

Message from the Chairperson



Chairperson: Ginko Sato

The Securities and Exchange Surveillance Commission (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.

On June 22, 1998, the Financial Supervisory Agency was established. Based on the standpoint that the neutral and objective role played by the SESC will remain important in the future, the SESC kept its

organization and was transferred to the Financial Supervisory Agency.

The SESC's organization is based on a council system comprising a chairperson and two commissioners, who implement their authority independently. These Commission members are appointed for three-year terms by the Prime Minister with the approval of the Diet. In July 1998, I was appointed as the new chairperson, and Takeo Takahashi and Konoe Kawagishi

were newly appointed as commissioners.

The SESC has an Executive Bureau and regional offices to carry out its regular work. The SESC carries out inspections of securities companies, daily market surveillance, and investigations of criminal offenses violating fairness in transactions. Through these activities, we aim to ensure market fairness and transparency, and contribute to the sound functioning of securities markets in Japan.

As reforms of Japan's financial system are implemented, the need for market monitoring is expected to grow. Moreover, given the ongoing internationalization of securities transactions, it will also become increasingly important to strengthen international cooperation to deal with violations of fairness in market transactions that extend beyond national borders. In

the future, the role of the SESC will become more important. To this end, we intend to exercise the authority bestowed on the SESC to the maximum extent, while further upgrading our systems and fulfilling our responsibilities.

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

佐藤 銀子

Ginko Sato

Chairperson

Securities and Exchange Surveillance Commission

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Summary

Our activities in SESC year 1997 (July 1, 1997, to June 30, 1998) are detailed throughout this report. Following is a summary of such activities.

1. Investigations of criminal offenses

With respect to investigations of criminal offenses, the SESC made a total of seven accusations for violations of the Securities and Exchange Law (SEL). These consisted of five cases of loss compensation by major securities companies, one case against a major securities company for submitting securities reports containing falsified information, and one case of insider trading.

Loss compensation by major securities companies became a prominent social problem in 1992 and precipitated the establishment of the SESC. Nevertheless, acts of loss compensation by major securities companies and their directors and employees have been repeated.

2. Inspections

Securities companies, financial institutions licensed to provide securities services, and other related parties, such as self-regulatory organizations (SROs), are subject to SESC inspections. During SESC year 1997, inspections were commenced on 72 domestic and

seven foreign securities companies, as well as one financial futures dealer and one SRO. During the year, inspections of 92 companies were completed, and problems found with 74 companies were notified to the companies.

The SESC's inspections uncovered numerous cases of violations of transaction rules, including the conclusion of discretionary trading account transaction contracts and securities transactions for speculative profit, as well as many problems related to sales practices and internal control systems of securities companies. These are deemed to be caused by a lack of awareness of the importance of compliance with laws among directors and employees of securities companies, as well as insufficient internal control systems in securities companies. It is necessary that the directors and employees of securities companies strengthen their awareness of the importance of compliance and strive to implement fair business practices. Also, securities companies themselves must work to build effective internal control systems.

As a result of its inspections, the SESC sent recommendations to the Minister of Finance for administrative disciplinary actions against 10 securities companies and 58 directors and employees of securities companies for grave violations of laws.

3. Market surveillance

In the year under review, the SESC conducted regular surveillance activities in 203 cases. These included 124 cases of suspected price manipulation, 59 of suspected insider trading, and 20 of suspected spreading of rumors and other matters.

Surveillance related to price manipulation centered on unnatural market price fluctuations, including sudden price rises and declines, as well as stock issues whose prices were judged to be fixed at certain levels.

Surveillance related to insider trading focused on significant market price fluctuations caused by the disclosure of information thought to have a major impact on investors' investment decisions.

Surveillance concerning spreading of rumors centered on stock issues whose prices fluctuated significantly due to various types of information. These included numerous instances of information about unstable financial conditions of companies. Rumors were considered to be spread by word of mouth, via "Dial Q2" telephone services, or over the Internet.

Among violations of laws found through the aforementioned investigations of criminal offenses, inspections, and market surveillance, noteworthy cases are summarized below.

