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Message from the Chairperson



Chairperson : Ginko Sato

The Securities and Exchange Surveillance Commission (SESC) was established in 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.

In those days, there were growing calls for: 1) a conversion in securities policies to non-discretionary ex-post-facto surveillance based on more transparent rules; and 2) separation of the role of supervising securities companies, etc. and that of surveillance of rule compliance. In order to accomplish these purposes, the SESC was

given the responsibility to play a central role in ensuring market fairness and transparency and to contribute to the sound functioning of securities markets in Japan through inspections of securities companies, daily market surveillance, and investigations of criminal offenses.

In June, 1998, the Financial Supervisory Agency (FSA) was established. Though the SESC was transferred to the FSA, the SESC kept its independence because of the reason that the neutral and objective role played by the SESC would remain important in the future. In order to stabilize and reconstruct the financial

system in Japan, the Financial Reconstruction Commission (FRC) was established in December, of the same year, and the FSA and the SESC were transferred to the FRC.

The SESC is an organization based on a council system comprising a Chairperson and two Commissioners, who implement their authority independently. The Chairperson and Commissioners are appointed by the Prime Minister with the consent of both Houses. Their status is guaranteed during their three-year term. The SESC has an Executive Bureau and regional offices to carry out its regular work.

In line with the unfolding drastic reform of Japan's financial system, the shift from the licensing system to registration system for securities companies was implemented and the obligation to concentrate trading on the exchange was abolished in December, 1998, and the liberalization of brokerage commissions was implemented and the restrictions on the business scope of the securities subsidiaries of banks was abolished in

October 1999. Moreover, given the ongoing increase in securities transactions across borders, the role played by the SESC in having market rules thoroughly observed would become more important and the transactions subject to the SESC inspections will become complicated.

In order to secure fair securities transactions and ensure investor confidence in the securities market, the SESC intends to exercise its authority to the maximum extent, while further upgrading its systems.

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

Ginko Sato

Chairperson

Securities and Exchange Surveillance Commission

March 2000

Summary

Following is a summary of main activities in SESC year 1998 (July 1, 1998, to June 30, 1999).

1. Investigations of criminal offenses

In order to secure fair markets, it is important to build investors' confidence that markets are and will be under the proper surveillance. The confidence could be built by strict enforcement of the related laws and regulations. From this perspective, the investigation of criminal offenses is regarded as one of the most essential duties of the SESC.

During the year under review, compulsory investigations visiting and searching the premises of suspects, and seizing related evidence were conducted against Nippon MIC Co.'s shares on suspected insider trading, and against Showa Chemical Industry Co.'s shares on suspected market manipulation and against the Long-Term Credit Bank of Japan on suspected submission of securities report containing falsified information. The SESC made a total of six accusations to public prosecutors against violations of the Securities and Exchange Law (SEL) — four cases of insider trading, one case of market manipulation and one case of submission of a

securities report containing falsified information. In the seven years since its establishment, the SESC has made a total of 24 accusations—10 cases of insider trading, seven cases of loss compensation, two cases of spreading of rumors, two cases of market manipulation and three cases of submission of securities report containing falsified information.

2. Inspections of securities companies

Rule compliant behaviors of securities companies are required as the first step in promoting compliance with transaction rules in the markets as a whole. The SESC inspects the actual state of compliance with transaction rules by securities companies. During the year under review, inspections were commenced on 80 domestic or foreign securities companies, and problems were found in and notified to 70 companies and organizations among 78 of them in which inspections were completed.

The SESC inspections uncovered numerous cases of violations of laws, including the conclusion of discretionary trading account transaction contracts and securities transactions for speculative profits by directors and employees of secu-

rities companies, as well as the sale of securities on the companies' own accounts without owning the securities, submission of transaction reports containing falsified information to customers and counter-bucketing and bucketing. The inspection also uncovered many problems related to the 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 (see Chapter 3) to the FRC and the Commissioner of the FSA for administrative disciplinary actions against 34 cases—11 securities companies and 67 directors and employees of securities companies—for their grave violations of laws.

3. Effective market surveillance

Effective collection and accurate analysis of information on the securities markets are essential in order to enable the timely detection of unfair transactions. To this end, the SESC strives for close cooperation with self-regulatory organizations (SROs) and collection of information from the general public in addition to checking the movements of stock prices, etc.

In the year under review, the SESC conducted surveillance activities in a total of 275 cases—104 cases of suspected price manipulation, 165 of suspected insider trading, and six of suspected spreading of rumors and other matters.

4. Measures to cope with computerization and internationalization

The progress of computerization has made financial products rapidly diversified and complicated and, as symbolized by the internet, it has had a significant impact on transaction methods and information media. In order to cope with these situations, the SESC introduced the Securities Comprehensive Analyzing System (SCAN-System) in 1993 to enhance its analysis

and search functions in securities companies inspections and market surveillance. In addition, the SESC collects information from the general public via its internet website.

As a result of increase in securities transactions across borders, exchange of information with other countries are essential in many cases in order to grasp the transactions in detail. The

SESC has been striving to strengthen cooperation with the regulatory/supervisory authorities of other countries on various occasions of the International Organization of Securities Commissions (IOSCO) and to conclude a Memorandum of Understanding (MOU) aimed at strengthening cooperation on a bilateral basis to exchange non-public information.

Section 1. Outline

1. Purpose of and authority for investigations of criminal offenses

The authority for investigations 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 of securities companies and other related financial institutions are conducted under the authority delegated by the FRC and the Commissioner of the FSA. Concerning the investigations of criminal offenses, the SESC's authority is not limited to securities companies but reaches all parties involved in securities transactions, including investors themselves.

The SESC may conduct non-compulsory in-

vestigations of criminal offenses (Article 210 of the SEL, Article 53 of the LFSF, and Article 106 of the FFTL), including making inquiries about suspects or related parties (hereinafter, suspects), 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 53 of 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 and accusations

The scope of criminal offenses is prescribed in the relevant Cabinet Orders (Article 45 of the SEL Enforcement Order, Article 23 of the LFSF Enforcement Order, and Article 14 of the FFTL Enforcement Order). These are loss compensation, spreading of rumors, market manipulation, insider trading, and submission of securities reports containing falsified information.

The results of criminal investigations are reported to the SESC by its investigation staff (Article 223 of the SEL, Article 53 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 (Article 226 of the SEL, Article 53 of the LFSF, and Article 122 of the FFTL).

Section 2. Investigations and accusations of criminal offenses

1. Investigations of criminal offenses

During the year under review, the SESC conducted compulsory investigations based on suspicion of insider trading concerning Nippon MIC Co.'s shares, on suspicion of market manipulation concerning Showa Chemical Industry Co.'s shares, and on suspicion of submission of securities reports containing falsified information concerning the Long-Term Credit Bank of Japan. 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 the results of investigation, the SESC sent a total of six accusations to public prosecutor's offices concerning possible SEL violations—four cases of insider trading, one case of market manipulation, and one case of submitting falsified securities reports. These are summarized below:

(Case 1: Insider trading)

On July 6, 1998, in relation to the insider trading case concerning Daito Kogyo Co.'s shares, the SESC sent accusations against two suspects to the Tokyo District Public Prosecutor's Office for offenses against the SEL (Article 166 (3), "Prohibited acts of company-insiders").

In August 1997, the suspect A, a director of a company affiliated with Daito Kogyo Co., on hearing from an employee of Daito Kogyo that Daito Kogyo will file commencement of reorganization procedure under the Corporate Reorganization Law, sold Daito Kogyo's shares he held prior to the official announcement of the important fact to avoid a possible loss, and sold Daito Kogyo's shares on margin transaction

prior to the announcement to make a profit by selling the shares in advance and then purchasing them after a fall in the share price.

The suspect B, a parent of an employee of the company affiliated with Daito Kogyo, on hearing from the employee of the important fact that the employee acquired through his duty at the company, sold Daito Kogyo's shares he held prior to the official announcement of the important fact in order to avoid a possible loss.

Note: On July 17, 1998, a prosecution against the accused two individuals was brought to the Tokyo Summary Court. On the same day, the suspect B received a summary order from the court to pay a fine of 500,000 yen and the case was closed.

The suspect A was handed down by the Tokyo District Court a sentence of six months in prison, followed by three years of probation and a fine of 500,000 yen on November 10, 1998. The case was closed.

