

### I. Outline

#### 1. Significance of market surveillance

In addition to investigations and inspections related to violations, the SESC monitors securities transactions as part of its regular market surveillance activities. The objective of market surveillance is to ensure the fairness of securities transactions and the protection of investors. These activities are carried out under the authority delegated by the Minister of Finance as prescribed in the SEL, LFSF and FFTL. The SESC meets its objectives by undertaking day-to-day monitoring of market

activities, through the collection of detailed reports about securities transactions and of necessary materials for daily market surveillance from securities companies and SROs.

As with the SESC's inspections, the authority to collect reports and materials is entrusted to directors-general of regional finance bureaus. (If necessary, however, the SESC can exercise said authority independently.)

Entities from which reports and materials are collected are listed as follows:

Securities companies and their parent financial institutions	(SEL Article 56)
Financial institutions licensed to provide securities services	(SEL Article 66)
Japan Securities Dealers Association	(SEL Article 79(15))
Stock exchanges	(SEL Article 154(2))
Branches of foreign securities companies	(LFSF Article 21(2))
Financial futures exchange and their members	(FFTL Article 52(2))
Financial futures dealers	(FFTL Article 77(2))
Japan Financial Futures Dealers Association	(FFTL Article 90(2))

Note: Information in parentheses indicates provisions for delegation of market surveillance authority from the Minister of Finance.

## **2. Scope of market surveillance**

The scope of market surveillance is regulated by the Cabinet Order (SEL Enforcement Order Articles 16, 17(5), 18(2) and 19(2); LFSF Enforcement Order Article 14; FFTL Enforcement Order Articles 3, 4, 7 and 10), prohibiting market manipulation, circulating rumors, insider trading and the activities of certain securities companies, their directors and employees.

## **3. Viewpoint and emphasis of market surveillance**

Market surveillance focuses on the following points:

- ① Stocks experiencing sharp price rises and drops
- ② Stock price movements before and after corporate accounting periods
- ③ Stock price movements for convertible bond issues before, on or after conversion price calculation dates
- ④ Stock price movements before and after cross-transactions
- ⑤ Stocks for which information appeared that significantly influenced the decisions of investors
- ⑥ Information provided by sources in the general public

The following points are emphasized in market surveillance:

- ① The involvement of securities companies, which have heavier responsibilities as intermediaries than investors in general
- ② Whether such transactions violate securities exchange laws and regulations
- ③ Whether the market surveillance functions of SROs are functioning appropriately

The SESC also maintains close relationships with the market surveillance sections of SROs, including stock exchanges and the JSDA, by exchanging necessary information on a regular basis or upon request. If necessary, based on the results of market surveillance, the SESC endeavors to clarify problems by conducting on-site inspections.

## **II. Status of Market Surveillance**

### **1. Number of cases**

Market surveillance activities include collecting market and corporate information and requesting necessary materials and reports from securities companies. In some cases, hearings are held and closer market sur-

veillance of market transactions is conducted for specific periods of time with regard to specific matters.

In the year under review, cases of detailed market surveillance were as follows:

<i>Related to market manipulation</i>	113 cases
○ Unnatural stock price movements, such as sharp rises and drops	65 cases
○ Stock price movements before or after corporate accounting periods	32 cases

○ Stock price movements before or after decisions were made about conditions for new stock issues	9 cases
<i>Related to insider trading</i>	74 cases
○ Revisions to corporate results forecasts	20 cases
○ Stock splits	13 cases
○ New share issues	11 cases
○ Others	9 cases

Details of market surveillance conducted by the SESC and regional finance bureaus are as follows:

**Table 4: Results of Market Surveillance**

(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>
Related to market manipulation	154	162	111	158	113
Related to insider trading	12	50	62	54	74
Others	4	5	22	3	9
Total	170	217	195	215	196
SESC	75	102	107	132	115
Regional finance bureaus	95	115	88	83	81

Conducted by the SESC	115 cases
Conducted by regional finance bureaus	81 cases

## 2. Summary of surveillance results

During the year, surveillance of market manipulation centered on sudden stock price increases and other unnatural movements, large fluctuations in prices of stocks held by companies at the end of said companies' accounting periods, and unusual price movements at the time of decisions covering issuing of new stocks.

Among stocks under surveillance experiencing sudden price increases, unnatural price movements, which did not reflect corporate results, were perceived, and many such stocks were small issues with relatively low prices or a low number of shares outstanding. These included stocks that were traded by certain groups of investors in a disguised and collaborative manner with the intention of raising stock prices.

Surveillance of insider trading focused on cases in which stock prices fluctuated significantly upon the announcement of information thought to have a considerable impact on the decisions of investors. These included numerous instances related to announcements of such matters as amendments of expected business results, stock splits, issuing of new stocks, damage caused by business operations, and changes in

cash dividends. Those under suspicion of insider trading included directors of issuers, in addition to companies and directors of companies dealing with said issuers.

Regular market surveillance through these activities is intended to function both as a direct and indirect deterrent to unfair transactions, depending on the circumstances.

Examples of specific surveillance cases during the year under review were as follows:

### *Surveillance related to manipulation*

① Stock-issuing Company A officially announced an issue of new shares, but the stock price of Company A rose immediately before the announcement. Furthermore, before and after the subscription price decision date, and between the application date and payment date, the closing price was fixed. During that time, several branches of multiple securities companies, located in the same area as Company A, together accounted for a large portion of the share offering.

② During the period in which the stock price of Company B rose sharply, in accordance with considerable transaction volume, a specific group of investors made successive market orders and successive limit

orders at prices higher than the latest contract price, and also distributed documents recommending Company B stock to many people.

③ The stock price of Company C rose sharply, in accordance with considerable transaction volume and frequent reports that Company C stock was being recommended by a specific group of investors who formed a membership alliance, giving rise to suspicion that the price rise may have been due to manipulation.

④ A specific group of investors made successive market orders and successive limit orders at prices higher than the latest contract price, accumulating a large volume of stocks. The price of said stock then rose, following recommendation by the Dial Q2 service of an investment advisory firm, and the group of investors subsequently sold their holdings.

⑤ The prices of a certain stock rose immediately prior to the end of the fiscal year despite the absence of special information that would affect stock prices. It was suspected that this resulted from the activities of a specific group of investors seeking to avoid write-down from evaluation of stockholdings by lower of cost or market method.

### *Surveillance related to insider trading*

① Stock-issuing Company D announced that it would merge with Company E, but prior to the announcement it was acknowledged that a sales representative of the securities company handling the merger sold stock.

② Stock-issuing Company F announced its intention to commence a corporate reorganization, but prior to the announcement it was acknowledged that a financial institution that deals with Company F sold stock in Company F.

③ Stock-issuing Company G announced that it would institute a stock split and capital increase, but prior to the announcement it was acknowledged that a company in the same corporate group as Company G purchased stock in Company G.

④ Stock-issuing Company H announced a considerable downward revision in its business results forecast for the fiscal year ended March 1996. Prior to the announcement, however, it was acknowledged that relatives of employees of a life insurance company, which had dealings with Company H, had sold stock in Company H.

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⑤ Stock-issuing Company I announced that it had incurred a loss as a result of the dissolution of a subsidiary, but prior to the announcement it was acknowledged that employees of a company that deals with Company I had sold stock in Company I.

*Surveillance related to other items*

In relation to an in-house report by Securities Company J recommending a certain stock, it was reported that the facts as represented in the report differed considerably from the facts later announced by the stock-issuing company, giving rise to suspicion that Securities Company J circulated rumors.