

I. Outline

Based on the results of inspections and investigations of criminal offenses, the SESC can, as necessary, send recommendations to the Minister of Finance for disciplinary actions or other appropriate measures (hereafter referred to as “administrative disciplinary actions”) to ensure securities transaction fairness (Ministry of Finance Establishment Law, Article 19(1)). Following are the major contents of these recommendations classified by type:

- ① Recommendations for administrative disciplinary actions against securities companies for legal violations;
- ② Recommendations for administrative disciplinary actions against SROs, such as securities dealers associations and stock exchanges, that neglect to execute 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 execute 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, under the Ministry of Finance Establishment Law, Article 19(2). The SESC can also request the Minister of Finance to report on actions taken based on its recommendations, under the Ministry of Finance Establishment Law, Article 19(3).

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

Matters concerning the registration of sales representatives, including administrative disciplinary actions against sales representatives, have been delegated by the Minister of Finance to the Japan Securities Dealers Association (JSDA). This association takes administrative 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 are taken after hearings by the JSDA, which follow notifications by the Minister of Finance and SESC inspection results.

II. Status of Recommendations and Measures Taken

In the year under review, the SESC sent 11 recommendations to the Minister of Finance for administrative disciplinary actions against directors or employees of securities companies for grave legal violations found during inspections and investigations of criminal offenses. There were no recommendations made against companies in the year under review.

In response to the 11 recommendations, administrative disciplinary actions were taken against 12 company directors and employees. Related violations of legal regulations, by act and content of wrongdoing, and administrative disciplinary actions taken by the Minister of Finance, are as follows:

Note: In cases where an inspection of a single securities company reveals multiple legal violations, only one recommendation is made. Therefore, the number of recommendations does not reflect the number of violations.

(1) Conclusion of discretionary trading account transaction contracts

(Violation of SEL Article 50(1)3)

① A sales representative of Branch A of Securities Company A, in order to avoid complications caused by frequent buying and selling price revisions, agreed with a customer to conduct stock index option transactions (March 1995 to February 1996). The nature of the agreement gave the sales representative discretionary powers to decide, with customer consent, whether to grant or purchase, as well as which options and the number of options to purchase, but without customer consent on the option prices. In this case, the sales representative used his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

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

② A sales representative of Branch A of Securities Company B made his own share recommendations to a customer, but the resulting purchases caused substantial losses for the customer. In order to compensate for the losses, the sales representative agreed with a

customer to conduct share trading transactions (January to May 1996). The nature of the 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 this case, the sales representative acted on his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

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

③ The branch manager of Branch A of Securities Company C, in order to increase his own stock trading commissions, agreed with a customer to conduct share trading transactions (June 1994 to April 1996). The nature of the agreement gave the branch manager discretionary powers to decide, without customer consent, whether to purchase or sell, shares issued, numbers of shares and prices. In this case, the branch manager acted on his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

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

④ The branch manager (who is also a director) of Branch A of Securities Company D, entrusted to manage assets inherited by a customer, agreed with the customer to conduct share trading transactions (June 1993 to May 1996). The nature of the agreement gave the managing director discretionary powers to decide, without customer consent, all aspects of share trading transactions—whether to purchase or sell, shares issued, numbers of shares and prices—or part thereof. In this case, the branch manager acted on his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

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

⑤ The sales development director of Securities Company E, entrusted to manage stocks held by a long-time customer, agreed with the customer to conduct share trading transactions (May 1995 to July 1996). The nature of the agreement gave the director discretionary

powers to decide, without customer consent, whether to purchase or sell, shares issued, numbers of shares and prices. In this case, the sales development director acted on his own judgment based on a discretionary trading account transaction contract.

Furthermore, a sales representative at the head office of Securities Company E, in order to attract new customers, persuaded his brother and a former classmate to open accounts, but then had difficulty contacting the new customers due to their business obligations. He therefore agreed with the customers to conduct share trading transactions (August 1995 to July 1996). The nature of the 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 this case, the sales representative acted on his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

Against the sales development director: Suspension of operations as registered sales representative (two weeks).
Against the sales representative: Suspension of operations as registered sales representative (three weeks).