(Case 2: Insider trading)

On October 30, 1998, in relation to the insider trading case concerning Nippon MIC Co.'s shares, the SESC sent an accusation against two suspects to the Tokyo District Public Prosecu-

tor's Office for offenses against the SEL (Article 166 (1), "Prohibited acts of company-insiders").

The suspect A, a representative director of INTEC Co., was a participant in business tie-up negotiations between INTEC and Nippon MIC Co. The two companies eventually reached an agreement in November 1995 under which Nippon MIC absorbed INTEC. Expecting the stock price of Nippon MIC to shoot up as a result of the merger involving the promising non-contact IC chip business, the suspect A purchased the stocks prior to the official announcement of the important fact under three different assumed names in collusion with the suspect B, an employee of Nichiei Securities Co. to make a profit by purchasing the stocks in advance and then selling them after a surge in the stock price.

Note: On November 2, 1998, a prosecution was instituted against the accused two individuals. The suspect B was handed down by the Tokyo District Court a sentence of six months in prison, followed by three years of probation and a fine of 500,000yen, and the case was closed. The case of the suspect A is pending

public trial.

(Case 3: Insider trading)

On December 17, 1998, in relation to the insider trading case concerning Toa Steel Co.'s shares, the SESC sent an accusation against two suspects to the Tokyo District Public Prosecutor's Office for offenses against the SEL (Article 166 (1), "Prohibited acts of company-insiders").

The suspect A was a managing director of Marubeni Co. in charge of the metal division. In August 1998, he was notified of the decision to dissolve Toa Steel Co., with which Marubeni had business contracts. The suspect A sold Toa Steel's shares on margin transaction prior to the official announcement of the important fact in collusion with the suspect B, his subordinate, and by using the names of the subordinate's relatives, to make a profit by selling the shares in advance and then purchasing them after a decline in the share price.

Note: On February 10, 1999, a prosecution against the accused two individuals was brought to the Tokyo Summary Court. On the same day, the suspect B

received a summary order from the court to pay a fine of 500,000 yen and the case was closed. The case of the suspect A is pending public trial at the Tokyo High Court. (On April 14, 1999, the suspect A was handed down by the Tokyo District Court a sentence of one year in prison and a fine of two million yen on account of this and Case 4 facts, but the defendant made an appeal to the Tokyo High Court.)

(Case 4: Insider trading)

On February 10, 1999, in relation to the insider trading case concerning Toa Steel Co.'s shares, the SESC sent an accusation against two suspects to the Tokyo District Public Prosecutor's Office for offenses against the SEL (Article 166 (2), "Prohibited acts of company-insiders").

The suspect B, a president of a steel material wholesaler, has been on friendly terms with the suspect A, a managing director in charge of the metal division at Marubeni Co. In August 1998, received a notice of Toa Steel's decision to dissolve itself from the suspect A and was advised to make a profit by conducting insider trading. The suspect B sold Toa Steel's shares on margin transaction prior to the official announcement of

the important fact to make a profit by selling the shares in advance and then purchasing them after a decline in the share price.(With regard to the suspect A, it was for the instigation of insider trading.)

Note: On February 10, 1999, a prosecution against the accused two individuals was brought to the Tokyo District Court. The case is pending public trial at the Tokyo High Court. (With regard to the suspect B, on April 14, 1999, was handed down by the Tokyo District Court a sentence of 10 months in prison and a fine of two million yen, but the defendant made an appeal to the Tokyo High Court. With regard to the suspect A, see Case 3.)

(Case 5: Market manipulation)

On March 4, 1999, in relation to the market manipulation case concerning Showa Chemical Industry Co.'s shares, the SESC sent an accusation against two suspect individuals and one suspect company to the Osaka District Public Prosecutor's Office for offenses against the SEL (Article 159 (1) (2), "Prohibited acts of market manipulation").

K.K.Flex Co. provides loans with securities as collateral. The suspect A alias B, a senior managing director and the effective president of the company, in collusion with the employees of the company, engaged in market manipulation of the share price of Showa Chemical Industry Co, listed on the second section of the Tokyo Stock Exchange, from June 1997 to August the same year, by using 15 accounts (including assumed names)

- ① by repeatedly conducting wash sale with the aim of creating artificial market activity, and
- ② by creating artificial market activity with the aim of inviting trading in the stock and by raising the stock price from around 860 yen to 1,150 yen through successive transactions (including ①) with the aim of causing fluctuations in the stock price.

Note: On March 5, 1999, a prosecution against the accused company and one individual was brought to the Osaka District Court. On June 24, 1999, the suspect B was handed down by the court a sentence of one year and six months in prison, followed by three years of probation and K.K.Flex was handed down a fine of four million yen. The case was closed.

(Case 6: Submission of securities reports containing falsified information)

On March 5, 1999, in relation to the submission of securities reports containing falsified information case concerning the Long-Term Credit Bank, the SESC sent an accusation against three suspect individuals and one suspect company to the Tokyo District Public Prosecutor's Office for offenses against the SEL (Article 197 (1), "Acts of submitting securities reports containing falsified information on important items").

The Long-Term Credit Bank is engaged in the banking business. The suspect A, the

president of bank, and two vice presidents the suspect B and C in collusion submitted securities reports containing falsified information in important items by reporting about 271.6 billion yen in unappropriated losses, about 313.1 billion yen less than the actual unappropriated losses of about 584.7 billion yen in the term ended March 31, 1998, through such means as not properly making allowances for or writing off uncollectable loans to affiliated companies.

Note: On June 30, 1999, a prosecution against the accused three individuals was brought to the Tokyo District Court. The case is pending public trial.

Section 1. Outline

The SESC conducts on-site inspections of securities companies and related organizations to supervise their compliance with laws and regulations that were made to secure fairness in securities transactions. The SESC inspections are carried out under the authority delegated by the FRC and the Commissioner of the FSA as prescribed in the SEL, LFSF and FFTL.

The objective of the SESC inspections is to protect the public interest and investors. The SESC inspections are expected to support the FRC and the Commissioner of the FSA in taking necessary measures and formulating policies concerning securities companies.

The following institutions are subject to the SESC inspections:

- ① Securities companies and their holding companies
- ② Financial institutions registered to provide securities services
- ③ Japan Securities Dealers Association (JSDA)
- ④ Stock exchanges
- ⑤ Branches of foreign securities companies and specified financial institutions

- ⑥ Financial futures exchanges and their members
- ⑦ Financial futures dealers
- ⑧ Financial Futures Dealers of Japan (FFA)

The scope of SESC inspections is regulated in Cabinet Orders (Article 38 of the SEL Enforcement Order and Article 20 of the LFSF Enforcement Order) and rules set by the FRC (Article 27. Related to FFTL). For example, the SESC is authorized to conduct inspections of suspected violations of laws and regulations by securities companies and their directors or employees (including discretionary trading account transactions, solicitation with definitive predictions, solicitation with promises of special profit, etc.), as well as such violations as loss guarantees and compensation, market manipulation, and insider trading.

Section 2. Basic policy and plan for inspections

Inspections periods are based on SESC years, from July 1 to the following June 30.

At the beginning of SESC year, the basic

policies and plans for inspections are made in order to ensure that all inspections by the SESC and those by regional offices are managed and conducted strategically.

In the basic policies for inspections, important inspection items and other basic matters are determined. In the basic plans for inspections, the number and types are described concerning inspections of domestic and foreign securities companies, and financial institutions registered to provide securities services.

Section 3. Results of inspections

1. Inspections of securities companies

During the year under review, the SESC and regional offices commenced inspections of 80 securities companies.

Of this total, the SESC commenced inspections of six domestic securities companies and 12 branches of foreign securities companies. Regional offices commenced inspections of 62 domestic securities companies.

Regarding inspections commenced during the year under review, inspections were completed on 53 domestic securities companies and 10

branches of foreign securities companies with the presentation of Notice of Conclusion to the companies (see Table 1). In addition, inspections commenced in SESC year 1997 but not completed by June 30, 1998, were completed during the year under review. These included inspections of 13 domestic securities companies, one SRO, and one financial futures dealer.

Following the SESC recommendations based on inspections concluded in SESC year 1998 (including those commenced in the previous year), the FRC and the Commissioner of the FSA took administrative disciplinary actions against 11 securities companies and 67 directors and employees of securities companies for their grave violations of laws and regulations (see Chapter 3).

Problems found through these inspections were reported by the SESC to the administrative sections, which then issued directives for improvement to the securities companies inspected.

2. Inspections of financial futures dealers

In SESC year 1998, when the SESC conducted inspections of securities companies who also

provided financial futures dealing services, in-
spections of financial futures dealers were con-

ducted concurrently.

