

## **I. Relationship between the SESC and SROs**

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SROs (securities dealers associations, stock exchanges, financial futures dealers associations, and financial futures exchanges) make self-regulatory rules and conduct surveillance activities of their members concerning whether member companies operate appropriately according to laws, regulations, and self-regulatory rules, in order to ensure the fairness and transparency of the market. When conducting surveillance, SROs operate in close cooperation with the SESC (see Diagram 4 on page 64).

Nevertheless, the SESC is also in a position to make inspections to judge whether SROs are conducting surveillance appropriately and whether SROs are imposing proper sanctions against members who violate laws, regulations, and self-regulatory rules (as for inspections of the JSDA conducted in April 1998, see “VII. Results of Inspections of SROs” in Chapter 2, page 17).

Having market mediators as members, SROs establish frameworks for acceptable behavior and demand of their members compliance with regulations, and are thus in a position to gain the trust of investors. Through their efforts, SROs bring greater benefits to market mediators in the long run. Along with the progress of

the Financial System Reform, the role of SROs backed by the law is becoming more and more important, and they are expected to intensify their efforts.

The SESC maintains close interactive relationships with SROs and holds hearings with them on such matters as the status of their surveillance.

Following are the activities of SROs from April 1997 to March 1998 (hereinafter “fiscal 1997”):

## **II. Activities of the Japan Securities Dealers Association**

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The activities of the JSDA during fiscal 1997 were as follows:

### **1. Status of surveillance of association members**

#### **(1) Main surveillance items**

Items of surveillance of members (see Note 1 below) include the following: (1) compliance with “principles of suitability” (see Note 2 below); (2) compliance with regulations related to prohibited acts in securities transactions; and (3) management of securities transactions and settlement.

*Note 1: Members*

*Members are classified into two types according to their rights and duties, as follows:*

(1) *Regular members (domestic and foreign securities companies); and*

(2) *Special members (financial institutions licensed to provide securities services)*

*Note 2: Principles of suitability*

*Principles of suitability, based on the premise that there are many cases in which securities companies have significant influence on their customers' investment decisions, call for securities companies to give their customers advice considering their financial conditions, experience, etc., and to actively undertake appropriate research on the customers' investment objectives, financial status, and other conditions.*

**(2) Status of surveillance**

In SESC year 1997, surveillance was conducted on 92 companies: 71 domestic and 21 foreign securities companies.

**(3) Summary of results**

Surveillance conducted in fiscal 1997 revealed a number of violations of regulations, including (1) disregard of principles of suitability, such as the failure to prepare customer management cards and to record necessary items on the cards, and the failure to submit transaction

reports appropriately; (2) disregard of regulations related to prohibited acts in securities transactions, such as accepting orders for transactions under assumed names, lending money to and borrowing money from customers, buying of securities from customers by sales representatives, and conducting of sales activities by unlicensed persons; and (3) problems related to management of securities transactions and settlement, such as the failure to prepare insider registration cards and to record necessary items on the cards, and the failure to submit certificates of securities deposit.

Apart from the above, in several cases the conditions of the customers who placed large-amount orders were not fully grasped, although this did not constitute a violation of a specific regulation.

In the year under review, improvement was deemed quite necessary as for 33 members that underwent regular surveillance (19 in the previous year) and two members that underwent special surveillance. The JSDA requested that these members report on improvements in their situation and provided other necessary guidance.

**2. Status of surveillance of special members**

**(1) Main surveillance items**

Items of surveillance of special members include the

following: (1) management of securities transaction orders; (2) compliance with rules related to prohibited acts in securities transactions; (3) management of the execution of orders and management of handing over and custody of securities; and (4) management of the operation related to securities transactions.

## **(2) Status of surveillance**

Surveillance of special members is primarily conducted by associations organized by special members (six in total), such as the Federation of Bankers Association of Japan under the delegation of operation by the JSDA. The associations implement surveillance working with personnel designated by the JSDA. In fiscal 1997, surveillance was conducted on 72 financial institutions (48 banks, 13 *shinkin* banks, nine insurance companies, and two money market brokers).

This surveillance did not reveal violations of regulations.

