

Message from the Chairman

I am very pleased to present this summary of the activities of the Securities and Exchange Surveillance Commission (SESC).

In accordance with the law, the SESC describes its activities in an annual report. This English-language publication is intended to familiarize readers with the SESC by outlining its activities, including its organization and the background of its establishment. It is based on the Japanese-language annual report for the period from July 1, 1994, to June 30, 1995 (SESC year 1994), which was released in October 1995.

The SESC was established on July 20, 1992, as an independent agency charged with ensuring fair securities and financial futures transactions, thus maintaining the confidence of investors in these markets.

The SESC is an organization based on a council system comprising a chairperson and two commissioners. Commission members are appointed by the Minister of Finance with the approval of the Diet, but the chairperson and commissioners implement their authority independently. In addition to an Executive Bureau, which carries out the SESC's regular operating



Chairman: Toshihiro Mizuhara

functions, the organization includes regional offices that primarily conduct inspections of local securities companies.

With this organization, the SESC implements investigations of criminal cases of violating the fairness of transactions, inspections of securities companies and other institutions, and regular surveillance of securities markets. The SESC strives, through the appropriate execution of its responsibilities, to ensure market

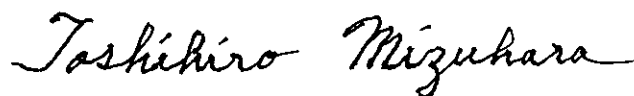
fairness and transparency, and contribute to the sound functioning of securities markets in Japan.

Specifically, based on provisions in the Securities and Exchange Law (SEL) and related legislation, the SESC has three main functions: ① investigations of criminal offences, which comprise non-compulsory investigations (inquiring, inspecting and provisional holding), and compulsory investigations (visiting, searching and seizing with legal warrants); ② on-site inspections of securities companies to supervise compliance with laws and regulations on the maintenance of transaction fairness; and ③ daily market surveillance of securities transactions based on information and reports from securities companies and self-regulatory organizations (SROs).

In addition, in accordance with the globalization of securities transactions and in view of the growing importance of international cooperation and cross-border law enforcement collaboration to ensure

fairness in securities markets in Japan, in October 1993 the SESC joined the International Organization of Securities Commissions (IOSCO) as an associate member. Also, the SESC actively participates in bilateral and multilateral meetings of foreign regulatory authorities together with the Securities Bureau of the Ministry of Finance. Through these activities, we will continue to actively exchange opinions and information.

It is my sincere hope that this report will facilitate public understanding of the SESC and the importance of its activities in securities markets.



Toshihiro Mizuhara

Chairman

Securities and Exchange Surveillance Commission

November 1995

Summary

The SESC's activities in SESC year 1994 (July 1, 1994, to June 30, 1995) are detailed throughout this report. Following are summaries of investigations of criminal offences, inspections and market surveillance activities conducted during this year.

(1) Investigations of criminal offences

With respect to investigations of criminal offences, one compulsory investigation was conducted on suspicion of "circulating rumors" (in an attempt to boost a certain stock price). Accusations of criminal offences were made to public prosecutors' offices under the Securities Exchange Law (SEL): two on suspicions of insider trading and one concerning the circulation of rumors.

As a result, since its establishment investigations by the SESC have resulted in a total of five accusations: one on the charge of market manipulation, one on the charge of submitting a securities report containing falsified information, two on charges of insider trading, and one on the charge of circulating rumors.

(2) Inspections

Securities companies and financial institutions licensed to provide securities services are subject to SESC

inspections. During SESC year 1994, inspections were commenced at 79 domestic and six foreign securities companies, and 11 financial institutions.

As a result, since its establishment the SESC has conducted a total of 236 inspections of domestic securities companies, 20 foreign securities companies and 35 financial institutions, meaning that the SESC has undertaken inspections of almost all the domestic securities companies.

In conducting inspections, the SESC puts priority on such matters as compliance with transaction rules, sales practices and internal control systems.

