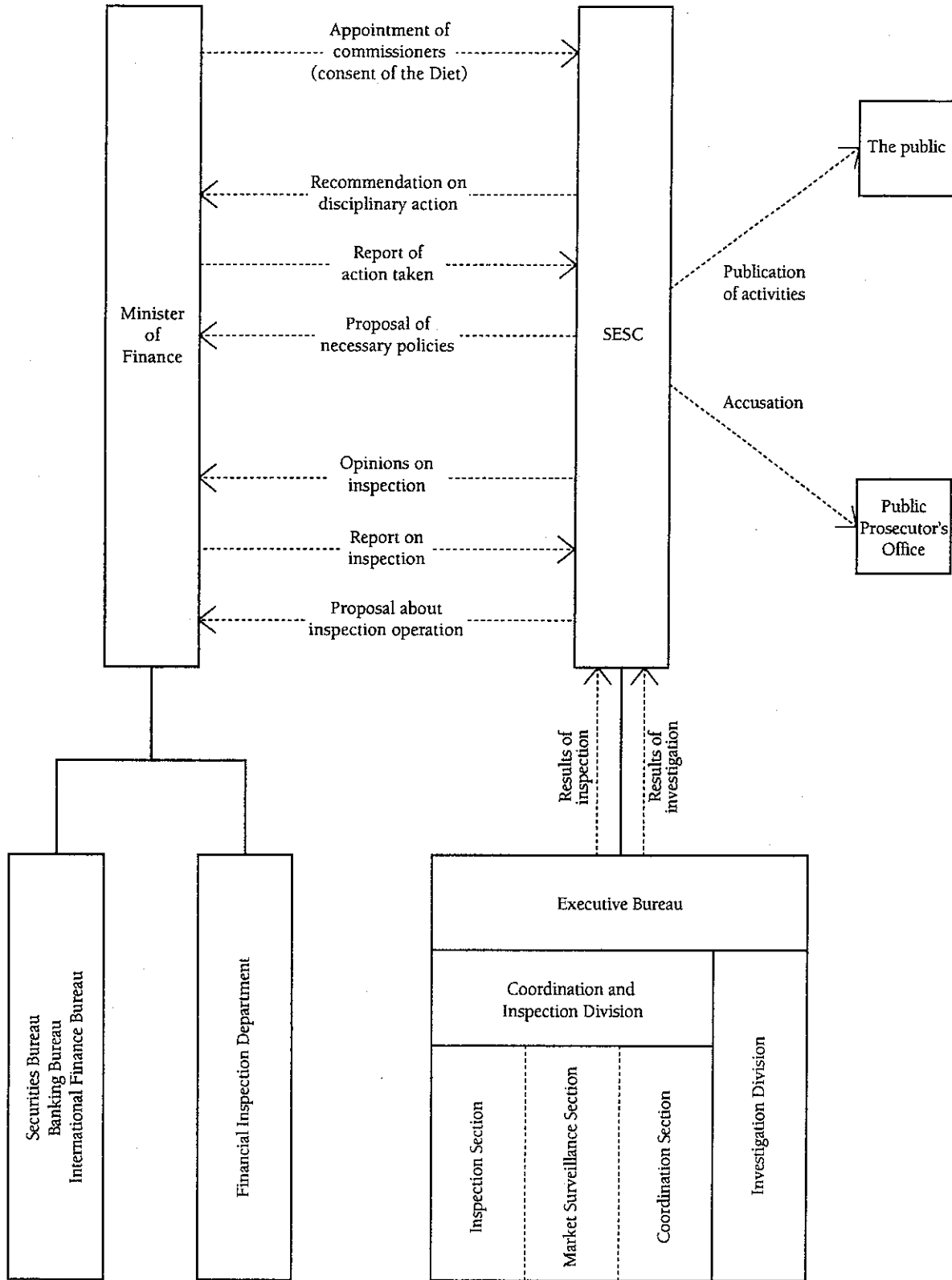


Diagram 3
Surveillance Framework

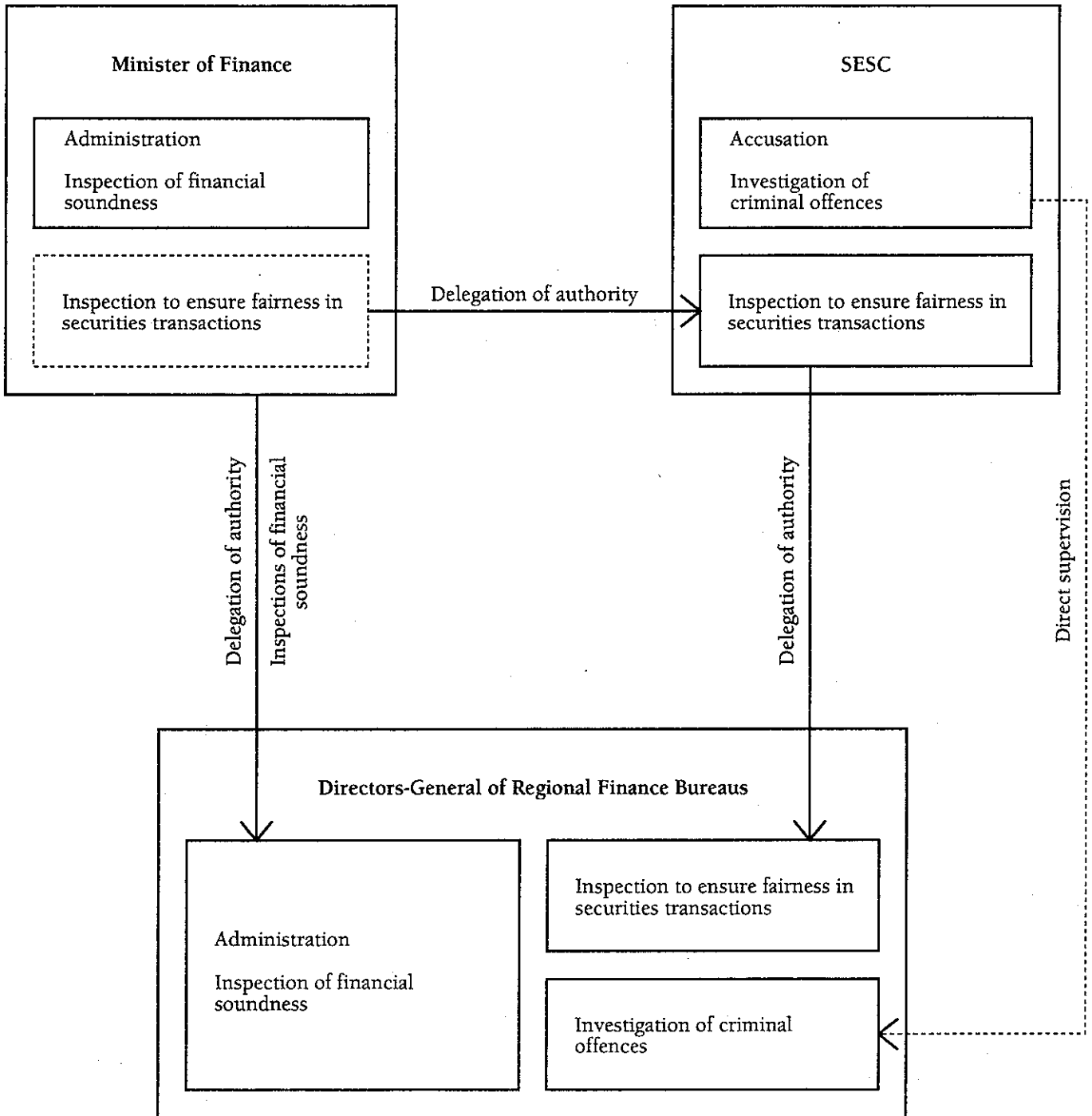