Table 1 : Inspection

Category	SESC Year 1994	SESC Year 1995	SESC Year 1996	SESC Year 1997	SESC Year 1998
Securities companies	85	86	83	79	80
Domestic (SESC)	79 (10)	84 (9)	80 (12)	72 (7)	68 (6)
(Regional offices, etc.)	(69)	(75)	(68)	(65)	(62)
Foreign (SESC)	6 (6)	2 (2)	3 (3)	7 (7)	12 (12)
(Regional offices, etc.)	(0)	(0)	(0)	(0)	(0)
Branch inspections	22	15	26	31	27
Financial institutions licensed to provide securities services (SESC)	11 (1)	10 (0)	7 (0)	0 (0)	0 (0)
(Regional offices, etc.)	(10)	(10)	(7)	(0)	(0)
Financial futures dealers (SESC)	0 (0)	0 (0)	0 (0)	1 (0)	0 (0)
(Regional offices, etc.)	(0)	(0)	(0)	(1)	(0)
SROs (SESC)	0 (0)	0 (0)	0 (0)	1 (1)	0 (0)
(Regional offices, etc.)	(0)	(0)	(0)	(0)	(0)

- Notes : 1. The above figures are the number of inspections commenced
2. The category "Branch inspections" shows the number of inspections conducted only on branches.
3. On December 1998, the licensing system for securities services was abolished and since then, only registration has been required for the provision of securities services. "Financial institutions registered to provide securities services" are included in the column on "financial institutions licensed to provide securities services."

Section 4. Results of securities company inspections

Inspections of securities companies in the year under review were conducted mainly to examine their compliance with transaction rules, sales practices, including investment solicitations, and internal control systems. Another important focus was to confirm that problems found through previous inspections had been improved .

Among the 78 companies and organizations of which inspections were completed, problems were found with 70 companies and organizations. Of the 70, inspections found violations of transaction rules by 63 companies and organizations. Inspections also revealed many problems related to securities companies' sales practices and internal control systems.

In the year under review, the SESC uncovered a particularly large number of grave violations of laws, for which it made recommendations to the FRC and the Commissioner of the FSA. These are believed to have been caused by a lack of awareness among directors and employees of the importance to comply with laws,

as well as insufficient internal control systems. 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, and that securities companies themselves build effective internal control systems.

As for problems related to the compliance with transaction rules, the SESC found violations of laws, such as the conclusion of discretionary trading account transaction contracts, securities transactions for speculative profit by directors or employees, as well as numerous instances of violations of self-regulatory rules, including the acceptance of orders under customers' assumed names. During the year under review, the SESC also uncovered numerous violations of Cabinet Orders, including the sale of securities on the companies' own accounts without owning the securities, the submission of transaction reports containing falsified information to customers, counter-bucketing and bucketing, and the granting of credit to customers by underwriting securities companies at the time of sales of securities.

As for problems related to sales practices,

there were cases where the profit of customers was substantially ignored and where an insincere or unfair act was conducted in solicitation. They included solicitation for investment in the stocks of foreign companies without fully explaining the companies' business performance or foreign exchange risks involved, solicitations for switching a foreign currency financial instrument to another financial instrument in the same foreign currency which was made without explaining the existence of the switching system that entails no exchange cost, and solicitations for switching investment trusts on amortization without explaining the availability of a preferential treatment for switching.

As for internal control systems, despite measures adopted by various companies to strengthen their systems there were still several problematic examples. They included a failure to find out violations of laws due to insufficient remedy measures for problems found in interviews with customers as well as a failure to report mistakes despite knowing violations of laws. These examples illustrate the facts that their internal control systems were practiced only in an insufficient or inappropriate manner and the

effectiveness of such systems was harmed by this, and that persons directly involved in controlling such systems lacked the awareness of the importance to comply with laws and rules.

The following is a summary of the problems found during inspections completed in SESC year 1998, including those commenced in the previous SESC year.

(1) Concerning the observance of transaction rules, the following problems were found in some securities companies

○ *Violations of laws that resulted in recommendations*

- ① Counter-bucketing and bucketing
- ② Submission of falsified transaction reports to customers
- ③ Solicitation with definitive predictions that the prices of securities would shoot up
- ④ Conclusion of discretionary trading account transaction contracts
- ⑤ False reports on securities transactions
- ⑥ Continued securities transactions to realize market prices that do not reflect real factors
- ⑦ Continued acceptance of securities transaction orders, knowing that such actions will

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|--|---|
| <p>have a manipulative effect on the market</p> <p>⑧ Securities transactions for speculative profit by directors or employees of securities companies</p> <p>⑨ Solicitation with the promise to compensate for losses</p> <p>⑩ Promising compensation for losses after a certain period</p> <p>⑪ Provision of property gains to compensate for losses</p> <p>⑫ Sale of securities on a company's own account without owing the securities</p> <p>○ <i>Violations of laws that did not result in recommendations</i></p> <p>⑬ Counter-bucketing and bucketing</p> <p>⑭ Conclusion of discretionary trading account transaction contracts</p> <p>⑮ Purchase of securities by a primary underwriting securities company on its own account during stabilization period</p> <p>⑯ Visits to customers accompanied by directors and employees of parent bank without the customers' request</p> <p>⑰ Granting of credit to customers by underwriting securities companies at the time of sales of securities</p> | <p>○ Violations of self-regulatory rules</p> <p>⑱ Inappropriate corrections of mistakes</p> <p>⑲ Solicitation for the purchase of securities before the announcement of the off-floor sale of securities</p> <p>⑳ Failure to explain that the disclosure of information about a company whose stocks are listed abroad is not obliged under the SEL</p> <p>㉑ Transactions by sales representatives without customers' consent</p> <p>㉒ Margin transaction and borrowing of customers' names by sales representatives</p> <p>㉓ Acceptance of securities transaction orders under borrowed names from sales representatives</p> <p>㉔ Acceptance of securities transaction orders by sales representatives under assumed names</p> <p>㉕ Borrowing of customers' names and lending money to and borrowing money from customers by sales representatives</p> <p>㉖ Use of documents by sales representatives without a responsible person's examination of the documents</p> <p>(2) Concerning sales practices, the solicitation for foreign stocks, convertible bonds, etc. dis-</p> |
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garding the profits of customers were found in some securities companies.

(3) Concerning internal control systems, the following problems were found in some securities companies:

- ① Insufficient internal control systems and insufficient operation of internal control systems
- ② Insufficient awareness by directors and employees of the importance of compliance with laws and regulations

With regard to the violations of laws pointed out in the inspections such as “Submission of falsified transaction reports to customers,” “Counter-bucketing,” “Continued securities transactions to realize market prices that do not reflect real factors,” “Violations of rules against short selling,” and “Conclusion of discretionary trading account transaction contracts,” the SESC prepared its basic point of view of specific examples and the applicability of laws against them and notified it to the regional offices and the JSDA for use as references in their future inspections.

Section 5. Results of inspections of financial futures dealers

Inspections of financial futures dealers were conducted in the same way as the inspections of securities companies, with an emphasis on the examination of their compliance with transaction rules, etc.

The SESC uncovered one case of conclusion of discretionary trading account transaction contracts (violation of laws) by one organization and made a recommendation (As to specific examples, see Chapter 3).

Section 6. Results of inspection of Self-Regulatory Organizations

An amendment to the SEL in July 1992 clarified the nature of the JSDA and stock exchanges as SROs and strengthened the function of the SROs. As the Financial System Reform progresses in the future, there will be an increasing demand for assuring transparency and fairness in securities markets.

The SESC conducted inspections of the JSDA from April to July 1998 to check the enforcement

of its fairness assurance measures.

Note: After a series of securities scandals in the summer of 1991, the issue of the function of securities dealers associations and other SROs surfaced. As a result, the need to strengthen the function was emphasized in a report by the Securities and Exchange Council (January 1992)

etc. The Securities and Exchange Council report points out that securities market regulations should be handled by related parties because of the highly specialized nature of securities transactions and the need to cope with changes. Based on the opinions described above, the SEL was amended to strengthen the function of SROs.

Section 1. Outline

Based on the results of inspections and investigations of criminal offenses, the SESC may, as necessary, send recommendations to the FRC and the Commissioner of the FSA, or the Minister of Finance, for disciplinary actions or other appropriate measures (hereinafter referred to as “administrative disciplinary actions”) to ensure securities transaction fairness (Article 29 (1) of the FRC Establishment Law (FRCEL)).