Based on its inspections, the SESC found the following facts: ① failure to comply with transaction laws, regulations and self-regulatory rules regarding the accepting of discretionary trading account transaction contracts; ② inappropriate aggressive solicitation for sales of foreign securities and convertible bonds, and improper sales practices that ignore the will of investors; and, ③ deficiencies in internal control systems due to insufficient awareness in observing transaction laws and regulations.

The SESC sent recommendations to the Minister of Finance to take appropriate measures against five

securities companies in which grave legal and regulatory violations by officers and/or employees were found related to the above points.

(3) Market surveillance

In SESC year 1994, the SESC conducted surveillance activities in 195 cases, including 111 of suspected manipulation, 62 of insider trading and 22 related to other matters. Since its establishment, the SESC has carried out surveillance activities in 582 cases, including 427 of suspected manipulation, 124 of insider trading and 31 related to other matters.

In conducting its market surveillance activities, the SESC examines how securities companies take part in specific securities transactions and whether said involvement violates the SEL and its regulations. The

SESC also oversees SROs, particularly whether they are properly performing their functions to monitor market activities.

Cases of surveillance related to manipulation included certain issues for which intense popularity was seen in spite of sluggish market activity, and for which prices surged suddenly and trading was conspicuous by specific agents, as well as on stocks that suddenly fluctuated at the end of the fiscal term. Regarding insider trading, amendments of expected business results by the issuing company, and the issuing of new stocks and mergers announced to cause sudden fluctuations in stock prices became the center of surveillance attention as the decisions of investors were possibly greatly influenced.

I. Outline

1. Significance of and authority for investigations of criminal offences

The authority for investigation of criminal offences was created especially for the SESC at its establishment. With this new authority, the SESC traces illegal actions violating laws and regulations, then calls for criminal prosecution through the making of accusations. This authority was created to ensure market fairness and soundness, as well as to protect investors.

Investigations of criminal offences are carried out by SESC staff by their particular authority under the SEL, the Law on Foreign Securities Firms (LFSF) and the Financial Futures Trading Law (FFTL), while inspections against securities companies and other related financial institutions are conducted under the authority delegated by the Minister of Finance. In addition, the SESC's authority is not limited to securities companies, but includes all parties involved in securities transactions, including investors themselves.

Specifically, the SESC staff may conduct noncompulsory investigations of criminal offences (SEL Article 210, LFSF Article 38(2), FFTL Article 106), including making inquiries of suspects and related parties, inspecting evidence obtained from those investigated and the provisional holding of relevant materials. The

SESC may also conduct compulsory investigations with legal warrants (SEL Article 211, LFSF Article 38(2), FFTL Article 107). Such investigations include visiting and searching the premises of suspects, and seizing related evidence.

2. Scope of criminal offences

The scope of criminal offences that violate securities transaction fairness prescribed in the relevant Cabinet Order is mainly offences involving the submission of securities reports with falsified information, providing loss compensation and guarantees on securities transactions, and committing market manipulation and insider trading.

The results of investigations are reported to the SESC by the investigating SESC staff. When convinced of a suspect's guilt, the SESC sends an accusation and delivers evidence seized during its investigations as well as lists of said evidence to public prosecutor's offices.

II. Status of Accusations of Criminal Offences

1. Investigations of criminal offences

During SESC year 1994, a compulsory investigation— including the visiting and searching of the premises of

suspects and related parties, and the seizure of evidence—was conducted in February 1995 based on the suspicion of circulating rumors regarding the stock of T.S.D. Co., Ltd.

2. Accusations

The SESC, according to the results of investigations of cases of possible SEL violations, sent a total of three accusations to public prosecutors concerning possible SEL violations, including two concerning suspicion of insider trading and one concerning the possible circulating rumors. These cases are summarized as follows.

(Case No. 1)

On October 14, 1994, the SESC, concerning the suspicion of insider trading in the stock of Nippon Shoji Kaisha Ltd., sent accusations against suspects (32 persons related to Nippon Shoji Kaisha) to the Osaka District Public Prosecutor's Office for offences under the SEL (Article 166(1), (3) "Prohibited acts of insiders").

