

# 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 FY2015

During FY2015 (April 1, 2015 to March 31, 2016), which is the period covered by this publication, the SESC was, under the Strategic Directions and Priorities 2015-2016, engaged in market surveillance as described below and strategically utilized the powers and human resources with which it has been vested.

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 stepped up its efforts to engage in dialogue with market participants and continued to actively disseminate information to the market for the purpose of encouraging each market participant to make voluntary efforts. In addition, the SESC held a meeting at the Kinki Finance Bureau—the meeting which the first time held outside the Tokyo metropolitan area—and exchanged opinions with relevant organizations in the area in an effort to increase the presence and raise awareness that “the SESC is watching”. The SESC contributes articles to various publications and the mass media, and uses the SESC Email Magazine to disseminate details of its activities, its awareness of problems and other information in a timely manner. The SESC has focused on expanding and enhancing the information content so that significance, characteristics and causes of recommendations for administrative disciplinary actions or filing of criminal charges could be correctly understood.

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 studying the state of affairs of IT-based trading like algorithm trading, 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 problems involving type I financial instruments business operators, including cases where such an operator sold corporate bonds while intentionally disguising the financial status of the issuer company; a sales representative solicited investment from investors by providing corporate information obtained by an analyst to the investors; and a purported investment from a qualified institutional investor in a fund operated by a person making notification for business specially permitted for qualified institutional investors turned out to be an investment without substance because the operator virtually provided the money. In addition, with regard to investment advisories/agencies, the SESC found cases including those in which an operator provided special benefit to a customer and a non-registered operator was engaged in discretionary investment management business. The SESC also found a case of a financial instruments intermediary service operator engaging in soliciting using corporate information obtained through business other than financial instruments intermediary service. 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 trading stocks, or acting as an intermediary for the consignment of stock trading, without proper registration as an operator. Additionally, as a result of investigations and inspections to persons making notification for business specially permitted for qualified institutional investors, the SESC also announced the names of financial instruments business operators which had violated relevant laws and regulations, such as engaging in investment solicitation or investment management without meeting the requirements of businesses specially permitted for qualified institutional investors and soliciting investment in a fund by making false representation using brochures which include information on investment method, fund performance, etc. that contradicted reality, as well as those with problems in terms of investor protection, such as inadequate handling of investment, investment management, inappropriately using invested money for dividend, redemption money to other funds and the company’s expenses.

With respect to market misconduct, the SESC made recommendations for administrative monetary penalty payment orders against several cases, including insider trading, market manipulation and fraudulent conduct. In addition, the SESC made a recommendation to the Financial Services Agency (hereinafter referred to as “FSA”) to order an administrative monetary penalty under regulations on information communication against the FIEA in which an individual of a company communicated material facts and information on a planned

take-over bid with the purpose of providing benefit to a third party, and also made recommendations on a case involving an operator that manipulated the market by using a proprietary trading system (PTS) and a case in which a stock price was supported through fraudulent means in order to maintain the listing of the company.

In addition, with respect to cross-border market misconduct by foreign investors, the SESC conducted investigations in close collaboration with overseas regulators under the global framework for cooperation and information exchange and made recommendations for administrative monetary penalty payment orders. The representative cases include: an insider trading case by an overseas individual investor who learned a material fact in the course of negotiation for a contract; a market manipulation case in which an overseas institutional investor took advantage of the difference in operating hours of a stock exchange and a PTS through transactions overarching between them; and another market manipulation case in which an investor placed sell orders at high prices without intention to execute the orders and repurchased the shares at an artificially lowered price.

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, among others, in an attempt to accelerate recovery from a steep decline in earnings, committed inappropriate accounting with various, including recording profits earlier, deferring expenses and understated allowances. The SESC also made a recommendation in a case in which some false descriptions were made in a securities registration statement.

In an effort to increase the flexibility of its disclosure inspection, the SESC commenced gathering and analyzing information, to focus on potential risks of material misstatement associated with changes in the business environment of listed companies. Moreover, for listed companies that committed false statements, the SESC enhanced efforts to urge such firms, to correct early and voluntarily the disclosure statements, and to establish an appropriate disclosure system through identifying the root cause of the violation in accordance with the nature of the case.

The SESC has conducted a wide range of market surveillance and filed criminal charges against malicious criminal acts that impair the fairness of markets.

The SESC recently filed criminal charges against a representative director and a managing director of a listed company for using fraudulent means and submitting an annual securities report containing false disclosure statements. To gain profits by selling the shares of the company, they published timely disclosure statements containing a false statement that the company revised figures such as net sales and ordinary profit upward and other false information. This case may be seen as a broader financial crime because, in relation to this case, a de facto owner of another company that had business with the company above was prosecuted on charges of fraud and violation of the Customs Act.

In addition, the SESC filed charges against individual investors for spreading rumors, using fraudulent means and failing to submit Reports of Possession of Large Volume in relation to shares of two listed companies. They raised prices of the shares of the companies by publicizing statements including false information on a website, to which many and unspecified persons can access, and sold a large amount of shares at artificially raised prices. The SESC also filed charges against the same investors for committing market manipulation on the shares of one of the two companies above by using methods such as raising the share

prices artificially by placing a large amount of market purchase orders before the opening of the morning session.

Moreover, the SESC filed charges, in cooperation with the police, against a representative director of a listed company for submission of an annual securities report containing false disclosure statements by recording fictitious assets, which constituted a large part of the net assets.

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 2015, which were compilations of preceding cases recommended to the commissioner of the FSA for administrative monetary penalties.

## **2. Future Challenges and policy**

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 the 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. New trading methods, like algorithmic trading, are increasing as information technology advances, while material facts regarding insider trading are diversified. In terms of listed companies' violations of disclosure requirements, a leading Japanese global company was found to have committed inappropriate accounting practices on a large scale, and there have been cases in which globally operating companies failed to establish adequate systems to manage their overseas subsidiaries.

In view of such circumstances, the SESC needs to enhance its methods for inspection and investigation in order to step up its market oversight from a forward-looking viewpoint based on the collection and analyses of macroeconomic information and address the increasingly diverse, complex and cunning nature of problem cases. The SESC also needs to examine the appropriateness of information disclosure by large listed companies, in addition to existing efforts to expose problem companies.

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.