For example, the SESC is authorized to make a recommendation for administrative disciplinary actions to be taken against securities companies which violate laws; and a recommendation requesting an order to the SROs that command them to take necessary actions against securities companies which violate laws when the SROs have not taken the necessary measures although violating behavior by securities companies was identified.

The FRC and the Commissioner of the FSA or the Minister of Finance must respect the recommendations made by the SESC (Article 29 (2) of the FRCEL). The SESC may also request that they report on actions taken based on the

SESC’s recommendations (Article 29 (3) of the FRCEL).

After receiving recommendations for administrative disciplinary actions, based on the results of inspections made by the SESC, the FRC and the Commissioner of the FSA, or the Minister of Finance hold hearings with the parties involved and take administrative disciplinary actions, such as suspending the operations of securities companies when deemed necessary.

The FRC may make the JSDA do office work concerning the registration of sales representatives and impose disciplinary actions on them (Article 64-7(1) of the SEL). Based on the SESC’s inspection results, the JSDA holds further hearings with the parties concerned and takes such measures as revoking the registration of sales representatives or suspending operations as sales representatives.

Section 2. Recommendations and actions taken

In the year under review, the SESC sent 36 recommendations to the FRC and the Commissioner of the FSA for administrative disciplinary

actions against securities companies and directors or employees of securities companies for their violations of laws found during inspections and investigations of criminal offenses. Of them, 34 recommendations were based on the results of inspections and two were based on the results of investigations of criminal offenses.

The number of recommendations calling for administrative disciplinary actions against securities companies (including directors and employees thereof) was 12 and the number of recommendations calling for appropriate actions against directors and employees of securities companies was 24. A total of 71 directors and employees of securities companies were referred to in the SESC recommendations.

Violations of laws referred to in the recommendations are as follows:

1. Violations of laws by companies

① Counter-bucketing and bucketing (Violation of Articles 39 and 129 (1) of the SEL)

From April 11, 1995 to August 27, 1998, Shinyei Ishino Securities Co., with the involvement of the manager of the bond department, purchased convertible bonds on its own

account, and after executing cross transaction in the securities market in the form of selling a certain amount of the convertible bonds on its account to its customers without receiving buy orders from the said customers, provided the purchase information to 16 branches to solicit purchases to promote branch sales. Later, the company received buy orders from many of its customers, but instead of placing the orders in the securities market, the company just moved transactions on the company's own account to the customers' accounts.

And on August 27, 1998, the Tokyo branch of the company, with the involvement of the manager of the first sales division, moved some of the convertible bonds on the account of a particular customer to the accounts of a multiple number of other customers who had placed buy orders for the convertible bonds, instead of placing such orders in the securities market.

② Submission of falsified reports to customers (Violation of Article 41 of the SEL, including the application of Articles 51-3 and 14 (1) of the LFSF)

On May 18th, 1998, Instinet Securities Co.

received a sell order of over-the-counter stocks from a customer and the company ordered a sell order of over-the-counter stocks from the agency.

At first, the chief of a section in the Trading Division informed the customer of the wrong contents of transaction. Later, he noticed the real contents of transaction when he confirmed the contents of transaction from the agency.

But he did not want the customer to know his mistake. For this reason, after gaining the understanding by the head of the Trading Division, he did not contact the customer to correct the situation. And he inputted the price which was different from the real execution price to a computer deliberately. Consequently, the company submitted transaction reports containing false statements based on these wrong data.

From August 1997 to July 1998, the employees of the domestic section and other sections of Dresdner Kleinwort Benson (Asia) Ltd., Tokyo Branch, informed certain customers of the wrong prices which were different from the market prices by mistake (18 orders).

After informing the customers of the prices of their orders, the company got to find that the

prices were wrong by checking up the prices of which the customers had been informed and the execution prices written on the transaction reports from the stock exchange.

Although the company realized that there were mistakes among the prices of which the customers had been informed, the company did not try to inform their customers of their mistakes because the company thought if their customers had realized its mistakes its reputation among customers would have been tarnished.

For this reason the company switched the customers' transactions actually executed in the market to the transactions on their own account and applied to the stock exchange for "corrections of errors" to make other transactions off the session to make up the customers' transactions with them and finished the deals of the customers so that the off-the-session transactions would seem to be real ones. As a result, the company made up false reports on them and sent them to the customers.

In addition to the case of counter-bucketing and bucketing in August 27, 1998, Shinyei Ishino Securities Co., with the involvement of the man-

ager of the first sales division at Tokyo branch, moved some of the convertible bonds on the account of a particular customer to the accounts of a multiple number of other customers who had placed buy orders for the convertible bonds, instead of placing such orders in the securities market, and notified the particular customer that some of his orders had not been fulfilled and delivered to him falsified transaction reports containing trading volume that was smaller than the actually contracted amount.

③ Conclusion of discretionary trading account transaction contracts (Violation of Article 74-3 of the FFTL)

From February 1992 to November 1994, Nanto Bank, Ltd., with the involvement of the employee belonging to the fund/securities department, concluded contracts for financial futures transactions with six customers. These contracts stipulated the selection of financial instruments (Japanese yen short-term interest rate futures), number of units transacted (number of contracts), etc. but allowed the company to make decisions without customers' consent for specific transactions concerning duration (deliv-

ery month), contract volume (price), whether to buy or sell, and settlement before maturity (reselling/buyback). From February 1992 to August 1997, the company accepted and executed orders from the customers (1,133 transactions and 98,718 contracts).

④ Continued securities transactions to realize market prices that do not reflect real factors (Violation of a Ministerial Ordinance, Article 42 (1) (ix) the SEL)

On March 31, 1997, Mita Securities Co., with the aim of raising the prices of two of the stocks it held and thus reducing the huge amount of unrealized losses on them, made a series of buy orders, with the involvement of a senior managing director, at market prices or high limit prices during 1:23 p.m. and 2:56 p.m. for one of the stocks and during 10:40 a.m. and 2:32 p.m. for the other stock.

On September 30, 1997, the company, with the involvement of the president, made a series of buy orders during 10:44 a.m. and 2:23 p.m. for one of the stocks and during 10:43 a.m. and 2:56 p.m. for the other.

On May 1997, Tokai Maruman Securities Co., with the involvement of the director in charge of the stock department, made a series of buy and sell orders on its own account at high limit prices for stock index options during 9:33 a.m. and 10:57 a.m. with the aim of raising the options prices to a predetermined level so that there should be no profit or loss both for the company and its customer, who wanted to buy back stock index options in an offset transaction with the company.

⑤ Continued acceptance of securities transaction orders knowing that such actions will have a manipulative effect on the market (Violation of a Ministerial Ordinance, Article 42 (1)(ix) of the SEL)

Between 10:43 a.m. and 10:58 a.m. on March 25, 1998, a commission sales representative of Marukin Securities Co.'s third sales department accepted and executed a series of sell orders for a particular stock from a particular customer, knowing that the customer was trying to lower the price of the stock by consecutively placing sell orders at market prices and thus buy back the same stock he sold short at a reduced price

in order to avoid a loss on his short position of the stock.

In the course of market manipulation of the share price of Showa Chemical Industry Co. from June 1997 to August the same year, Miyako Securities Co., with the involvement of a managing director, accepted and executed a series of transaction orders from a suspected violator of laws, knowing that the suspect was trying to raise the price of particular stocks by continuously placing buy orders at high limit prices.

From June 23, 1997 to August 15, 1997, Shinwa Securities Co., with the involvement of director and the company's Osaka branch manager, accepted and executed a series of stock trading orders placed by the suspect in the same manner as Miyako Securities did.

⑥ Provision of property gains to compensate for losses (Violation of Article 42-2 (1)(iii) of the SEL)

A sales representative of the first sales division of Tokai Maruman Securities Co.'s Tokyo

branch, responding to requests from customers to compensate for their losses incurred in investment trusts, provided property gains by remitting to the customers' bank accounts on April 3, 1996 sums of money he had borrowed from relatives in order to compensate for the customers' losses in their entirety. (The compensation amounted to about 370,000 yen.)

A manager and a sales section chief of Hinode Securities Co.'s Mita branch (in Hyogo Prefecture), responding to strong requests from customers to compensate for their losses and for fear of the fact being brought to the attention of company management, jointly provided property gains by paying the customers cash amounts between January 31, 1992 and July 31, the same year, in order to partially compensate for the customers' losses with their own funds. (The compensation amounted to 27 million yen.)

