

1. Background of establishment

Following a series of securities and financial scandals in the summer of 1991, various discussions 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."

In light of the report and of 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 the Ministry of Finance Establishment Law to survey securities transactions.

(1) Chairperson and commissioners

The SESC comprises a chairperson and two commissioners, and topics of proceedings are resolved by majority vote among these three members.

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

The chairperson and commissioners are appointed by the Minister of Finance with the consent of both houses of the Diet.

The terms of the chairperson and commissioners are three years, and they can be reappointed. In addition, they cannot be dismissed against their will except in cases where certain judicial reasons exist.

Accordingly, in the first term (July 20, 1992, to July 19, 1995), Toshihiro Mizuhara served as chairman,

and Hidetaka Mihara and Masamichi Narita served as commissioners. In the second term, beginning July 20, 1995, Toshihiro Mizuhara is serving a second term as chairman, and Masamichi Narita (second term of office) and Ginko Sato are serving as commissioners.

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, respectively, of the Executive Bureau. The number of personnel in the Bureau, following approval in fiscal 1996 to add one Inspector for Securities and Exchange and one Investigator for Securities and Exchange, is 91. In addition, authorization was given to establish one new post, Market Surveillance Coordinator, to strengthen the SESC's surveillance systems.

① **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.

② **The Investigation Division** is authorized to probe into suspected cases of criminal offenses.

(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 offenses under the direction and supervision of the SESC.

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

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 offenses.

① 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.

② 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.

③ Investigations of criminal offenses

The SESC can investigate suspected criminal offenses, 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

① 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.

② Proposals

Based on the results of inspections and investigations of criminal offenses, 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 offenses, if the SESC believes that a crime has been committed, it will make accusations about the

suspect to the Public Prosecutor's Office.

(4) Opinions and other matters concerning inspections of financial institutions conducted by the Minister of Finance

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

① Opinions on annual policies and other basic points in conducting inspections by the Ministry of Finance

② Receipt of quarterly reports concerning the conduct of inspections

③ Proposals concerning the operation of inspections and other policies

(5) Reports of activities

The SESC publicizes its activities in an annual report.