Outline of facts

Nippon Shoji Kaisha, with stock listed on the Osaka Securities Exchange, put on sale in September 1993 a new medication developed and manufactured for the treatment of skin rashes. Patients who used this

medication together with fluorouracil applications succumbed as a result of the interaction of the two medications. An official public announcement was released revealing fatalities and a suspension of sales of the new medication.

(1) Suspect A and 25 other suspects, as employees of Nippon Shoji Kaisha, upon learning through the course of their duties the material facts that death had occurred from side effects of the new medication, sold their personal holdings of stocks prior to the public announcement of said material facts to avoid possible losses from a drop in the stock price of Nippon Shoji Kaisha.

(2) Suspect B and two other suspects were employees of Company A, which had a sales promotion contract with Nippon Shoji Kaisha. Suspect C was a director of Company B, which had business contracts with Nippon Shoji Kaisha. All of these suspects, upon learning of the material facts concerning Nippon Shoji Kaisha through the fulfilling of their contractual commitments, disposed of their holdings of stocks of Nippon Shoji Kaisha prior to the public announcement of the material facts to avoid possible losses from a drop in the stock price of Nippon Shoji Kaisha.

(3) Suspect D was informed of the material facts concerning Nippon Shoji Kaisha by Suspect A, who learned these facts through his work. Suspect D sold his stocks of Nippon Shoji Kaisha prior to the public announcement of the material facts to avoid possible losses from a drop in the stock price of Nippon Shoji Kaisha.

(4) Suspect E was informed of the material facts concerning Nippon Shoji Kaisha by an employee of Company X, who learned said material facts through contracts between Company X and Nippon Shoji Kaisha. Suspect E was convinced that the stock price of Nippon Shoji Kaisha would drop following the public announcement of the material facts. Then, in order to make an unfair profit, through margin transactions Suspect E sold stocks of Nippon Shoji Kaisha at a high price and, after the public announcement, repurchased them at a low price.

Note: On December 20, 1994, 25 persons (including one person who was not included in the SESC accusation) were charged with acts of insider trading in this case by the Osaka District Public Prosecutor's Office.

(Case No. 2)

On February 10, 1995, the SESC, concerning the suspicion of insider trading in the stock of Shinnihon

Co., Ltd., sent accusations against suspects (two companies, and three officers and employees) to the Tokyo District Public Prosecutor's Office for offences under the SEL (Article 166(1), "Prohibited acts of insiders").

Outline of facts

Promissory notes issued by Shinnihon, the stock of which was registered with the Japan Securities Dealers Association (JSDA), were not paid, owing to insufficient funds. Said promissory notes were dishonored in March 1994.

(1) Suspect Company A, which is a company that holds deposits, lends funds, etc., had a money loan contract with Shinnihon. Suspect B was an executive director and Suspect C was the financial division manager of Suspect Company A. Suspect B, in fulfilling the contractual obligations, and Suspect C, through his work, learned the material fact that a lack of funds had caused the nonpayment of promissory notes by Shinnihon. To avoid losses from the possible drop in the stock price of Shinnihon following the public announcement of said material fact, Suspects B and C sold the stocks of Shinnihon held by Suspect Company A.

(2) Suspect Company D sold and leased construction machinery and materials and had contracts with

Shinnihon. Suspect E was the representative director of Suspect Company D and learned the material fact in fulfilling contractual obligations. To avoid suffering losses from the possible drop in the stock price of Shinnihon following the public announcement of said material fact, Suspect E sold the stocks of Shinnihon held by Suspect Company D prior to the public announcement.

Note: On March 24, 1995, two companies and three persons were charged with acts of insider trading in this case by the Tokyo District Public Prosecutor's Office.

(Case No. 3)

On June 23, 1995, the SESC, concerning the suspicion of circulating rumors related to the stock of T.S.D. Co., Ltd., sent a formal accusation of misconduct against one person to the Tokyo District Public Prosecutor's Office for offences under the SEL (Article 158, "Prohibition of rumor circulation for the purpose of boosting a stock price").