The branch manager, feeling responsible for complaints from some other customers, also provided property gains by paying cash amounts to the customers on April 4, 1992 in order to partially compensate for the customers' losses with his own funds. (The compensation amount-

ed to about 3.56 million yen.)

⑦ Sale of securities on a company's own account without owning the securities (Violation of Article 162 (1) (i) of the SEI)

Between August 1995 and May 1998, Jujiya Securities Co.

(1) sold stocks and convertible bonds on securities markets many times without making it clear to sell the securities without owning the securities (hereinafter referred to as "short-selling"), and

(2) conducted short-selling of stocks on its own account on securities markets many times at prices below the most recent market prices.

Between April 1995 and August 1998, Chuo Securities Co.

(1) conducted short-selling of stocks on its own account on securities markets many times without making it clear to short-sell the stocks, and

(2) conducted short-selling of stocks on its own account on securities markets many times at prices below the most recent market prices.

Between October 1998 and January 1999, Kokyo Securities Co.

(1) did not make it clear to stock exchanges that the short-selling it conducted on its own account on stock-exchange exchanges many times was short-selling, and

(2) conducted short-selling on its own account many times at prices on stock exchanges below the prices most recently published by the stock exchanges.

2. Violations of laws by directors and employees

In the year under review, the SESC made recommendations against directors and employees of securities companies concerning the following violations of laws:

① Conclusion of discretionary trading account transaction contracts (Violation of Article 42 (1)(v) of the SEL)

At the request of customers or in order to increase sales performance, sales representatives concluded contracts that gave themselves discretionary power to make decisions concerning all or some items in stock and other transactions, namely whether to buy or sell, selection of

issues, number of stocks to be bought or sold, and price, without the consent from customers in each individual transaction, and actually received orders and conducted transactions. (Recommendations made against 17 companies and 28 individuals.)

② Solicitation with definitive predictions that the prices of securities would shoot up (Violation of Article 42 (1)(i) of the SEL)

A sales representative solicited particular customers to purchase particular stocks by providing a definitive prediction that the price of the stocks would soar. (Recommendation made against one company and one individual.)

③ Submission of falsified transaction reports to customers (Violation of a Ministerial Ordinance, Article 42 (1)(ix) of the SEL)

Sales representatives, on receiving inquiries from customers about the breakdown of their deposited assets and their appraised values, prepared notes overestimating the appraised values of the assets out of their desire to continue transactions with the customers, and delivered the notes or orally conveyed the contents

of the notes to the customers. (Recommendations made against one company and two individuals.)

④ Securities transactions for speculative profit by directors or employees (Violation of a Ministerial Ordinance, Article 42 (1)(ix) of the SEL)

Sales representatives, in order to pursue their own profits and increase commission income, conducted trading in stocks, etc. on their own judgment on many occasions by using customers' accounts. (Recommendations made against 14 companies and 19 individuals.)

⑤ Solicitation with the promise to compensate for losses, Promising compensation for losses after a certain period, and Provision of property gains to compensate for losses (Violation of Articles 42-2 (1)(i), (ii), and (iii) of the SEL)

Requested by customers to guarantee the principals in the process of soliciting for investment trusts, sales representatives promised to guarantee the principals.

Receiving complaints from customers about appraisal losses on stocks, sales representatives send the customers a written memorandum of understanding that they would compensate for

losses and promised to provide property gains in order to fully compensate for the appraisal losses.

Moreover, since sales representatives had been making falsified reports to customers on their losses concerning stock trading and since they had been strongly requested by the customers to pay the amount entered into the reports, they paid in cash or remitted to customers' accounts to compensate totally or partially for the losses on securities and other trading either with their own funds or funds misappropriated from other customers' accounts, etc., thus providing property gains. (Recommendations made against five companies and seven individuals.)

⑥ Prohibited acts by company-related persons (Violation of Article 166 (1)(iv) of the SEL)

A sales representative, in collusion with his customers, obtained important information subject to insider trading regulations and purchased stocks prior to the announcement of the information by using fictitious accounts. (Recommendation made against one company and one individual.)

Other violations uncovered included counter-
made against one company and 13 individuals),
continued securities transactions to realize mar-
ket prices that do not reflect real factors (recom-
mendations made against two companies and
two individuals), continued acceptance of secu-
rities transaction orders, knowing that such
actions will have a manipulative effect on the
market (recommendations made against two

bucketing and bucketing (recommendations
companies and four individuals), submitting of
falsified transaction reports to customers (re-
commendations made against one company and
one individual), and inappropriate acts as sales
representatives (recommendations made against
two companies and four individuals).

Section 1. Outline

In addition to inspections and investigations related to violations, the SESC conducts market surveillance as part of its regular 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 FRC and the Commissioner of the FSA as prescribed in the SEL, LFSF, and FFTEL. The SESC conducts day-to-day monitoring of market activities by requesting detailed reports on securities transactions from securities companies and collecting relevant materials for market surveillance.

- Institutions from which reports and materials are collected are listed as follows:
- ① Securities companies and their holding companies
 - ② Financial institutions registered to provide securities services
 - ③ JSDA
 - ④ Stock exchanges
 - ⑤ Branches of foreign securities companies and specified financial institutions
 - ⑥ Financial futures exchanges and their mem-

bers

- ⑦ Financial futures dealers
- ⑧ FFA

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, or making references to factual information.

Section 2. Market surveillance

1. Market surveillance

Market surveillance activities include gathering information on the market and enterprises, collecting materials from securities companies, and conducting hearings. Through these activities, close analysis of specific market transactions is conducted for certain periods.

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

(1) Related to market manipulation 104 cases		
Sharp stock price rises	70 cases	
Stabilized stock price movements	11 cases	
(2) Related to insider trading 165 cases		
New share issues	29 cases	

Mergers	23 cases
Application for the commencement of corporate reorganization proceedings	15 cases
(3) Others, including spreading of rumors	6 cases
Cases of market surveillance conducted by the SESC and regional offices were as follows:	
Conducted by the SESC	171 cases
Conducted by regional offices	104 cases

2. Summary of surveillance results

The results of market surveillance conducted during the year can be summarized as follows:

Surveillance concerning market manipulation centered on sudden stock price rises or declines and on other unnatural movements, as well as on cases where stock prices were deemed to be maintained at fixed levels. Stock under surveillance for having experienced sudden price rises included stocks that were traded by certain groups of investors in a disguised and collaborative manner with the intention of raising stock prices.

Surveillance concerning 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 a considerable amount of information that would cause price rises, such as the announcement of new stock issues and mergers, and information that would cause price declines, such as the application for the commencement of corporate reorganization proceedings. Cases concerning the suspicion of insider trading involved companies and their directors and employees dealing with the issues, in addition to the directors and employees of the issuers.

Surveillance concerning the spreading of rumors centered on issues whose prices fluctuate significantly owing to various types of information.

Cases that required further investigations would be dealt with by conducting on-sight inspections, etc.

Regular securities market surveillance through these activities is considered to function as a direct or indirect deterrent to unfair transactions.

Section 1. Market surveillance with overriding priority

Between September and October 1998, the prices of particular stocks, including the stocks of some banks, fluctuated significantly owing to various types of information, giving rise to a suspicion of spreading of rumors .

In response, the SESC issued the document “Market surveillance with overriding priority ” effective on October 7, 1998, to the Presidents of Stock Exchanges and the JSDA, calling for their cooperation in collecting information concerning cases that may distort the price-formation function of the market. Also on the same day, the SESC sent a notice to the regional offices, calling on them 1) to strive for the collection of information, 2) to take prompt actions such as collection of information and analysis of buy-sell orders when cases arise that might distort the price-formation function of the market, and 3) to focus on violations of laws and regulations that might distort the price-formation functions of the market in their inspections of securities companies.

Section 2. Receiving information from the general public

1. Information receiving system

Information provided by telephone, visit, or letter (including facsimile) from the general public is useful for inspections, market surveillance activities, and investigations of criminal offenses. The SESC has established a system for receiving such information and has been actively seeking information from the general public.

From 1 April, 1999, the SESC offered a section on its website (<http://www.fsa.go.jp/sesc/watch>) to receive opinions from the general public, and this made it possible to collect information via the internet.

2. Information received

In the year under review, the SESC received 241 pieces of information from investors, etc., namely, 77 telephone calls, 21 visits, 55 letters, 49 Internet, and 39 messages forwarded from the FSA and regional offices. By type of information, 145 pieces were related to specific issues, 68 pieces were related to the sales practices of securities companies, and 28 pieces were opin-

ions, etc. directed to the SESC.

