

7. Surveillance Activities, Efforts to Strengthen Surveillance Functions

1) Strengthening of surveillance systems

1. Staff increase

a) Staff increase

The number of employees at the SESC increased by 37 during fiscal 2003, following a rise of 61 in the previous year, bringing its total workforce to 217 at the end of fiscal 2003.

Meanwhile, the number of staffers at local Finance Bureaus' securities surveillance sections rose by 17 in fiscal 2003, to stand at 199 at the end of that year. The combined number of staffers at the SESC and local Finance Bureaus total 416.

b) Use of private-sector experts

In order to increase the professional expertise of surveillance officers, the SESC recruited 20 professionals from the private sector, including lawyers and certified public accountants well-versed in derivatives and other securities trading. The number of officers with the experience of professional service in the private sector totaled 46 at the SESC at the end of June 2003.

2. Improving information gathering and analyzing capability

As a way to analyze an enormous amount of complex securities transactions and shed light on these deals, the SESC has been developing the Securities Comprehensive Analyzing System (SCAN-System) since 1993. The system to make the SESC's business operation more efficient is still under development.

(Note) The SCAN-System is broadly used in the SESC's inspections of securities companies, daily surveillance of these firms' operations, and investigations into criminal-offense cases. The system's basic development was completed by fiscal 2001, but the system has had room for further improvement in terms of increasing business efficiency of the SESC's surveillance operations, which has led the SESC to continue developing main parts of the system. Under the Surveillance by Technical Analysis of Corporate Finances (SCAN-STAF) system introduced in the 2002 SESC year, all business corporations that submit securities reports have become subject to SESC analysis.

The SCAN-System consists of two parts, the Securities Company Inspection System and the Market Surveillance System. Support systems under the SCAN System are the SCAN-Internet Patrol System (SCAN-IPS) and the SCAN-STAF system, as well as the information control system which is meant to process information supplied by the general public efficiently.

2) New authority over investor identity verification

The law to help verify the identity of customers was placed in force in January 2003. Aimed at improving customer management systems at brokerage houses, the law has required securities companies and other financial institutions to verify the identity of their customers. Under the new law, the SESC has been delegated authority by the FSA Commissioner to inspect whether securities companies are adequately checking the identity of customers in securities trading and order them to submit reports and relevant transaction data if the use of false identity is suspected. The SESC has also been given authority to launch investigations into suspected use of false names by customers to conceal their identity, which constitutes illegal acts, as criminal-offense cases.

3) Cooperation with FSA and SROs

The SESC has been stepping up cooperation with the FSA, including sharing of information on a daily basis. In order to make inspection operations effective as well as promoting daily exchange of information, the SESC and the FSA's Inspection Bureau conduct joint inspections of the same securities companies at the same time.

Self-regulatory organizations (SROs) such as the Japan Securities Dealers Association and stock exchanges across Japan are also conducting surveillance of day-to-day trading and operations of securities companies. The SESC has joined forces with these organizations in monitoring securities markets while exchanging information.

4) Cooperation with Foreign Regulators

1. Activity at IOSCO

Given rising cross-border securities transactions in recent years, it has become increasingly important for Japanese securities authorities to strengthen their cooperation with foreign regulators on the legal front in order to ensure fairness of trading in domestic markets.

The SESC joined the International Organization of Securities Commissions (IOSCO) in October 1993. Every year since then, the SESC has attended its annual general conference, a chairman-level meeting for IOSCO member countries. Belonging to the Standing Committee (SC4), a committee in charge of matters related to legal execution and information sharing, SESC officials meet their foreign counterparts to discuss how to cooperate in information supply between securities regulators of different countries and implementation of memorandums of understanding (MOU) between the securities regulators.

The SESC is also a member for plenary sessions of the Asia-Pacific Regional Committee (APRC), a regional group under IOSCO, and meetings of IOSCO officials in charge of legal affairs. At a January 2003 APRC meeting in Sri Lanka, SESC representatives explained its overall operations to other Asian IOSCO members in a report. The SESC representatives also met with officials from other securities regulators in Asia, which has close economic ties with Japan, and strengthened their mutual cooperation while discussing how to deal with various issues in securities trading.

2. Conclusion of information-exchange agreements with overseas regulatory authorities

With securities trading becoming more international, deals made in a certain country may undermine fairness of trading in other countries. Under this circumstance, the SESC thinks it is indispensable for it to exchange information with overseas securities regulators as part of its efforts to beef up its information-collecting ability across the globe. To help expedite information sharing

with overseas securities authorities, Japan's FSA has concluded information-exchange agreements with the China Securities Regulatory Commission (CSRC), the Monetary Authority of Singapore (MAS), the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission (CFTC).

3. Bilateral exchanges and cooperation with overseas regulatory authorities

The SESC has promoted interchange with overseas securities regulators on both formal and informal bases in order to establish firm cooperative relations with them on a bilateral basis. In the 2002 SESC year, the SESC exchanged views with the SEC, the Financial Services Authority (FSA) of the United Kingdom, the MAS, the Securities and Futures Commission (SFC) of Hong Kong, the Commission des Operations de Bourse (COB) of France and Germany's BaFin over the regulation of securities companies engaging in cross-border trading, including how to conduct on-the-spot inspections of their overseas operations.

4. Training of officials at Asian securities regulators

Every year, the SESC sponsors seminars on securities-related legal issues for legal affairs officials at securities regulators from emerging Asian economies.

Officials from the SESC, the FSA, self-regulatory organizations and experts from securities regulators in the Asia-Pacific region are invited to give lectures on such issues as research, inspection and market analysis for Asian trainees. The purpose of the seminars is to assist emerging Asian economies in forging securities policies in the future and to develop their securities markets by helping them foster human resources.

In the 2002 SESC year, such a seminar, the second of its kind, was held for five days from November 25, with 29 trainees from emerging Asia-Pacific economies participating.

5) Dealing with Internet trading

The number of Internet users in Japan has increased sharply in recent years and an enormous number of Web sites have been created. The Internet has become a new means of transmitting information.

With full liberalization of stock brokerage commission fees in 1999, securities transactions using the Internet have been rising, particularly among individual investors. But the diffusion of the Internet has also motivated some traders to engage in illicit activities backed by the Web's anonymous nature, such as trying to create an artificial market and spreading rumors on certain securities. This has increased the importance of the SESC closely monitoring possible unfair transactions using the Internet.

Responding to these developments in the securities market, the SESC has been beefing up surveillance of Internet-related deals by, for example, boosting the number of officials in charge of monitoring the Internet. These officials gather and analyze information posted on the Internet on a daily basis, utilizing the Internet Patrol System (IPS).

(Note) SESC officials in charge of Internet monitoring check, collect, and analyze a variety of information posted on bulletin boards and home pages on the Internet as part of their daily surveillance work.

6) Efforts to prevent violations on information disclosure

For investors to make securities investments based on rational judgment all the information that would be necessary for such judgment should be first disclosed by the debt-issuing company to the investing public both in an accurate manner and at an appropriate timing. The outbreak last year of a series of accounting scandals in the United States indicated that improper information disclosure hampers investors, particularly individual investors, from making rational investment judgment, eventually causing damages to the investors. In the 2002 SESC year, the SESC hired six

professionals like certified public accountants as part of its efforts to strengthen its surveillance of any illicit activities that may amount to the violation of information disclosure rules, including false statements on securities reports.

Because of these efforts, the SESC filed criminal accusations with prosecutors in the 2002 SESC year in connection with three information disclosure violation cases, including the submission of a securities report with false information. It marked the first time that a complaint on false securities statements was brought to public prosecutors.