⑥ The sales director at Securities Company F, in order to fulfill his obligations by attracting new customers for options transactions, persuaded his brother-in-law to open an account, but then had difficulty contacting the customer due to the latter's business obligations. He therefore agreed with the customer to conduct stock price index option transactions (June 1995 to September 1996). The nature of the agreement gave the sales representative discretionary powers to decide, without customer consent, all aspects of option trading transactions—whether to grant or purchase, issues, numbers of options and prices—or part thereof. In this case, the sales director acted on his own judgment based on a discretionary trading account transaction contract.

Administrative disciplinary action

Against the sales director: Suspension of operations as registered sales representative (two weeks).

(2) Giving falsified information related to securities trading

(Violations of pre-amended Ministerial Ordinance 1(1), according to pre-amended SEL Article 50(1)5, and Ministerial Ordinance 2(1) under SEL Article 50(1)6)

① A sales section chief of Securities Company G embezzled securities owned by a customer in order to repay personal debts. To conceal his wrongdoing, the section chief submitted false reports, created falsified financial statements and provided forged receipts when conducting transactions with the customer (October 1984 to December 1994). In this case, the section chief gave falsified information related to securities trading.

Administrative disciplinary action

Against the section chief: Cancellation of operations as registered sales representative.

② A commission sales representative of Securities Company H, when acting as intermediary for transactions between customers, indicated trading prices without first confirming market prices (November 1994 and July 1995). In this case, the sales representative gave falsified information related to market prices of securities.

Administrative disciplinary action

Against the sales representative: Not reported as of August 31, 1997.

(3) Securities transactions for the purpose of pursuing speculative profits

(Violations of pre-amended Ministerial Ordinance 1(5), according to pre-amended SEL Article 50(1)5, and Ministerial Ordinance 2(5), according to SEL Article 50(2)5)

① A sales section chief of Securities Company G embezzled securities owned by a customer in order to repay personal debts. To conceal his wrongdoing, the section chief used the customer's account to trade shares on his own behalf (October 1984 to January 1994).

Administrative disciplinary action

Against the section chief: Cancellation of operations as registered sales representative.

② A commission sales representative at Securities Company I, for the purpose of pursuing personal profit and improving his sales results, used a customer's account to trade shares on his own behalf (January 1996 to January 1997).

Administrative disciplinary action

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

(4) Receipt of undisclosed information about a share-issuing company from the parent company or other parties

(Violation of ministerial ordinances 2(2)8, according to SEL Article 50(2)3)

The deputy manager of the capital markets department of Securities Company J, which is the subsidiary of a bank, received information from the parent company on July 23, 1996, about the proposed schedule for an issue of convertible bonds arranged by another securities company on behalf of a corporation with which Securities Company J was also making a bond issue proposal. In this case, the deputy manager received information related to a bond issue schedule that was not disclosed to the public, without the specific consent of the issuing company (otherwise known as a “firewall” violation).

Administrative disciplinary action

Against the deputy manager: Suspension of operations as registered sales representative (one week).

(5) Supplementing customer profits through property gains, in order to compensate for losses

(Violation of SEL Article 50(3)1-3)

The sales director at the head office of Securities Company K recommended an issue to a customer, which resulted in a loss for that customer. Around July 10, 1996, in order to partially compensate for the loss, the director undertook securities trading and other transactions. In this case, the director purchased the securities at prices higher than market price, thus producing profits through property gains. (Amount compensated: ¥29,000)

Administrative disciplinary action

Against the sales director: Not reported as of August 31, 1997.

Table 1: SESC Recommendations

(Unit: cases)

<i>Category</i>	<i>SESC Year 1992</i>	<i>SESC Year 1993</i>	<i>SESC Year 1994</i>	<i>SESC Year 1995</i>	<i>SESC Year 1996</i>
Number of recommendations	2	13	5	10	11
Based on inspections	2	12	5	9	11
Based on SESC inspections	1	7	0	2	1
Based on regional finance bureau inspections	1	5	5	7	10
Based on investigations of criminal offenses	0	1	0	1	0