Outline of facts

Suspect A was representative director of T.S.D., a software development company registered with the JSDA. Regarding Swiss-franc convertible bonds issued in October 1990 by T.S.D., Suspect A, to stimulate holders to convert the bonds into stocks prior to the date of maturity and avoid the implementation of rights to redeem said bonds, planned to raise the stock price of T.S.D. With this objective, in August 1992 during a news conference at the Tokyo Stock Exchange, although there were no supporting facts, Suspect A gave reporters the following false information: ① that T.S.D. had established a joint venture company in Thailand for the purpose of producing a vaccine for Acquired Immune Deficiency Syndrome (AIDS); ② that clinical tests were being implemented on said vaccine in Thailand under the supervision of T.S.D.; and ③ that T.S.D. had officially contracted with a national university in Russia for clinical testing and joint research of the AIDS vaccine.

Note: On July 26, 1995, one suspect was charged with acts of circulating rumors by the Tokyo District Public Prosecutor's Office.

I. Outline

According to the results of inspections and investigations of criminal offences, as deemed necessary the SESC can send recommendations to the Minister of Finance for disciplinary actions or other appropriate measures to ensure securities transaction fairness. (Ministry of Finance Establishment Law, Article 19(1)) Following are the contents of these recommendations classified by type:

- (1) For disciplinary actions against securities companies for legal violations;
- (2) For disciplinary actions against SROs, such as securities dealers associations and stock exchanges, which neglect to enact their authority and take necessary actions in cases of violations by securities companies and financial institutions licensed to provide securities services; and
- (3) Recommendations that the Minister of Finance instruct SROs to take appropriate measures when said SROs neglect to enact their authority and take necessary actions in cases of violations by securities companies and financial institutions.

The Minister of Finance must respect recommendations made by the SESC. The SESC can also request the

Minister of Finance to report on actions taken based on its recommendations.

After receiving recommendations for disciplinary actions, and based on the results of inspections and investigations by the SESC, the Minister of Finance holds hearings for securities companies and, when deemed valid, takes appropriate actions, such as suspending the operations of the accused company.

Matters concerned with the registration of sales representatives, including disciplinary actions against sales representatives, have been delegated by the Minister of Finance to the Japan Securities Dealers Association (JSDA). This association takes disciplinary actions in cases of illegal sales activities by securities companies. When deemed valid, the JSDA takes such measures as revoking sales representative registrations and suspending operations as sales representatives. These measures result from notifications by the Minister of Finance following hearings by the JSDA of the accused based on SESC recommendations and inspection results.

II. Status of Recommendations

In SESC year 1994, the SESC sent five recommendations to the Minister of Finance for disciplinary actions

against securities companies and their officers and employees for grave legal violations found during inspections of securities companies and investigations of criminal offences. Those subject to disciplinary action included five companies and six company officers and employees.

The details of these cases, classified by the violating parties and their acts, are detailed later in this report, but the related violations of legal regulations, by act and content of wrongdoing, and disciplinary actions taken by the JSDA, are as follows:

Officers and employees in violation of laws and regulations

① Conclusion of discretionary trading account transaction contracts

(Violation of SEL Article 50(1)3)

(a) A commission sales representative in Sales Division II of the headquarters of Securities Company A, for the purpose of increasing his commission income, agreed with multiple customers to accept orders for securities transactions (January 1992 to March 1994). The nature of this agreement gave the sales representative discretionary powers to decide, without customer consent, whether to purchase or sell, shares issued, numbers of shares and prices. In addition, this sales representative

agreed with other customers to accept orders for securities transactions (January 1992 to March 1994). The nature of this agreement gave the sales representative discretionary powers to decide, with customer consent, whether to purchase or sell, shares issued and number of shares, but without customer consent on share prices. In these cases, the sales representative completed the transactions respectively on his own judgment based on discretionary trading account transaction contracts.

Disciplinary action

Against the employee: Suspension of operations as registered sales representative (three months).

(b) A commission sales representative of Branch B of Securities Company D provided counseling to a certain customer known to him who had little investing experience. The sales representative agreed with this customer to accept orders for securities transactions (November 1992 to June 1994). The nature of this agreement gave the sales representative discretionary powers to decide, without customer consent, whether to purchase or sell, shares issued, numbers of shares and prices. In this case, the sales representative acted on his own judgment based on a discretionary trading account transaction contract.