• Loss compensation by major securities companies

With regard to loss compensation by major securities companies, by the end of 1995 the SESC's Market Surveillance Section had obtained various clues through its regular surveillance activities, and the Investigation Division then carried out investigations, including compulsory investigations, of criminal offenses. These investigations revealed violations of laws by the four major domestic securities companies. The SESC subsequently sent accusations against the securities companies and their directors and employees to the Tokyo District Public Prosecutor's Office. In addition to these violations, insufficient internal control systems of the companies were recognized as a cause of violations such as loss compensation. The SESC made recommendations to the Minister of Finance for administrative disciplinary and other appropriate actions. In addition, the SESC made proposals to the Minister of Finance to take necessary and appropriate actions in view of the institutionalization of separating customers' transactions from those on securities companies' own accounts.

• Tobashi case involving Securities Company A

Once it became clear in November 1997 that Securities Company A had hidden large amounts of off-balance-

sheet liability, the SESC's Inspection Section conducted special inspections to grasp the nature and cause of the case. These inspections revealed a number of violations of laws, including loss compensation, solicitation with promises of special profit, the conclusion of discretionary trading account transaction contracts, and so on.

With respect to the falsification of securities reports, the Investigation Division conducted investigations, including compulsory ones, and recognized violations of laws. On March 20, 1998, the SESC sent an accusation against the company and its directors to the Tokyo District Public Prosecutor's Office.

On April 2, 1998, the SESC made recommenda-

tions to the Minister of Finance for administrative disciplinary and other appropriate actions, based on the results of its inspections and investigations of criminal offenses.

Tobashi transactions are repeated off-record transactions, and were executed so that no trace of such transactions will be found in the securities company's records. In past inspections, the SESC was unable to detect and uncover the details of such transactions. In the future, the SESC intends to implement accurate and rigorous inspections through more thorough inspections of basic documents and, where necessary, by confirming facts with customers of securities companies.

I. Outline

1. Purpose of and authority for investigations of criminal offenses

The authority for the investigation of criminal offenses was given to the SESC at its establishment in order to ensure market fairness and soundness, as well as to protect investors. With this authority, the SESC traces illegal actions violating laws and regulations, then calls for criminal prosecution by making formal accusations.

Investigations of criminal offenses are carried out by the SESC staff under the particular authority stipulated in the SEL, the Law on Foreign Securities Firms (LFSF), and the Financial Futures Trading Law (FFTL). In contrast, inspections against securities companies and other related financial institutions are conducted under the authority delegated by the Prime Minister (the Commissioner of the Financial Supervisory Agency; Minister of Finance as for the period up to and including June 21, 1998). The SESC's authority is not limited to securities companies but reaches all parties involved in securities transactions, including investors themselves.

Specifically, the SESC may conduct non-compulsory investigations of criminal offenses (Article 210 of the SEL, Article 38–2 of the LFSF, and Article 106 of the

FFTL), including making inquiries of suspects or related parties, inspection of materials in the possession of or left behind by suspects, and the confiscation of materials supplied or left behind by suspects. The SESC may also conduct compulsory investigations with warrants (Article 211 of the SEL, Article 38–2 of the LFSF, and Article 107 of the FFTL). Such investigations include visiting and searching the premises of suspects and seizing related evidence.

2. Scope of criminal offenses

The scope of criminal offenses covers acts that violate securities transaction fairness, and is prescribed in the relevant Cabinet Orders (Article 45 of the SEL Enforcement Order, Article 20 of the LFSF Enforcement Order, and Article 14 of the FFTL Enforcement Order). These mainly involve providing loss compensation, spreading of rumors, market manipulation, insider trading, and submission of securities reports with falsified information (specific cases are summarized below).

The results of criminal investigations are reported to the SESC by its investigation staff (Article 223 of the SEL, Article 38–2 of the LFSF, and Article 119 of the FFTL). When convinced of a suspect's guilt, the SESC sends an accusation to a public prosecutor's office, together with evidence seized during its investigations

and the lists of such evidence, if any (Article 226 of the SEL, Article 38-2 of the LFSF, and Article 122 of the FFTL).