Out of the information related to specific issues, information concerning suspected market manipulation was most frequently seen. This was followed by the information concerning suspected insider trading and submission of falsified securities reports. Among information concerning the sales practices of securities companies, cases of transactions without the custom-

ers' consent were most frequently seen. This was followed by conducting discretionary transactions, and solicitation with definitive predictions (see Table 2).

Information received is passed to, and used by, sections conducting inspections, market surveillance, investigations of criminal offenses, and regional offices.

Table 2 : Information Received (last 3 years)

Category		July/1996~ June/1997	July/1997~ June/1998	July/1998~ June/1999
No. of information received (Total)		255	341	241
Method of receipt	Telephone Calls	120	145	77
	Visits	18	45	21
	Letters	82	107	55
	Internet	-	-	49
	Forwarded information from the FSA and the regional offices	35	144	39
Information content	Specific issues	111	181	145
	Suspected market Manipulation	34	63	51
	Suspected insider trading	27	32	31
	Suspected loss guarantees and compensation	20	15	10
	Submission of falsified securities reports	8	15	11
	Others (spreading of rumors, etc.)	22	56	42
	Sales practices of securities companies, etc.	113	109	68
	Transactions without customers' consent	27	29	15
	Solicitation with definitive predictions	15	10	5
	Solicitation taking advantage of customers' lack of knowledge	6	3	3
	Conducting discretionary transactions	6	4	7
	Large-volume recommendation sale	4	1	2
	Others	55	62	36
	Others, Opinions, etc. directed to the SESC	31	51	28

Section 3. Cooperation with overseas regulatory authorities

Along with the internationalization of securities transactions, cross-border misconduct affecting fairness in markets around the world has been occurring. As a result, international cooperation in the field of law enforcement has become increasingly important to ensure fairness in domestic markets.

Taking this situation into consideration, the SESC continued to actively promote international exchanges in the year under review, such as exchanging opinions with various overseas securities regulatory authorities regarding law enforcement.

1. Relationship and cooperation with overseas regulatory authorities

In order to promote the reform of Japan's securities markets and improve its surveillance system, it is necessary to understand the precedents in other countries and how they have dealt with their problems. The SESC promotes exchanges of information on pressing issues with overseas regulatory authorities on various occa-

sions of IOSCO meetings held every year and through individual interviews at various levels. In particular, the SESC has contact persons to collect day-to-day general information from and make inquiries to contact persons at the regulatory authorities of major countries, including the U.S. Securities and Exchange Commission.

Note: IOSCO is an international forum that promotes international harmony in securities regulations and cooperation among securities regulatory authorities. As of March 1999, 159 institutions from 94 countries, provinces, and regions around the world have membership in IOSCO.

2. MOU and exchange of law enforcement information

As a result of the internationalization of securities transactions, the need for information exchange with overseas regulatory authorities is increasing for the SESC's investigations of unfair trading practices. Because it is necessary for regulatory authorities in Japan to conclude MOU in order to exchange non-public information with overseas regulatory authorities, the

SESC has been working on the authorities concerned to positively promote the conclusion of MOU with overseas regulatory authorities.

In addition, the SESC exchanges information with the other Asia-Pacific Regional Committee (APRC) member countries according to the resolution adopted among the members in April 1997, which calls for exchange of information whenever a member country announced information on securities and exchange law violations relevant to other member countries. The SESC publishes the press releases of its recommendations on its website.

Section 4. Strengthening surveillance systems

Since 1993, the SESC has been developing its SCAN-System, which can be broadly utilized for securities company inspections, market surveillance, and investigations of criminal offenses.

The SCAN-System is divided into 2 systems: the Securities Company Inspection System and the Market Surveillance System.

① The Securities Company Inspection System assembles all kinds of financial data con-

cerning securities companies and uses computers to automatically produce a register that makes a comparison of companies, thus raising the efficiency of inspections. This system has been in operation since fiscal year 1995.

② The Market Surveillance System makes it possible, in the course of preparing basic data for conducting surveillance of insider trading, market manipulation, and other activities, to make a quick and comprehensive reference to listed or over-the-counter issues showing unnatural price movements, as well as the content of announcements of important facts and the content of transactions. The System also has a function to automatically replay transaction in individual issues as well as an analysis function for investigations of insider trading. The system commenced operations in April 1997.

The SESC has been continuing to develop the Systems in order to further improve their functions. From fiscal 1999, the SESC intends to develop a function to analyze corporate finances, including financial statements, expand the scope of investigations (off-floor trading, etc.), and build a computer-backed database for trading contracts and buy/sell orders.

Section 1. Relationship between the Securities and Exchange Surveillance Commission and Self-Regulatory Organizations

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 in accordance with 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 44).

The SESC is also in a position to make inspections to judge whether SROs are conducting surveillance in the appropriate manner and whether SROs are taking proper actions against members who violate laws, regulations, and self-regulatory rules (as for inspections of the JSDA conducted in April 1998, see “Results of inspections of Self-Regulatory Organizations” in Chapter 2, Section 6, on page 19). Having market mediators as members, SROs establish frameworks for acceptable conduct and demand

that their members comply with regulations, and are thus in a position to enhance investors’ confidence in markets and mediators. 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 increasingly 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.

The following are the activities of SROs from April 1998 to March 1999 (hereinafter “fiscal 1998”):

Section 2. Activities of the Japan Securities Dealers Association

1. Surveillance of members

The JSDA surveys the activities of its regular members with respect to : ① compliance with “suitability” ; ② compliance with regulations related to prohibited acts in securities transactions; ③ management of securities transactions

and settlement; and ④“The Code of Conduct for Customer Management by Securities Companies” and establishment of, compliance with and check of in-house guidelines based on the Code.

Note : 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 (as from December 1998, shift from the license system to the registration system)*

Concerning the special members, the activities of them are surveyed with respect to: ① management of securities transaction orders; ② compliance with rules related to prohibited acts in securities transactions; and ③ management of the execution of orders and management of handing over and custody of securities. The 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. These associations implement surveillance working with per-

sonnel designated by the JSDA.

2. Surveillance of securities market

The JSDA's Over The Counter (OTC) Stock Surveillance Division, which is responsible for market surveillance, collects market information related to registered OTC stocks and monitors the stock prices and trading volume of certain stocks, as well as the involvement of members in transactions of those stocks. The Division conducts investigations into certain stocks when it observes irregularities in transactions in the stocks. In addition, when the Securities Business Division reports 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, the JSDA takes appropriate measures in accordance with

its Articles of Association against the members involved to prevent such transactions from recurring. In addition, when inappropriate securities transactions are suspected, but cannot be proven, the JSDA cautions the members involved.

Section 3. Activities of stock exchanges

1. Inspections of members and special participants

Inspections of stock exchange members and special participants are conducted on their compliance with laws and rules laid down by stock exchanges. The members and special participants are mainly inspected with regard to : ① loss compensation/provision of profits ② discretionary trading account transaction contracts ③ short selling, and ④ margin deposits.

Note: Special participants

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

2. Market surveillance

Taking the Tokyo Stock Exchange (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 order to prevent such transactions from recurring.

In addition, when securities transactions are suspected of being inappropriate, but cannot be proven, stock exchanges caution the members involved to exercise prudence in transactions in the future in order to prevent unfair transactions from occurring.

In response to the “Concerning Thorough Surveillance System” issued to the presidents of stock exchanges by the SESC with regard to the spreading of rumors, the TSE has been strengthening its surveillance by holding hearings with member securities companies concerning issues whose prices declined significantly. The Osaka Securities Exchange (OSE), for its part, has been striving to make securities companies familiarize themselves with the SESC’s direction at meetings of securities company officials in charge of trading management.