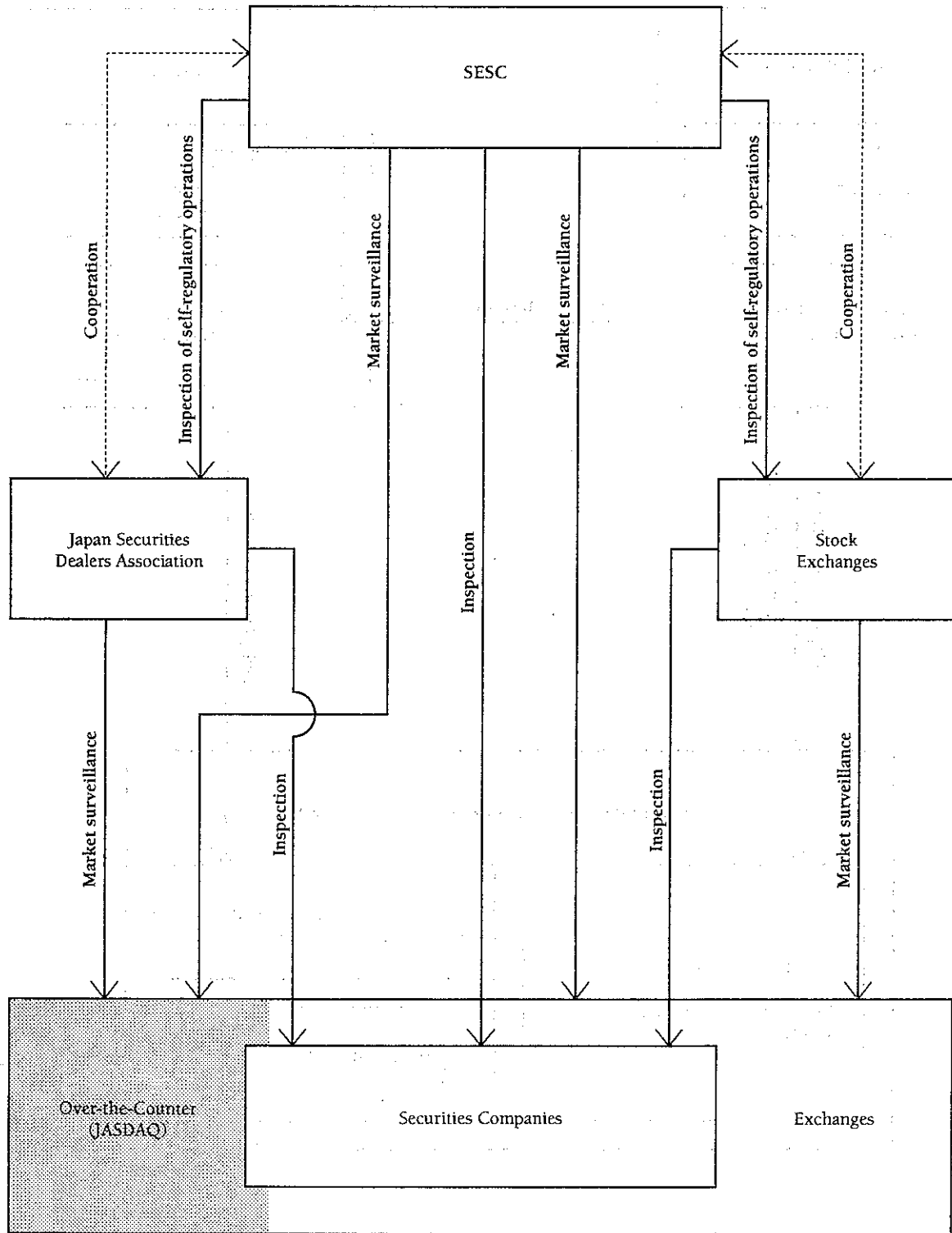


Diagram 4

Relationship between the SESC and SROs



Securities market

Note: This relationship is the same for financial futures transactions.