

Towards Enhanced Market Integrity

The Securities and Exchange Surveillance Commission (hereinafter referred to as “SESC”) is engaged in market surveillance under a mission of ensuring the integrity of capital markets and protecting investors.

The SESC for the 8th term was established in December 2013, and it announced “Towards Enhanced Market Integrity” as a medium-term policy statement (hereinafter referred to as “Policy Statement”; See Appendix 2-1) in January 2014. Under the Policy Statement, the SESC formulated three policy directions consisting of: (1) Market oversight with prompt and strategic actions; (2) Enhanced surveillance in response to the globalization of markets; and (3) Efforts for enhanced market integrity. Pursuant to these three policy directions, the SESC continues to strive to secure effective and efficient market surveillance with strong emphasis on prioritized items: (1) Proactive market oversight through enhanced information-collecting ability; (2) Strict action against severe and malignant market misconduct and false disclosure statements; (3) Timely and efficient inspections in response to disclosure violations; (4) Use of administrative monetary penalty system against market misconduct, etc.; (5) Efficient and effective inspections corresponding to the characteristics of firms to be inspected; (6) Responding to malicious businesses engaged in fraudulent operations; (7) Effective dissemination of information; and (8) Enhanced cooperation with self-regulatory organizations.

1. Activities in FY2014

During FY2014 (April 1, 2014-March 31, 2015), which is the period covered by this publication, the SESC was engaged in market surveillance as described below and strategically utilized the power and human resources with which it has been vested.

With respect to routine market surveillance, the SESC continued its efforts, including accepting information from ordinary investors, etc., conducting market oversight targeting primary and secondary markets, cooperating with overseas regulators in view of the globalization of markets, reviewing insider trading, market manipulation and fraudulent activities, and responding to new financial instruments, etc. Sometimes the information collected or the market oversight would reveal certain conducts impairing the fairness of transactions as well as other problems. In these events, following an investigation and inspection by the relevant divisions within the SESC, the SESC would make a recommendation for administrative disciplinary actions or file a criminal charge.

Inspections of financial instruments business operators and the like revealed cases in which a type I financial instruments business operator failed to establish an appropriate trading screening system for proprietary trading of exchange-traded derivatives thereby overlooking market manipulation, and another type I financial instruments business operator who caused losses to customers through the book-value trading of privately-placed bonds which had declined in value between funds in a conflict of interest. The inspections of type II financial instruments business operators also revealed cases in which one operator obtained approval for registration based on false amounts on the balance sheet attached to the submitted application, and another operator, recognizing the intended misappropriation of the

received capital contribution, had lent its name to an unregistered business operator to solicit customers for the purchase of funds using pamphlets stating yields, etc., at levels without reasonable grounds. In addition, with regard to investment advisories/agencies, the SESC found cases in which operators who were not registered as type I or type II financial instruments business operators acted as intermediaries for OTC derivatives and engaged in offerings of overseas funds, etc. Further, there was an investment manager who, despite an existing discretionary investment contract with a pension fund, did not take the necessary actions on trades that were deemed unfavorable to the trust fund and caused losses to the pension fund, thereby breaching his duty of care. In cases where a serious violation of laws or regulations was found, including the financial instruments business operators involved in these cases, the SESC has made recommendations for administrative disciplinary actions.

Furthermore, the SESC has also filed petitions for court injunctions pursuant to Article 192 “Prohibition Order or Order for Suspension Issued by Court” of the Financial Instruments and Exchange Act (FIEA) against financial instruments business operators which committed violations of the FIEA such as by providing customers with false information for fund solicitation and selling funds without proper registration. Additionally, as a result of investigations and inspections of persons making notifications for businesses specially permitted for qualified institutional investors, etc., the SESC also announced the names of financial instruments business operators which had violated relevant laws and regulations such as by soliciting customers for a fund purchase without obtaining a capital contribution from a qualified institutional investor, thereby failing to meet the special eligibility for operating the business permitted for qualified institutional investors and providing customers with false information for fund solicitation; and financial instruments business operators with issues from the investor protection point of view, including misappropriation of received funds, careless monitoring of subscriptions to and performance of the related fund, issuance of performance reports containing false statements, and dividend payouts using funds received while there is no income from investments.

