

Date of Recommendation (Category)	Violations Subject to Recommendation	Administrative Disciplinary Measures
<p>August 5, 2003 (Investigation) (Inspection)</p>	<p>○ Act of engaging in fictitious trading and coordinated trading and failure to fulfill self-regulatory operation (Recommendation in which disciplinary measures were sought against a securities company)</p> <p>With the aim of misleading investors by making OSE stock options trading appear to be drawing more participants than it actually was, the (then) Osaka Securities Exchange Vice President (who was OSE Executive Director before June 1999) engaged in approximately 250 fictitious transactions not designed for actual securities acquisition for a total of about 38,000 units of stock options listed on the exchange between around December 1998 and around October 1999 using a tactic in which buy orders placed by Japan Electronic Securities Co. on its own account were absorbed by sell orders placed by the same securities company on its own account or in which buy orders placed by Roitofax through a brokerage house were absorbed by sell orders placed by the same company. The Vice President also engaged in about 340 coordinated transactions for 72,000 units of stock options listed on the exchange between around December 1998 and around March 2000 using a tactic in which trading was coordinated between Japan Electronic Securities and Roitofax before the actual transactions so that orders placed by Japan Electronic Securities on its own account were countered by orders placed by Roitofax through a brokerage house in the same amount and at the same price.</p> <p>○ Failure to fulfill self-regulatory operation (Recommendation in which disciplinary measures were sought against a securities company)</p> <p>As of the benchmark inspection date of May 8, 2003, the problems shown below were found in the operation of the OSE's self-regulatory business.</p> <p>(1) Inspection business The OSE failed to devise long-term plans to foster the ability of officers in charge of securities inspections. No systemic or sufficient efforts were made to compile inspection plans. The OSE failed to consider elements other than those checked at regular inspections in selecting OSE member companies subject to inspection, including transaction records at the OSE and information obtained by relevant divisions of the OSE.</p> <p>(2) Measures taken based on inspections The OSE failed to clarify the standards used in determining measures taken based on inspections. The OSE also did not make efforts to establish such standards in a systemic manner while continuing to take steps against member companies based on ambiguously set standards.</p> <p>(3) Market administration business The OSE failed to devise long-term plans to foster the ability of officers in charge of market administration. The OSE also did not act to improve the system of taking samples of transactions for the surveillance of illicit trading practices. The standards currently used by the OSE in extracting such samples do not accurately reflect the actual state of the market, causing the number of samples to be in the extreme: sometimes enormous and other times zero. The OSE did not take measures to review these standards. Even though the OSE took trading samples for surveillance of illicit trading practices like fictitious trading and coordinated trading, the exchange did not look into the records of dubious own-account transactions by securities companies involved in cross-trade transactions and financial situations of firms that sought brokerage services from securities companies for the transactions in question.</p> <p>(4) Cooperation between relevant sections The OSE failed to make efforts to promote in-house cooperation and information-sharing among relevant sections. Due to the lack of this in-house cooperation, information obtained separately by different sections was not used effectively in the OSE's overall inspection and market administration business.</p> <p>In particular, the OSE's problems in the market administration business as shown in (3) were seen as a major cause for having left illegal activities unattended for so long—until they were unearthed by the latest investigation of criminal offenses. This indicated that the OSE should be blamed seriously for failing to fulfill the duty assigned to it as a self-regulatory organization.</p>	<p>Administrative disciplinary measures taken against the entity</p> <p>Business suspension order</p> <ul style="list-style-type: none"> <li>• Three-month suspension of business related to the listing of stocks issued by the OSE on the OSE market</li> <li>• Three-month suspension of business related to the new listing of stock options</li> </ul> <p>Business improvement order</p> <ul style="list-style-type: none"> <li>• Devising preventive measures and disseminating these measures thoroughly among executives and other employees of the entity</li> <li>• Drastically reviewing the entity's organizational structure and business methods to help solve problems related to the operation of its self-regulatory business</li> <li>• Taking specific remedial measures after finding out what had caused the irregularities pointed out by the Inspection Bureau of the FSA</li> </ul> <p>Reporting and examination</p> <ul style="list-style-type: none"> <li>• Reporting the implementation of orders to the SESC in writing</li> <li>• Reporting the implementation of measures being worked out under the orders to the SESC in writing on a quarterly basis for the time being</li> <li>• Having a project team led by OSE supervisory officers check if the SESC orders have been implemented</li> </ul> <p>(Notes) Disciplinary measures against the entity under this case were based on recommendations issued by the SESC following its inspections and criminal investigations and the results of inspections conducted by the Inspection Bureau of the FSA.</p>

- **Data on the recommendation issued to the Osaka Securities Exchange (OSE)**

- 1. Outline of inspection**

- (1) Inspection business**

- 1) There is an imbalance of officers in charge of inspections in terms of experience and age. The OSE failed to devise long-term plans to foster the ability of inspection officers, such as holding in-house training sessions aimed at improving inspection methods.
- 2) The OSE failed to set clear standards used in selecting OSE member companies subject to inspection and also failed to consider elements other than those checked at regular inspections in selecting such OSE member companies, including transaction records at the OSE and information obtained by relevant divisions of the OSE.

- (2) Measures taken based on inspections**

The OSE failed to clarify the standards used in determining specific measures taken against violating companies based on inspections, such as disciplinary action, admonition, warning, and request. The OSE also did not give systematic consideration when actually applying these measures.

- (3) Market administration business**

- 1) There is an imbalance of officers in charge of the market supervisory business in terms of experience and age. The OSE failed to devise long-term plans to foster the ability of officers in charge of market administration, such as holding in-house training sessions aimed at improving their ability to check securities transactions.
- 2) The OSE had set standards used in taking samples of stock index options trading for surveillance, such as ratios of transactions by particular companies on a certain issue against the overall trading, price fluctuation ratios, and large-lot orders apparently seen to counter earlier orders in fictitious and coordinated deals. However, such standards did not consider the nature of options trading, resulting in the number of sample deals that were taken under the standards becoming enormous. This prompted the OSE to stop taking samples of stock options for surveillance in 1997. On the other hand, stock options prices set as standards in taking samples for price-formation surveillance are much higher than levels reached in actual options deals, resulting in the number of sampled cases becoming zero. Despite the extremity in sample standard-setting as explained above, the OSE did not take any action to review the standards.
- 3) In surveying of some stock options cases, the OSE took samples in connection with alleged fictitious and coordinated transactions. However, its research focused only on price formation-related areas, such as whether the deviation between the contracted price and theoretical price was within a permissible range. It was found that the OSE did not check elements considered more related to the illicit transactions, such as specific transactions made by securities companies, which had been involved in cross-trade transactions, on their own account in what appeared to be fictitious or coordinated trading and the situation of companies that sought brokerage services from securities companies to carry out the transactions in question.

- (4) Cooperation between relevant sections**

The OSE failed to make efforts to promote cooperation among sections within the self-regulatory headquarters and information-sharing with relevant sections outside the headquarters. Due to a lack of this kind of cooperation, information obtained separately by different sections was not used effectively in the OSE's overall inspection and market administration business.