## **3. Status of securities market surveillance**

The JSDA's OTC Stock Surveillance Division, which is responsible for market surveillance, collects market information related to registered OTC stocks and monitors stock prices and trading volume of certain stocks, as well as the involvement of members in transactions

of those stocks. The Division conducts investigations of certain stocks when it observes irregularities in transactions of them. In addition, when the Securities Business Division reports on violations of laws or the occurrence of incidents related to OTC-registered companies and having a considerable influence on investors' judgments, the Surveillance Division also conducts investigations, and when deemed necessary, further detailed surveillance.

The Surveillance Division maintains close relationships with relevant divisions in conducting market surveillance, and, if necessary, requests an audit by the Audit Division.

When inappropriate securities transactions are uncovered through surveillance, according to its Articles of Association, the JSDA takes appropriate measures against the members involved to prevent such transactions from recurring. In addition, when the inappropriateness of securities transactions is suspected, but not proven, the JSDA cautions the members involved.

## **4. Summary of sanctions against members**

When surveillance reveals that a member company has come to the condition which Article 25 of the JSDA's Articles of Association stipulates, such as violations of laws or regulations, behaving against others' faith, and

so on, the JSDA can take disciplinary actions after giving the member in question an opportunity to give an explanation. Disciplinary actions include reprimands, the imposition of penalties of up to ¥100 million (up to ¥500 million for serious violations of laws, etc., from February 1998), the suspension of or restriction on membership for a period not exceeding six months, or the revocation of membership.

During fiscal 1997, one reprimand and six cases of the imposition of penalties (totaling ¥287 million), were conducted according to Article 25 of the Articles of Association.

### **III. Activities of Stock Exchanges**

Following are the activities of stock exchanges in fiscal 1997:

#### **1. Status of inspections**

##### **(1) Main inspection items**

Items of inspection of stock exchange members and special participants (see Note below) are generally classified as follows: (1) compliance with regulations related to margin transactions and futures and options transactions; (2) administration of customer accounts; (3) compliance with regulations related to commis-

sions; and (4) compliance with other rules, regulations, and principles of suitability.

##### *Note: Special participants*

*"Special participants" refers to financial institutions other than regular members that are certified to participate directly in transactions of listed financial futures.*

#### **(2) Status of inspections**

In fiscal 1997, inspections were made of 48 member companies of the Tokyo Stock Exchange (TSE) (37 domestic securities companies, six foreign securities companies, and five special participants), and 20 member companies (domestic companies only) of the Osaka Securities Exchange (OSE).

#### **(3) Summary of inspection results**

The results of inspections carried out by the TSE and OSE in fiscal 1997 revealed a number of improper acts, including (1) the failure to observe regulations related to margin transactions and futures and options transactions, including delays in the collection of papers on agreements to open transaction accounts for futures and options transactions, as well as shortages of deposits and delays in collecting deposits for customers' margin transactions; and (2) problems related to the

administration of customers' accounts, including the temporary payment for customers for their losses incurred from margin transaction settlements and that for securities purchased in cash and the confusion between customers' accounts concerning collateral securities and cash, as well as violations of regulations in conducting off-market transactions of listed bonds at prices exceeding limitations.

According to the results of inspections, stock exchanges requested their members and special participants to submit reports and provided directions as necessary for the improvement of operational disposition (in fiscal 1997, directions were provided to two companies from the TSE concerning their failure to record necessary items on their books, and to two companies from the OSE concerning their inappropriate management of their customers' settlements).

## **2. Status of market surveillance**

### **(1) Summary of surveillance**

Taking the TSE as an example, the Department of Market Surveillance and Compliance conducts investigations and surveys of issues selected by examining collected market information, issues notified by the Stock Market Department and Bond Market Department as abnormal in their trading, and issues about

which the Office of Listings Supervision reported the occurrence of information that could influence investment decisions. Thus, the Department of Market Surveillance and Compliance conducts market surveillance in close cooperation with these departments.

When inappropriate transactions are uncovered through market surveillance, stock exchanges impose sanctions or take other actions against the members or special participants involved in view of preventing such transactions from recurring.

In addition, when the inappropriateness of securities transactions is suspected but not proven, stock exchanges caution the members involved to exercise prudence in transactions in the future in order to prevent unfair transactions from occurring.