II. Status of Accusations of Criminal Offenses

1. Investigations of criminal offenses

During the year under review, the SESC conducted compulsory investigations based on suspicion of loss compensation by major securities companies and on suspicion of submission of falsified securities reports by Securities Company A. These investigations included visiting and searching the premises of the suspected companies and related parties, and the seizure of evidence. The SESC also exercised its authority to conduct non-compulsory investigations as deemed necessary.

2. Accusations

Based on investigation results, the SESC sent a total of seven accusations to public prosecutor's offices concerning possible SEL violations. These consisted of five cases of loss compensation, one case of submitting falsified securities reports, and one case of insider trading. These cases are summarized below.

(Case 1)

On September 17, 1997, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of Article 50-3(1) and (2) of the SEL (Penal regulation: the SEL, Article 207(1)).

Outline of facts

Securities Company A, with the involvement of the company's directors, etc., moved overseas futures transactions made on its own account (by which a profit had been made) to its customer's account with the intention of disguising the original party of the transactions. Such acts were taken to compensate for the customer's losses incurred through his securities transactions or to provide additional profits to the customer.

Note: On October 8, 1997, a prosecution against the accused company and eight individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 2)

On October 21, 1997, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of Article 50-3(1) and (2) of the SEL (Penal regulation: the SEL, Article 207(1)).

Outline of facts

Securities Company B, with the involvement of the company's directors, etc., moved stock purchase transactions made on its own account to its customer's account with the intention of disguising the original buyer after the stock price went up. Such acts were taken to compensate for the customer's losses incurred through his securities transactions.

Note: On November 11, 1997, a prosecution against the accused company and five individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 3)

On October 23, 1997, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of Article 50-3(1) of the SEL (Penal regulation: the SEL, Article 207(1)).

Outline of facts

Securities Company A, with the involvement of the company's directors, etc., moved overseas futures transactions made on its own account (by which a profit had been made) to its customer's account with the intention of disguising the original party of the transactions. Such acts were taken to compensate for the customer's losses

incurred through his securities transactions.

Note: On November 12, 1997, a prosecution against the accused company and seven individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 4)

On October 28, 1997, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of Article 50-3(1) and (2) of the SEL (Penal regulation: the SEL, Article 207(1), etc.)

Outline of facts

Securities Company C, with the involvement of the company's employees, moved stock purchase transactions made on its own account to its customer's account with the intention of disguising the original buyer. Such acts were taken to compensate for the customer's losses incurred through his securities transactions.

Note: On November 18, 1997, a prosecution against the accused company and seven individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 5)

On March 9, 1998, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of

Article 50-3(1) of the SEL (Penal regulation: the SEL, Article 207(1)).

Outline of facts

Securities Company B, with the involvement of the company's directors, etc., moved stock purchase transactions made on its own account to its customer's account with the intention of disguising the original buyer after the stock price went up. Such acts were taken to provide additional profits to the customer.

Note: On March 10, 1998, a prosecution against the accused company and two individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 6)

On March 20, 1998, the SESC sent an accusation to the Tokyo District Public Prosecutor's Office for offenses of the SEL (Penal regulation: Article 197(1) and 207(1)).

Outline of facts

Securities Company A, with the involvement of the company's directors, submitted securities reports containing falsified information in important items. Specifically, the company dealt with securities containing

unrealized losses off the record, and reported fiscal year-end losses that were lower than actual losses on the company's financial statements.

Note: On March 24, 1998, a prosecution against the accused two individuals was brought to the Tokyo District Court. The case is pending public trial.

(Case 7)

On May 29, 1998, the SESC sent an accusation to the Yokohama District Public Prosecutor's Office for offenses of Article 167(1) of the SEL, Article 31 of the SEL Enforcement Order (Penal regulation: the SEL Article 200(Vi)).

Outline of facts

A director of Company M was engaged in arranging share transfer contracts for his company, including the sale of Company N's shares to Company O. While in the process of concluding the contract, the director received information about Company O's plan to buy up 5% of Company N's total outstanding shares in the market. Prior to the official announcement of such information, the director himself purchased Company N's shares.