

7. Efforts to Strengthen Activities and Function of Surveillance

1) Strengthening of surveillance systems

1. Expanding of human resources

a) Staff increase

The number of employees at the SESC increased by 23 during fiscal 2004, following a rise of 37 in the previous year, bringing its total workforce to 237 at the end of fiscal 2004.

Meanwhile, the number of employees at Local Finance Bureaus' securities transactions surveillance sections rose by 7 in total in fiscal 2004, to stand at 204 at the end of that year.

b) Use of private-sector experts

In order to improve the accuracy of market surveillance and increase the professional expertise of surveillance officers, the SESC recruited 18 professionals from the private sector, including lawyers and certified public accountants, and persons well-versed in derivatives and other securities trading. The number of officers with the experience of professional service in the private sector totaled 59 at the SESC at the end of June 2004.

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 market surveillance, 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 operations, which has led the SESC to continue developing main parts of the system. In the 2003 SESC year, the SESC's surveillance work, which was still conducted manually, became computerized, increasing its overall efficiency.

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-Surveillance by Technical Analysis of corporation Finance system (SCAN-STAF), as well as the information control system which is meant to process information supplied by the general public efficiently.

2) New surveillance functions

The First Subcommittee within the Sectional Committee on Financial System of the Financial System Council compiled a report entitled "The Reestablishing the Financial System with Market Function Set as Its Core." The report called for the SESC to strengthen its market-surveillance function and system by introducing an imposition of administrative civil money penalty on violators of laws and expanding the scope of inspections (the authority to conduct inspections is delegated to the SESC by the FSA).

Based on the report, the FSA reviewed the SEL and came up with a bill to partially revise the law. The bill was designed to strengthen the SESC's market-surveillance function and system by introducing an imposition of administrative civil money penalty on certain violations of laws and expanding the scope of inspections. The bill was presented to the Diet

and enacted on June 2, 2004.

Based on the revised the SEL, the administrative civil money penalty system will be introduced on April 1, 2005 while the SESC will have a wider scope of inspections from July 1, 2005.

3) Efforts to communicate with investors

The SESC strives to deepen individual investors' understanding about the SESC and their confidence in the securities market by disseminating information on its activities through the sponsoring of lectures and the Internet. Also, the SESC has been calling for information that may be useful enough for its operation including investigations through posters, ads in major newspapers and CS broadcasting.

4) 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, the SESC and the FSA's Inspection Bureau conduct joint inspections of the same securities companies at the same time as well as promoting daily exchange of information each other.

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 of securities companies. The SESC has joined forces with these organizations in monitoring securities markets while exchanging information.

5) Cooperation with Foreign Regulators

1. Activity at IOSCO

Given rising cross-border securities transactions in recent years, it has become increasingly important for the SESC to strengthen its cooperation with foreign regulators on the law enforcement front in order to ensure fairness of trading in Japanese 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 meeting a chairman-level meeting for IOSCO member countries. Belonging to the Standing Committee 4 (SC4), a committee in charge of matters related to law enforcement and information sharing, SESC officials meet their foreign counterparts to discuss how to facilitate information sharing and cooperation between securities regulators and to review applications to IOSCO's multilateral agreement for information sharing and cooperation (MMOU).

In addition, the SESC has attended plenary sessions of the Asia-Pacific Regional Committee (APRC), a regional group under IOSCO, and meetings of officials in charge of law enforcement. (Such a meeting was held in New Zealand in February 2004. APRC meetings are also held during IOSCO's general meeting.) Attending these meetings, the SESC explained its recent activities to other IOSCO members, and deepened its relations with overseas counterparts in Asian-Pacific region which are geographically close to and have close economic ties with Japan.

2. Bilateral exchange and cooperation with overseas regulatory authorities

(1) Information exchange and opinion interchange

The SESC has promoted the exchange of views and experiences with overseas securities regulators on both formal and informal bases on other occasions than IOSCO's meetings in order to establish firm cooperative relations with them on a bilateral basis. In the past, the SESC exchanged views with the Securities and Exchange Commission (SEC) of the United

States, the Financial Services Authority (FSA) of the United Kingdom, the Monetary Authority of Singapore (MAS), the Securities and Futures Commission (SFC) of Hong Kong, the Commission des Opérations de Bourse (COB) of France and the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) of Germany over regulations of securities companies engaged in cross-border trading and their compliance with such regulations. Taking advantage of bilateral cooperation accords with overseas securities regulators of these countries, the SESC has been making efforts to gather information on cases where illegal securities transactions are suspected.

(2) Conclusion of information-exchange agreements (bilateral MOU)

With the number of cross-border securities transactions increasing, deals made overseas may undermine the fairness of trading in Japanese markets. Under this circumstance, it is important to expedite information sharing with overseas securities authorities, and the FSA has concluded information-exchange agreements with the China Securities Regulatory Commission (CSRC), the MAS, the SEC, and the Commodity Futures Trading Commission (CFTC) of the United States. In addition, the FSA is in negotiations with other overseas securities regulators to conclude similar information-sharing accords.

(3) Training program for officials of overseas securities regulators

Every year, the SESC holds the Tokyo enforcement seminar for securities regulators of Asian emerging economies. At the seminar experienced officials from the SESC, SROs, and one of largest securities firms in Japan, and experts invited from securities regulators in the Asia-Pacific region give lectures on such issues as investigation, inspection and market surveillance for Asian trainees. The purpose of the seminar is also to assist emerging Asian economies is fostering human resources and consequently in developing their securities markets and regulatory regime.

In the 2003 SESC year, the 3rd Tokyo enforcement seminar was held for five days from December 1, with 29 trainees from 15 countries.

8. Operations of Self-Regulatory Organizations to Ensure Fair Trading

1) Roles of self-regulatory organizations

Self-regulatory organizations (The Japan Securities Dealers Association, stock exchanges, Financial Futures Association of Japan and the Tokyo International Financial Futures Exchange) are supposed to do their utmost in order to increase investor confidence in markets and member brokerage entities by establishing norms of conduct and having member brokerages observe such norms. Such efforts on the part of SROs are likely to increase the interest of brokerages in the long run. With the rapid advancement of financial system reforms, legally backed roles of SROs have become increasingly important, and the public has placed high expectations on SROs strengthening their operations. The SESC has been in close contact with SROs and has exchanged information with them.

2) Activities of self-regulatory organizations

In fiscal 2003, from April 2003 to March 2004, the Japan Securities Dealers Association inspected operations at 104 of its regular members (90 Japanese securities companies and 14 foreign securities companies) and 72 special members (48 banks, 13 shinkin banks, 10 insurance companies and 1 short-term money house).