## **3. Summary of sanctions against members**

Pursuant to Article 50 of the TSE Charter, if the TSE deems that a member or special participant has violated laws or regulations, including the TSE charter, behaved against others' faith, etc., after hearing from the member, it may impose sanctions such as penalties of up to ¥100 million (up to ¥500 million for serious law violations, etc. from February 1998); censure; suspension from or restriction on transactions in the market; suspension of membership for up to six months; and

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revocation of membership (suspension or cancellation of license to conduct transactions, in the case of special participants).

Pursuant to Article 55 of the TSE Charter, if a member or special participant undergoes administrative disciplinary actions, such as business suspension, business restriction, or license revocation, based on the extent of the above disciplinary actions, the Exchange shall suspend or restrict the member's transactions in the market or revoke its membership.

In fiscal 1997, sanctions by the TSE included six cases of the imposition of penalties (totaling ¥2.66 million) under Article 50 of the Charter, and 15 cases of restrictions on securities transactions. In addition, under Article 55 of its charter the OSE imposed sanctions, such as restrictions on transactions, concerning 11 cases.

#### **IV. Activities of the Financial Futures Dealers Association of Japan**

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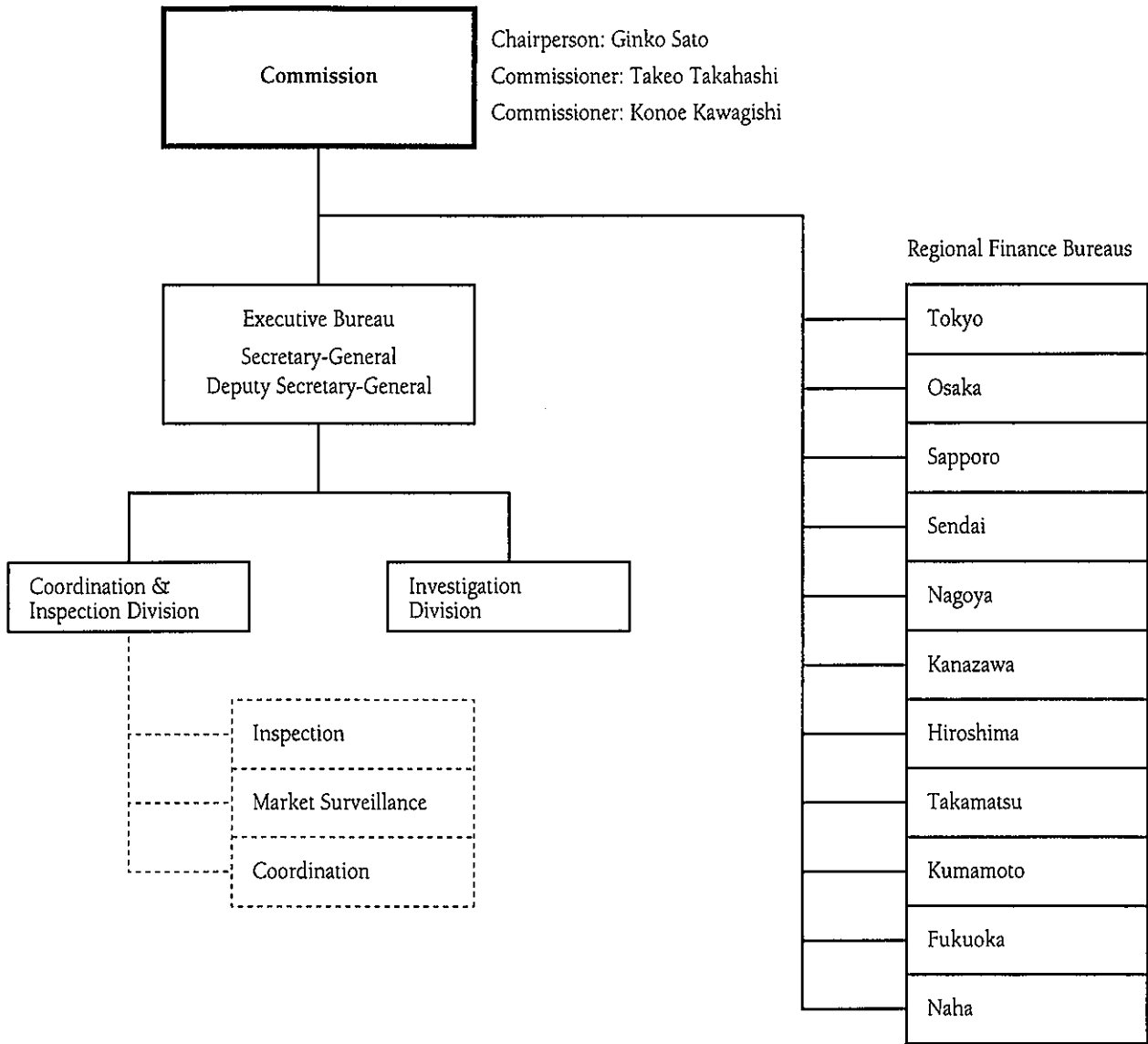
Main items of surveillance of association members conducted by the Financial Futures Dealers Association of Japan in fiscal 1997 included the management of financial futures transaction orders, the management of customers' deposits, and compliance with