With respect to market misconduct, the SESC made recommendations for administrative monetary penalty payment orders against several cases, including an officer of a tender offeror committing insider trading based on information on the scheduled TOB obtained during the course of his/her duties, with several individuals who received such information from the officer also committing insider trading, and market manipulation in a manner intended to raise the share prices by placing buying orders at high limit prices and executing them at high prices, and by matching buying orders and selling orders placed at high limits at around the same time for the purpose of inducing sales and purchases of the shares.

In addition, with respect to cases of market misconduct by both Japanese and foreign professional investors using cross-border transactions, etc., the SESC, in close collaboration with overseas regulators with the aid of a global framework for cooperation and information exchange, conducted close investigation of market manipulation cases including those done through selling and buying orders for the purpose of inducing market trading of derivatives without any intention of executing them, a large volume of orders 30 seconds before the close of the market in sync with a change in the constituents of a stock index and a corporate entity which had been subject to an SESC recommendation to issue an administrative monetary payment order in the past. As a result, the SESC also made recommendations for administrative monetary penalty payment orders.

With respect to the violation of disclosure requirements, the SESC made recommendations to the FSA to order an administrative monetary penalty against a listed company that had submitted securities registration statements and annual securities reports, etc., containing material misstatements on important matters including reporting sales by executing sales agreements while, in reality, there were no executions of a trade based on such agreements and assets (software in progress) by faking the software development. Further, even in the case where the SESC finds no material misstatement on important matters in the disclosure documents as a result of inspection, the SESC urges issuers to revise their annual securities report, etc., voluntarily, when deemed necessary.

With respect to malicious offenses which impair fairness of markets, the SESC filed criminal charges against cases of insider trading by an individual who obtained information on the planned TOB in conspiracy with his/her acquaintance, market manipulation by day traders in a conspiracy regarding 4 listed shares through deceptions of layering of order book and spoofing, etc., and submission of an annual securities report containing material misstatements by recording fictitious sales and inflated recoveries from receivables that had been written off. Furthermore, the SESC continuously watched the overall market and exposed a wide range of malicious criminal acts, including filing criminal charges against the perpetrators. For example, in cooperation with law enforcement agencies, the SESC investigated and filed criminal charges against the cases of market manipulation regarding one listed share through wash trading, price ramping and marking the close, and submission of an annual securities report containing material misstatements through recording fictitious sales amounts.

With respect to the enhancement of market discipline, the SESC has worked with financial instruments exchanges and financial instruments firms associations, etc., to share their respective awareness of problems through periodic exchanges of information. In addition, the SESC has continued to actively engage in dialogue with market participants and dissemination of information to the market so as to encourage the voluntary efforts of each market participant. Specifically, the SESC made speeches at compliance forums for listed companies organized by different securities exchanges throughout Japan, and contributed articles to various public relations and mass media. The SESC also used the SESC Email Magazine to disseminate details of its activities, its awareness of problems and other information in a timely manner. Furthermore, in order to enhance the transparency of market surveillance administration and to encourage the self-discipline of market participants, the SESC published an edition of the *Casebook on the Administrative Monetary Penalties under the FIEA (Market Misconduct and Violation of Disclosure Requirements)* in August 2014, which are compilations of preceding cases recommended to the commissioner of the FSA for administrative monetary penalties.

2. Future Challenges

As described above, the SESC has been engaged in effective and efficient market surveillance for the past year.

On the other hand, given the dynamically changing environment surrounding the Japanese

market, as seen in situations where revisions of FIEA and where innovative financial instruments and trades have advanced with the aid of information technology, the SESC's market surveillance needs to address these changes appropriately. In addition, in conducting inspections of financial instruments business operators, the SESC believes it is essential to further enhance its ability to identify potential problems with consideration given to each characteristic of diverse business types of financial instruments business operators, customers, and increasingly complex and diverse financial instruments and transactions. Also, the SESC will strengthen its capabilities to collect and analyze information accordingly. Furthermore, with regard to violations involving cross-border transactions, the SESC is required to continue to respond harshly to market misconduct by both Japanese and foreign professional investors, while enhancing surveillance on frequently conducted cross-border trading in cooperation with overseas regulators.

The SESC will continue to do its best to handle these challenges appropriately, perform more effective and efficient market surveillance, and sustain investors' confidence in the market to secure the protection of investors.