

Message from the Chairman

It is a pleasure to present this annual report, which summarizes the activities of the Securities and Exchange Surveillance Commission (SESC).

In accordance with the law, the SESC describes its activities in an annual report. The Japanese-language annual report, for the period from July 1, 1996, to June 30, 1997 (SESC year 1996), was released in October 1997. It is intended to familiarize readers with the SESC by outlining its activities, including its organization and the background of its establishment. This English-language publication is based on that report.

The SESC was established on July 20, 1992, as an independent agency. Its mission is to ensure fair securities and financial futures transactions, thus maintaining the confidence of investors in these markets.

The SESC's organization is 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 functions, the organization includes regional finance bureaus that primarily conduct inspections of local



Chairman: Toshihiko Mizuhara

securities companies.

The SESC conducts investigations of criminal cases of violating the fairness of transactions. It also carries out inspections of securities companies and other institutions, and undertakes regular surveillance of securities markets. Through these activities, we aim to ensure market fairness and transparency, and contribute to the sound functioning of securities markets in Japan.

Based on provisions in the Securities and Exchange Law (SEL) and related legislation, the SESC has three main functions. First, we conduct investigations of

criminal offenses. These consist of compulsory investigations, namely visiting, searching and seizing with legal warrants, as well as non-compulsory investigations, such as inquiring, inspecting and provisional holding. Second, we carry out on-site inspections of securities companies to ensure compliance with laws and regulations on the maintenance of transaction fairness. Third, we undertake daily market surveillance of securities transactions based on information and reports from securities companies and self-regulatory organizations (SROs).

More than five years have passed since the establishment of the SESC. To date, it is felt that there is a deeper general understanding regarding the importance of compliance with rules of securities transactions, but certain areas are lacking. Especially on the part of securities companies, which serve as market intermediaries, and the directors of those securities companies, the level of understanding of the importance of compliance is insufficient.

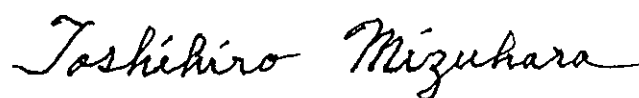
With a major restructuring of Japan's financial system being proposed, the need for market monitoring is expected to grow. The role of the SESC will become more important, and it will be necessary to

ensure that the responsibilities bestowed upon the SESC are carried out appropriately.

In October 1993, the SESC joined the International Organization of Securities Commissions (IOSCO) as an associate member. The purpose of our participation is to ensure fairness in Japanese securities markets given the increasingly global nature of securities transactions and the growing importance of international cooperation and collaboration in cross-border law enforcement.

Also, we actively participate 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.

I sincerely hope that this report will enhance public understanding of the SESC and the importance of its activities in securities markets.



Toshihiro Mizuhara

Chairman

Securities and Exchange Surveillance Commission

December 1997

Our activities in SESC year 1996 (July 1, 1996, to June 30, 1997) are detailed throughout this report. Following are summaries of investigations of criminal offenses, inspections and market surveillance activities conducted during this year.

1. Investigations of criminal offenses

With respect to investigations of criminal offenses, the SESC conducted compulsory investigations on Nippon Orimono Kako Co., Ltd., and Shintom Co., Ltd., on suspicion of insider trading. Another compulsory investigation, conducted on Nomura Securities Co., Ltd., on suspicion of loss compensation, resulted in searches of relevant premises and seizure of property. In addition, five accusations of criminal offense—three related to insider trading, one for circulating rumors (for the purpose of influencing market prices) and one for loss compensation—were made to a public prosecutor's office under the Securities Exchange Law.

As a result, in five years of SESC activity, the number of accusations resulting from SESC investigations has risen to 11. These break down into one on the charge

of market manipulation, one for submitting a securities report containing falsified information, five for insider trading, two for circulating rumors and two for loss compensation.

2. Inspections

Securities companies, financial institutions licensed to provide securities services, and other related companies, such as self-regulatory organizations (SROs), are subject to SESC inspections. During SESC year 1996, inspections were commenced at 80 domestic and three foreign securities companies, and seven financial institutions.

As a result, in the five years since its establishment the SESC has conducted a total of 400 inspections of domestic securities companies. In addition, the SESC has conducted inspections of 25 foreign securities companies and 52 financial institutions.

In SESC year 1996, problems related to failure to comply with transaction laws were uncovered in approximately 40% of inspection cases. Problems related to sales practices included aggressive solicitation to make

investments that disregarded the profit of customers. Regarding internal control systems, there were such problems as insufficient implementation of check systems.

The SESC sent recommendations to the Minister of Finance to take appropriate measures against 11 securities companies and 12 directors and/or employees, based on grave legal and regulatory violations related to the above points.

3. Market surveillance

In SESC year 1996, the SESC conducted surveillance activities in 196 cases. These included 113 cases of suspected manipulation, 74 of insider trading and nine related to other matters.

Most of the stocks subject to surveillance of insider trading were related to small companies, and a relatively low number of stocks were issued on securities markets.

Many stocks subject to surveillance of insider trading focused on cases where there were amendments of expected business results, stock splits and new stock issues by the issuing company, damages caused by

business operations, and release of information about changes in cash dividends.

In the five years since its establishment, the SESC has carried out surveillance activities in 993 cases, including 698 of suspected manipulation, 252 of insider trading and 43 related to other matters.