rules regulating financial futures transactions. Surveillance conducted in fiscal 1997 uncovered cases of insufficient management of papers on agreements to open transaction accounts, the failure to record necessary items on customer management cards and order forms, and on reports of operating results. The Association advised the members involved to correct these points.

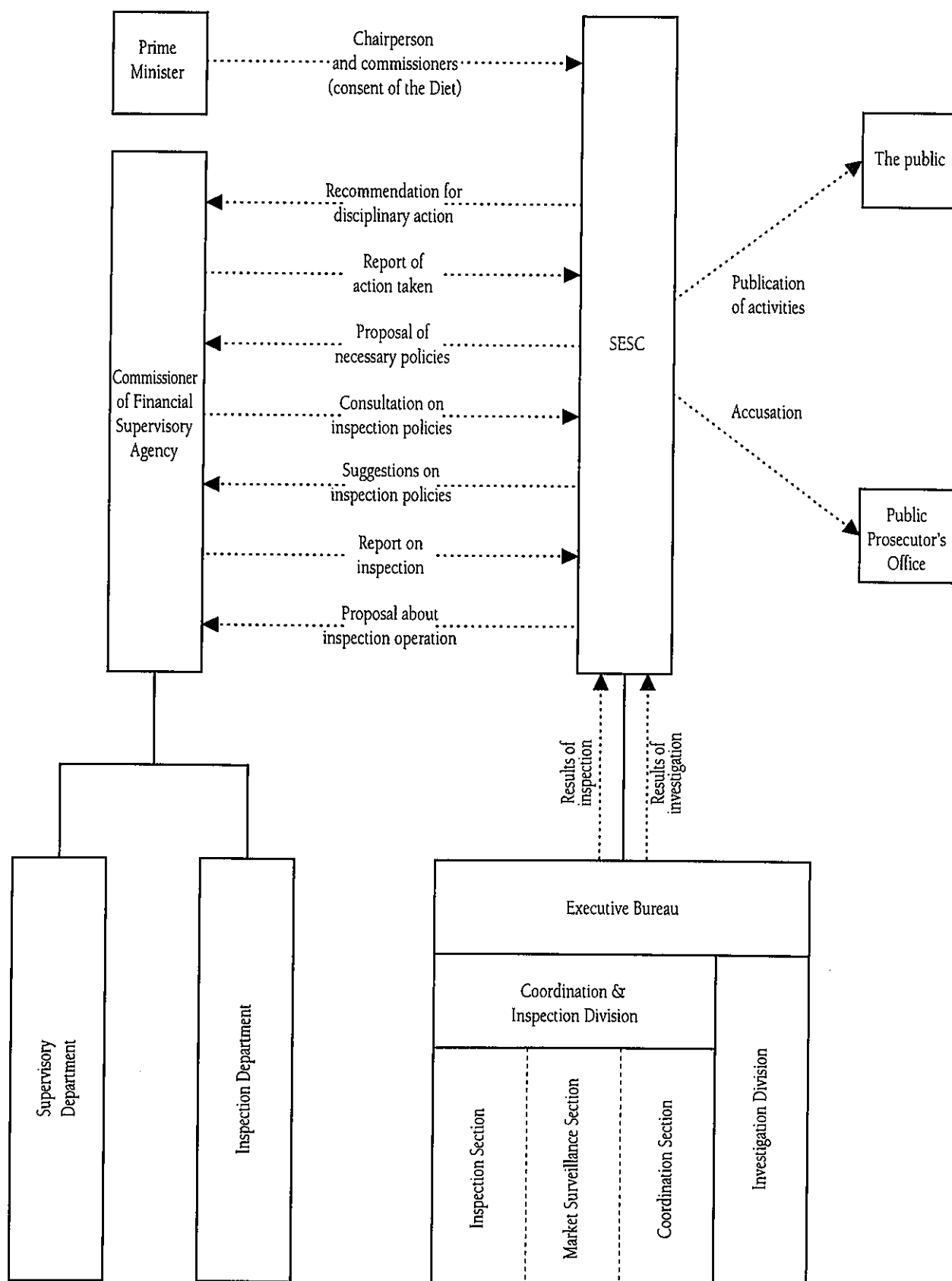
#### **V. Activities of the Financial Futures Exchange**