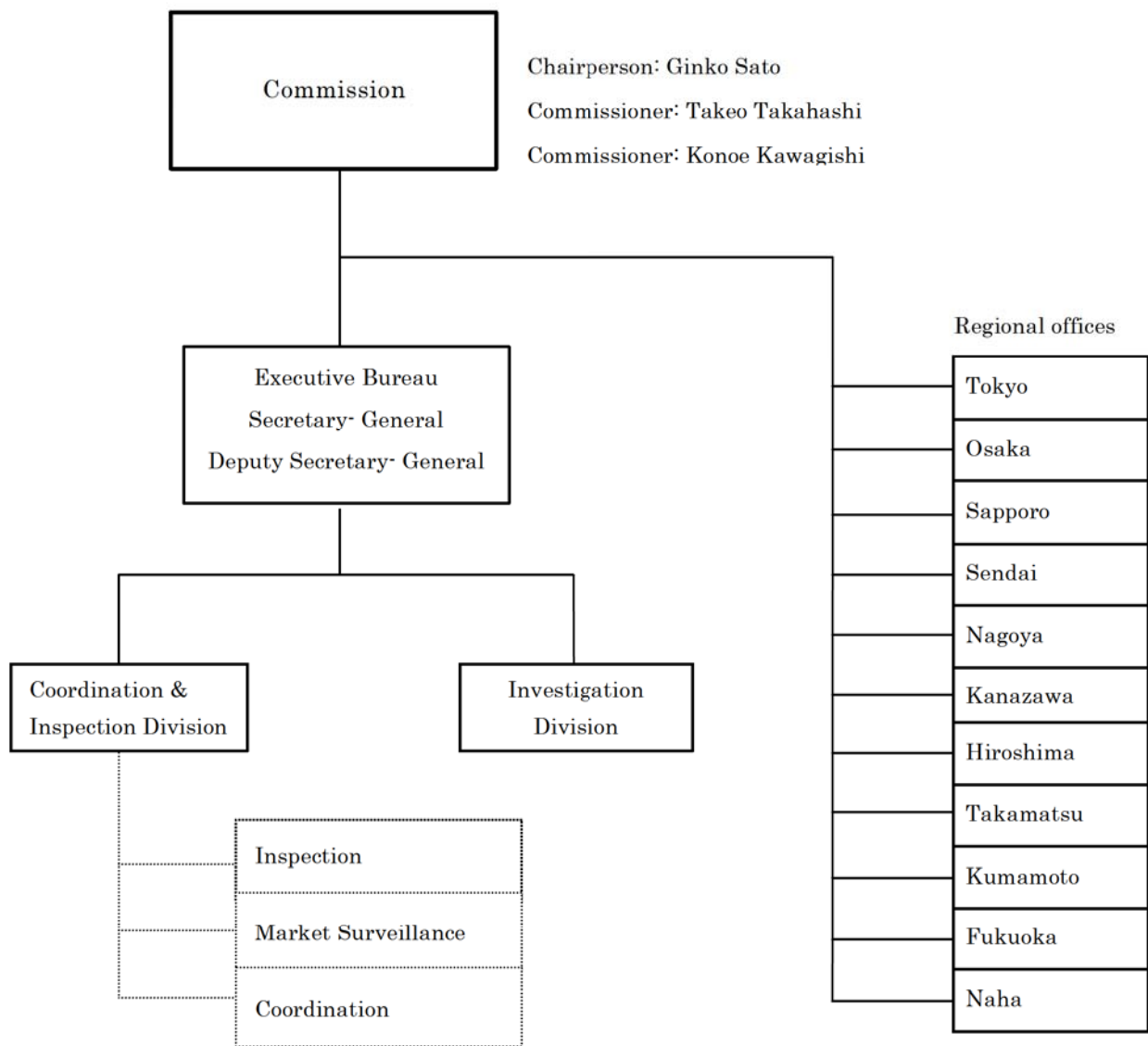
Section 4. Activities of Financial Futures Association of Japan

The FFA surveys the activities of its members with respect to the management of financial futures transaction orders, the management of customers’ deposits, and compliance with rules

regulating financial futures transactions.

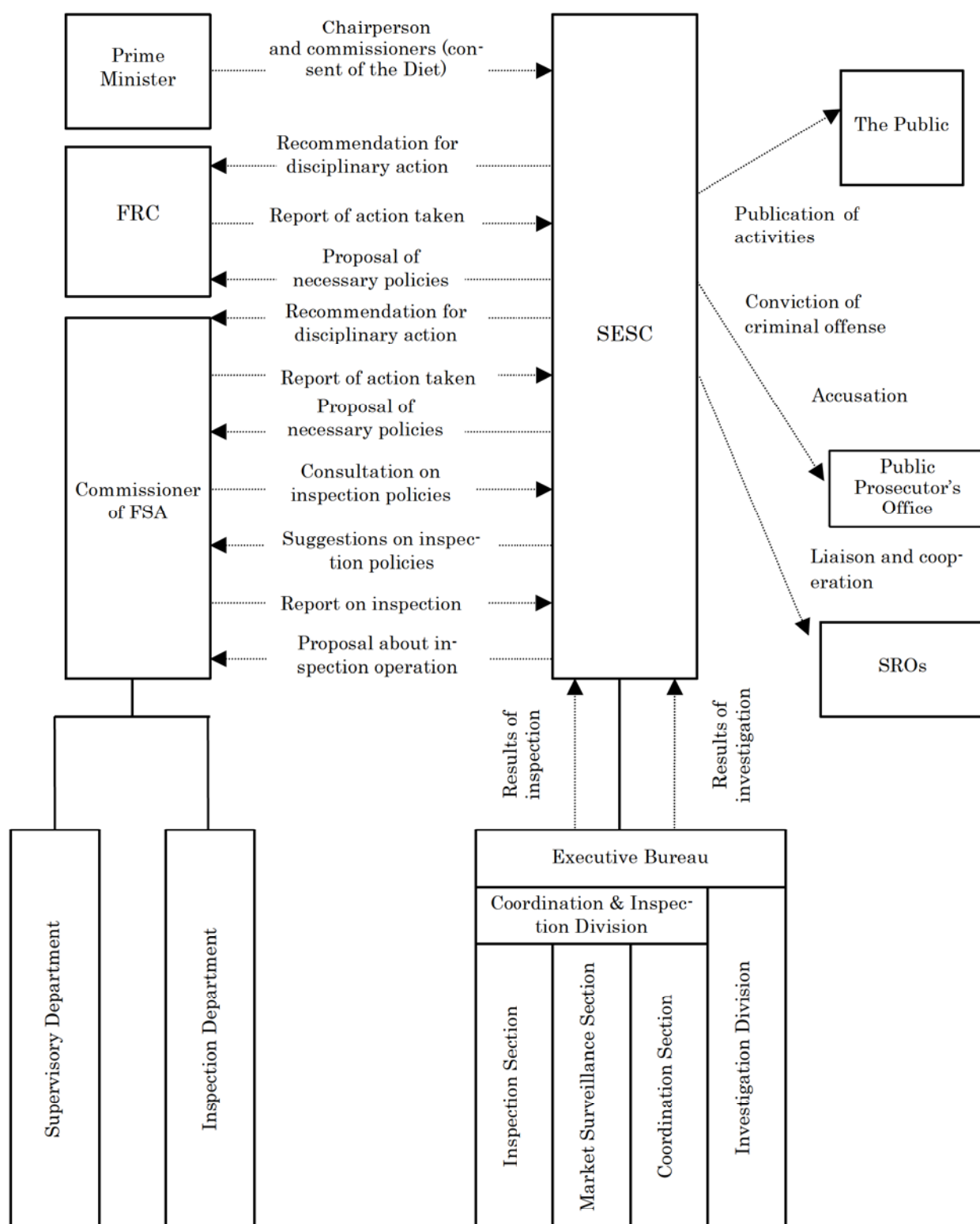
Section 5. Activities of the Financial Futures Exchange

The Financial Futures Exchange inspects the activities of its members with regard to compliance with rules related to prohibited acts concerning financial futures transactions, the management of internal control systems, and the management of acceptance of financial futures transaction orders.