Disciplinary action

Against the employee: Suspension of operations as registered sales representative (one month).

(c) The division manager of the head office marketing division of Securities Company E agreed with a specific customer to accept orders for securities transactions (March 1992 to March 1994). Because of difficulties in contacting the customer owing to the customer's business obligations, the division manager obtained customer consent regarding the decision to purchase or sell and shares issued, but on multiple occasions used discretionary powers to decide, without customer consent, the number of shares and share prices. In this case, the division manager acted on his own judgment based on a discretionary trading account transaction contract.

Disciplinary action

Against the employee: Suspension of operations as registered sales representative (one month).

Ⓢ Marketable security transactions for the purpose of pursuing speculative profits

(Violations of ministerial ordinances, according to pre-amended SEL Article 50(1)5, and ministerial ordinances under pre-amended SEL Article 50(1)6)

(a) A commission sales representative of the marketing section of sales office A of Securities Company B, for the purpose of pursuing speculative profit and improving his sales results, using his father-in-law's account, on multiple occasions implemented stock sales and purchases through margin transactions based on his own calculations (November 1990 to May 1994). (Number of transactions: approximately 330; number of stocks traded: approximately 900,000.)

Disciplinary action

Against the employee: Suspension of operations as registered sales representative (one month).

(b) A commission sales representative of the head office asset consultation division of Securities Company C, for the purpose of pursuing speculative profit and increasing his commission results, using his brother-in-law's account, on multiple occasions implemented stock sales and purchases through margin transactions based on his own calculations (October 1981 to June 1994). (Number of transactions: approximately 850; number of stocks traded: approximately 8,800,000.)

Disciplinary action

Against the employee: Suspension of operations as registered sales representative (one month).

(c) A managing director of Securities Company E, for the purpose of managing his own assets, using a friend's account, on multiple occasions implemented stock sales and purchases through margin transactions based on his own calculations and implemented stock price index futures (February 1991 to March 1994). (Number of stock transactions: approximately 250; number of stocks traded: approximately 4,500,000; number of stock price index futures transactions: approximately 10; number of contracts: approximately 100.)

Disciplinary action

Against the officer: Suspension of operations as registered sales representative (two months).

Note: For recommendations based on results of inspections, in the case of an inspection of a single securities company, if multiple violations or regulations are discovered, they are collected into one recommendation. For this reason, the total number of recommendations does not necessarily reflect the total number of incidents of violations of regulations.

Table 1: SESC Recommendations

(Unit: cases)

| Category | SESC Year 1992 | SESC Year 1993 | SESC Year 1994 |
|--|----------------|----------------|----------------|
| Number of recommendations | 2 | 13 | 5 |
| Based on inspections | 2 | 12 | 5 |
| Based on SESC inspections | 1 | 7 | — |
| Based on regional finance bureau inspections | 1 | 5 | 5 |
| Based on investigations of criminal offences | — | 1 | — |

I. Outline

The SESC can send proposals to the Minister of Finance as necessary for maintaining securities transaction fairness based on the results of inspections and investigations of criminal offences. (MFEL, Article (20))

In its proposals, the SESC states its view about laws, regulations and self-regulatory rules, after analyzing facts found through inspections and investigations of criminal offences. SESC proposals are to be reflected in the policy planning of the Ministry of Finance and SROs.

Proposals by the SESC are treated as important materials for carrying out policies of the Ministry of Finance.

In June 1994, an SESC investigation of violations resulted in the acknowledgment of problems regarding the registration screening for over-the-counter registration of a company's stock. For this reason, the SESC submitted a proposal to the Minister of Finance that

necessary and appropriate measures be taken regarding the rules of registration screening for over-the-counter stock sales by the JSDA. As illustrated by this case, the concrete contents of proposals are suggestions for topics of investigation or review regarding the form that regulations and self-regulatory rules should take. Such proposals originate in the actual conditions of transactions and other matters when currently applicable regulations and self-regulatory rules are insufficient. The SESC points out these facts from its standpoint as a body to ensure fairness in securities transactions.

II. Status of Proposals

Proposal status

In SESC year 1994, through its inspections the SESC found no problems requiring the submission of proposals.