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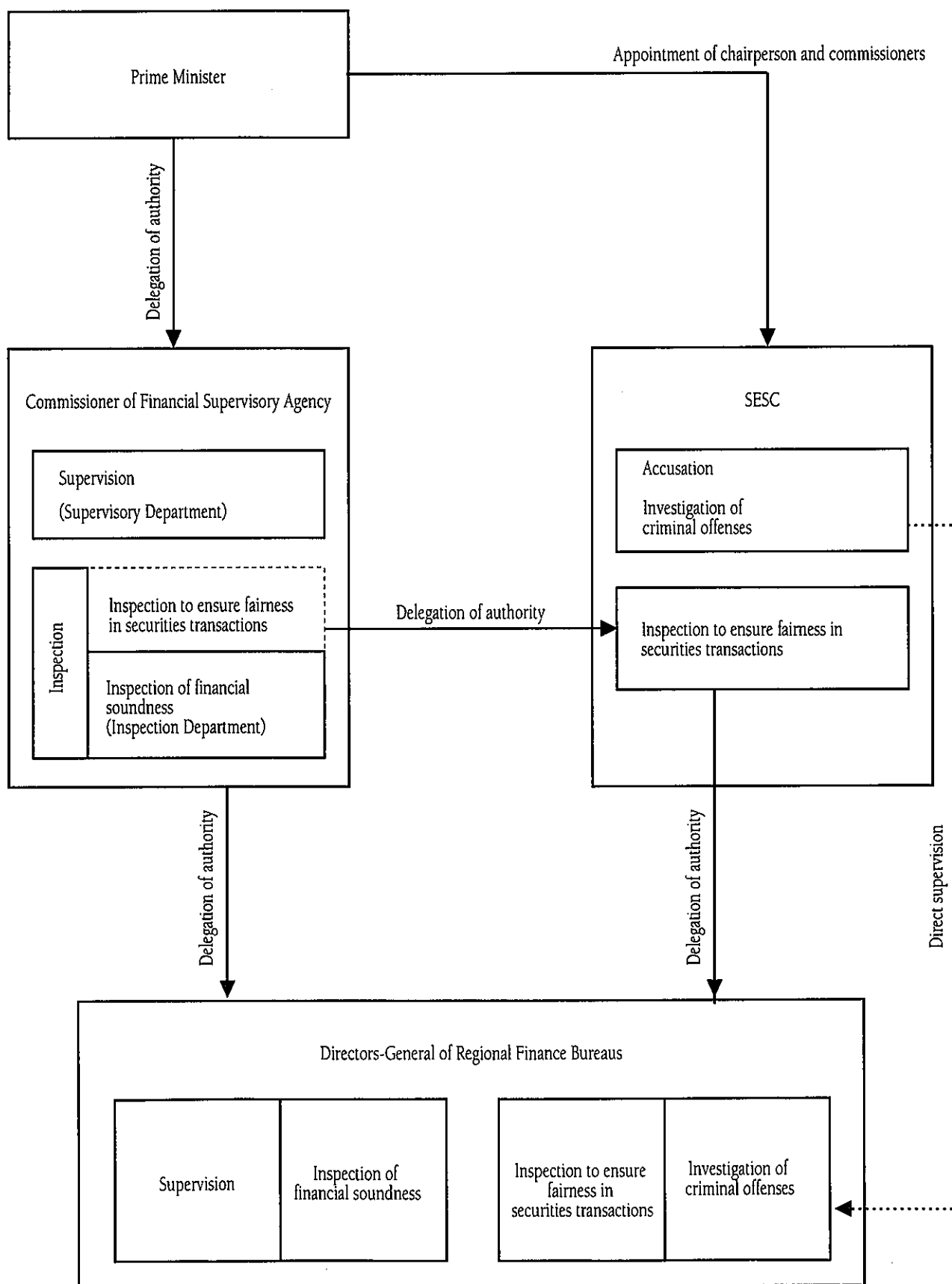
Main items of inspection of exchange members by the Financial Futures Exchange in fiscal 1997 included the management of acceptance of financial futures transaction orders, compliance with rules related to prohibited acts concerning financial futures transactions, and the management of internal control systems. Inspections conducted in fiscal 1997 revealed problems, including the failure to keep legally required books and reserve them, the failure to list necessary items on agreement papers to open accounts, and a lack of distinction between transactions on members' own accounts and those on customers' accounts. The Exchange advised the members involved to correct these points.