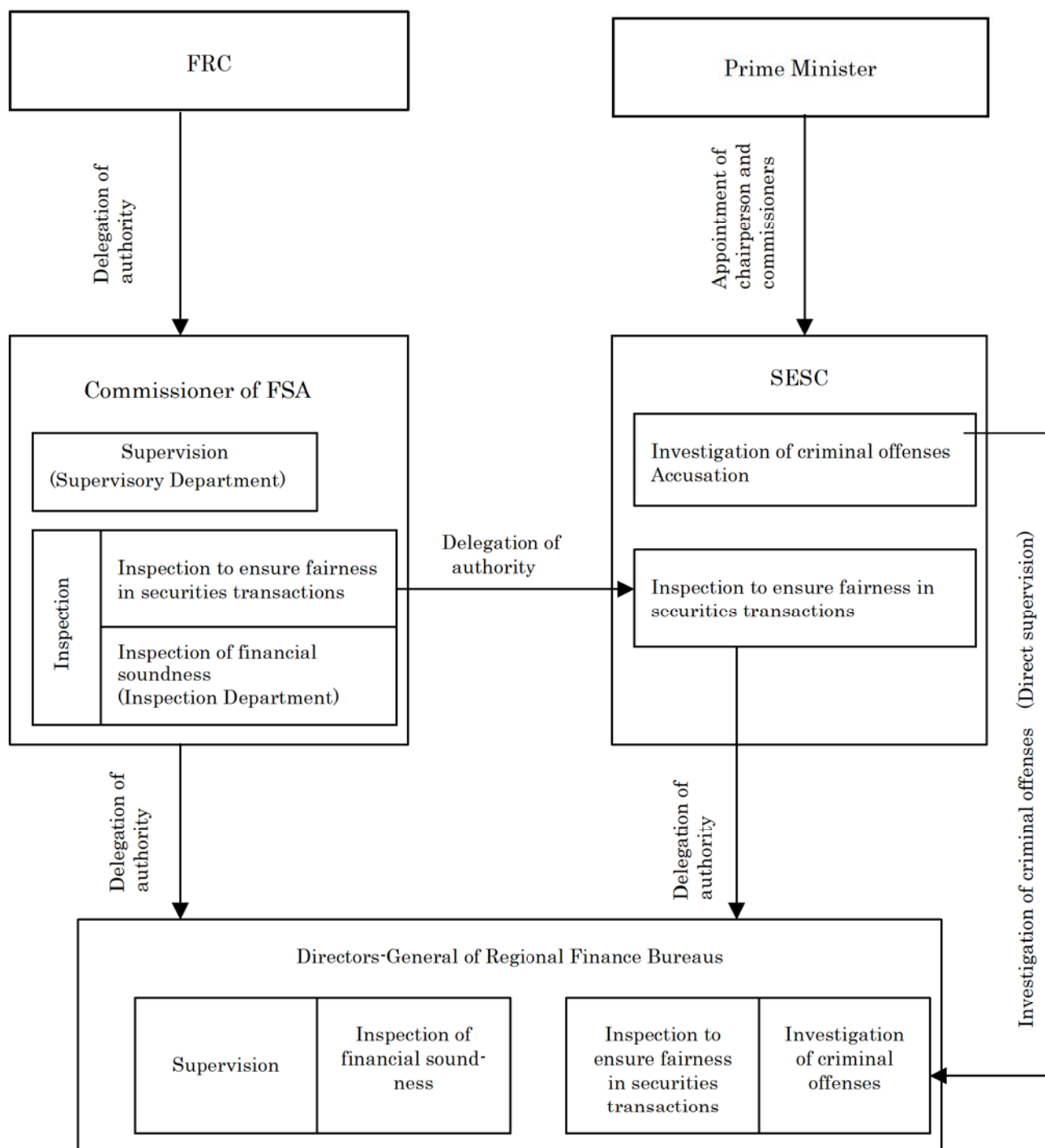


Note: "Regional offices" were established under the Regional Finance Bureaus of the Ministry of Finance to carry out the SESC's surveillance activities. The Directors-General of Regional Finance Bureaus conduct inspections and market surveillance under the authority delegated by the SESC and investigations of criminal offenses under the direction and supervision by the SESC (see Diagram 3).

Diagram 2 **Surveillance Framework**



Note: SESC may send recommendations and proposals to the FRC and the Commissioner of the FSA, or the Minister of Finance (Articles 29 and 30, of FRCEL)

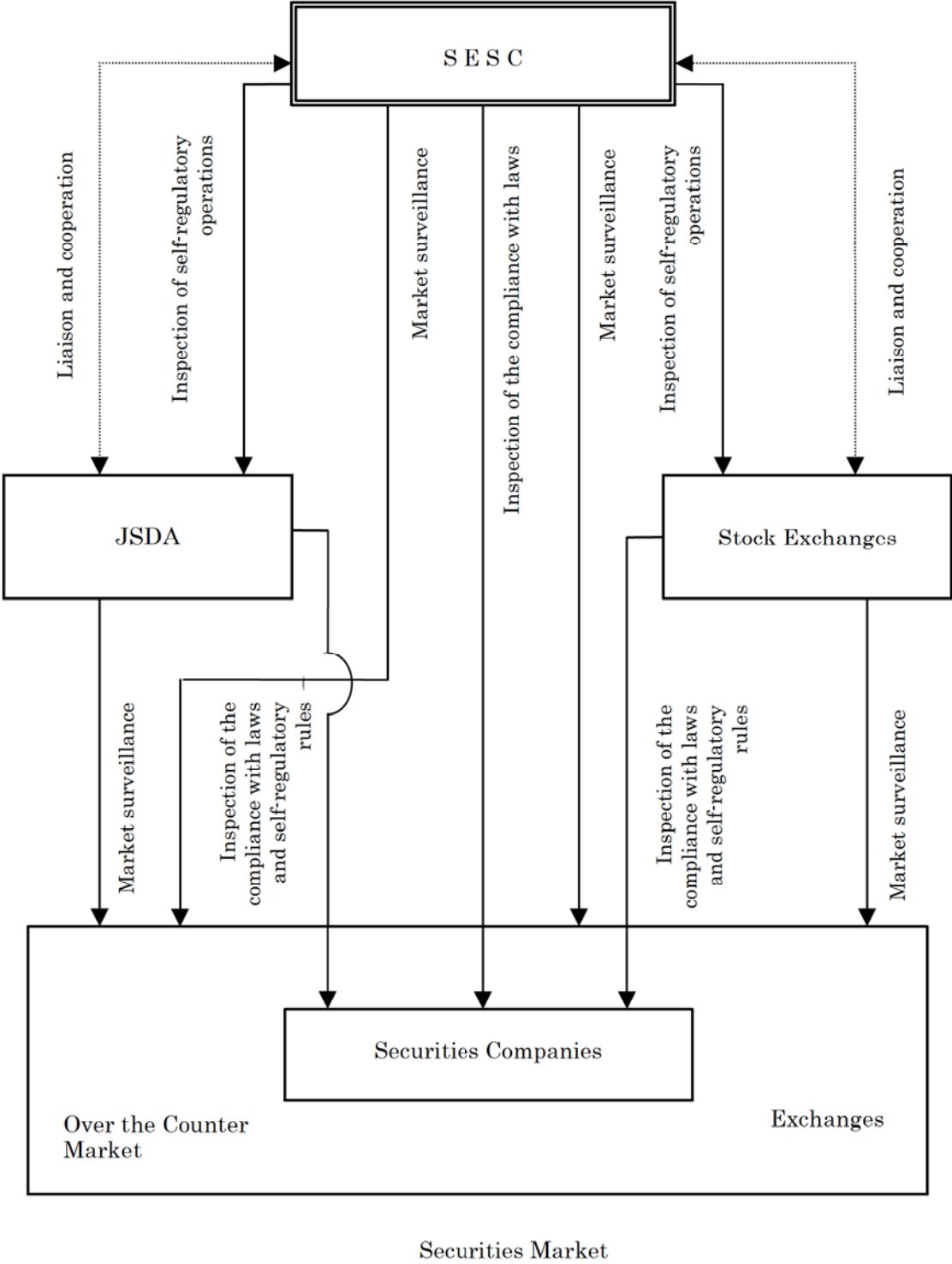


Note: Investigations of criminal offenses are carried out by the SESC staff under the particular authority.

*Authority of non-compulsory investigation (Article 210 of the SEL, Article 53 of the LFSE, and Article 106 of the FFTL)

*Authority of compulsory investigation (Article 211 of the SEL, Article 53 of LFSE, and Article 107 of the FFTL)

Diagram 4 Relationship between the Securities and Exchange Surveillance Commission and Self-Regulatory Organization



Note: The same system applies to financial futures.

Chairperson and Commissioner Profiles

Chairperson

Ginko Sato



- 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



- 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



- 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

List of Abbreviations

APRC	Asia-Pacific Regional Committee
FFA	Financial Futures Association of Japan
FFTL	Financial Futures Trading Law
FRC	Financial Reconstruction Commission
FRCEL	Financial Reconstruction Commission Establishment Law
FSA	Financial Supervisory Agency
IOSCO	International Organization of Securities Commissions
JSDA	Japan Securities Dealers Association
LFSF	Law on Foreign Securities Firms
MOU	Memorandum of Understanding
OSE	Osaka Securities Exchange
SCAN-System	Securities Comprehensive Analyzing System
SEL	Securities and Exchange Law
SRO	Self-Regulatory Organization
TSE	Tokyo Stock Exchange