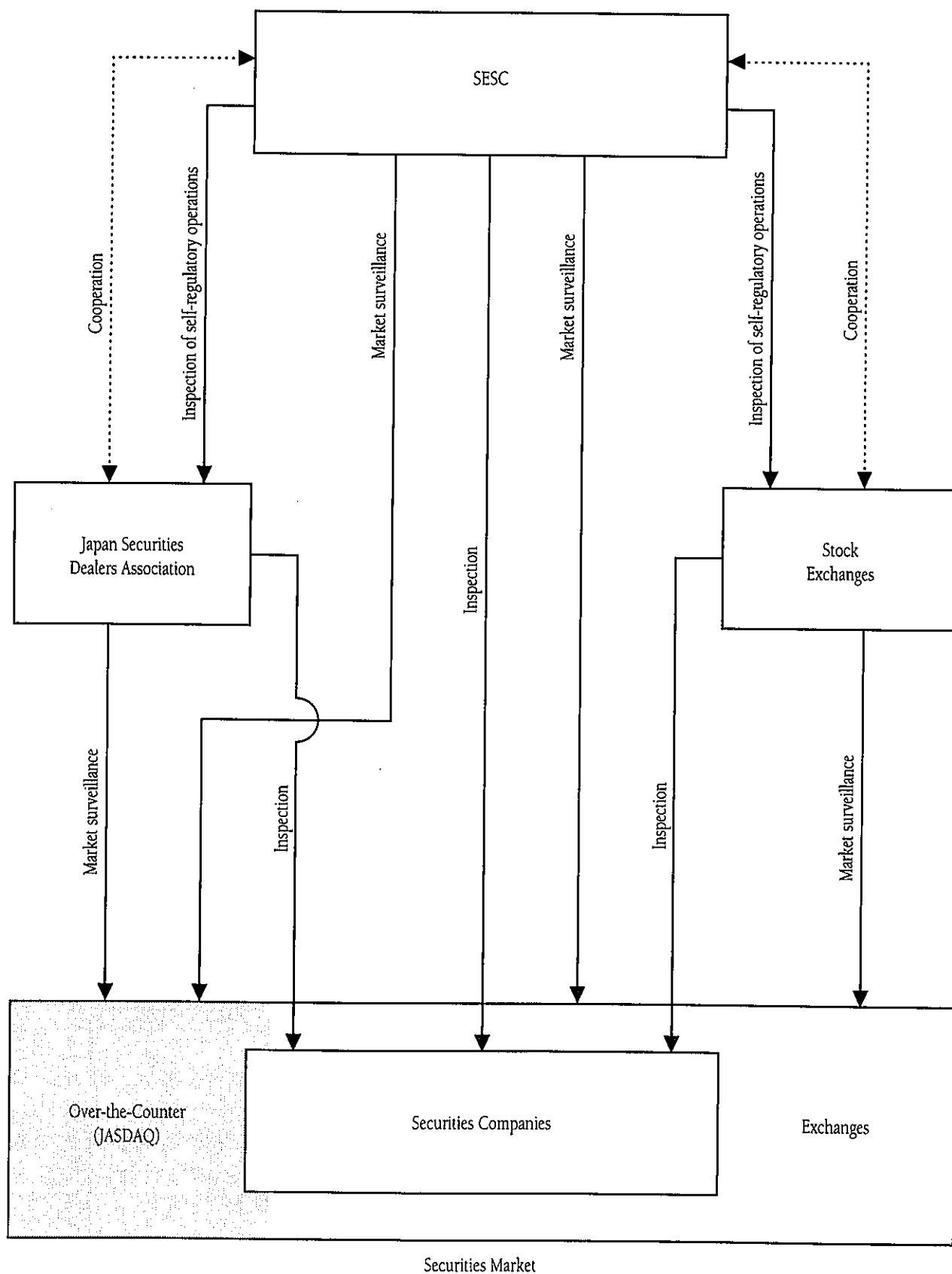
## Diagram 2 Surveillance Framework







**Diagram 4 Relationship between the SESC and SROs**



# Chairperson and Commissioner Profiles

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## Chairperson

### Ginko Sato

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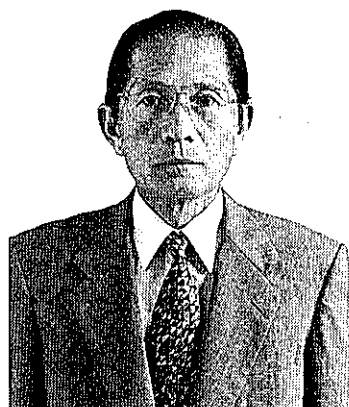


- 1958 Graduated from University of Tokyo, Department of International Relations  
Ministry of Labor
- 1979 Director, Women Workers' Division, Women's and Young Workers' Bureau
- 1984 Director, International Labor Affairs Division, Minister's Secretariat
- 1985 Councilor of Minister's Secretariat
- 1986 Director-General, Women's Bureau
- 1990 Assistant Minister of Labor
- 1991 Ambassador to Kenya, Ministry of Foreign Affairs
- 1995 Commissioner, SESC
- 1998 Chairperson, SESC

## Commissioner

### Takeo Takahashi

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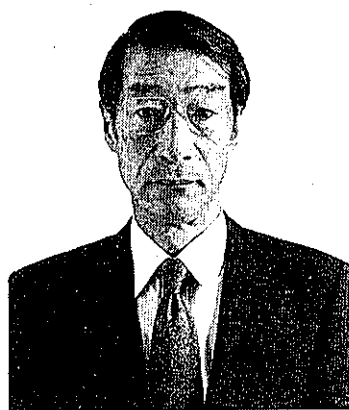


- 1959 Graduated from Waseda University, Law Department
- 1963 Public Prosecutor, Yokohama District Public Prosecutor's Office
- 1989 Public Prosecutor, the Supreme Public Prosecutor's Office
- 1990 Chief Prosecutor, Yamagata District Public Prosecutor's Office
- 1991 Deputy Superintending Prosecutor, Tokyo District Public Prosecutor's Office
- 1993 Deputy Superintending Prosecutor, Tokyo High Public Prosecutor's Office
- 1994 Chief Prosecutor, Yokohama District Public Prosecutor's Office
- 1995 Chief Prosecutor, Tokyo District Public Prosecutor's Office
- 1997 Superintending Public Prosecutor, Fukuoka High Public Prosecutor's Office
- 1998 Commissioner, SESC

## Commissioner

### Konoe Kawagishi

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- 1961 Graduated from Hitotsubashi University, Economics Department; The Yomiuri Shimbun (YS, Japanese Newspaper Company)
- 1974 Correspondent, General European Bureau, YS
- 1981 Correspondent, Washington D.C. Bureau, YS
- 1984 Deputy Editor of Economic News Department, YS
- 1988 Editorial Writer, YS
- 1992 Deputy Chief of Editorial Board, YS
- 1998 Commissioner, SESC