

1 Overview of activities in Fiscal Year 2019

In FY2019 (April 2019–March 2020), the economic environment surrounding Japanese securities markets went through substantial changes. At the beginning of the fiscal year, the Japanese economy was recovering at a moderate pace. However, recently, the global economy is worsening rapidly in an extremely severe situation due to the COVID-19 pandemic. Therefore, it is necessary to keep a close watch on the effects of volatility in the financial and capital markets.¹

In order to deal with the significantly changing capital markets, in January 2020, the Securities and Exchange Surveillance Commission (SESC) published the Strategy & Policy of the SESC 2020-2022.² In FY2019, the SESC also engaged in market surveillance on a timely basis, such as gathering and analyzing information from macroeconomic perspectives with a focus on potential risks. In its investigation and inspection, the SESC not only made recommendations for administrative actions and filings of criminal charges of violations of regulations, but also analyzed the root causes of the violations of regulations to prevent recurrence.

¹ In light of the impacts of the COVID-19 outbreak, a statement by the Minister for Financial Services issued on March 24, 2020, stated that "the JFSA will cooperate with the SESC and the stock exchanges to conduct thorough monitoring of market manipulation and other market abuse, and to take rigorous actions against violations,

2 Recommendations for administrative monetary penalty payment orders and filings of criminal charges of market misconduct

(1) Recommendations for administrative monetary penalty payment orders and filings of criminal charges of market misconduct

In FY2019, the SESC made recommendations for administrative monetary penalty payment orders in 29 market misconduct cases (of which 24 were insider trading and 5 were market manipulation) and filed criminal charges in 1 case.

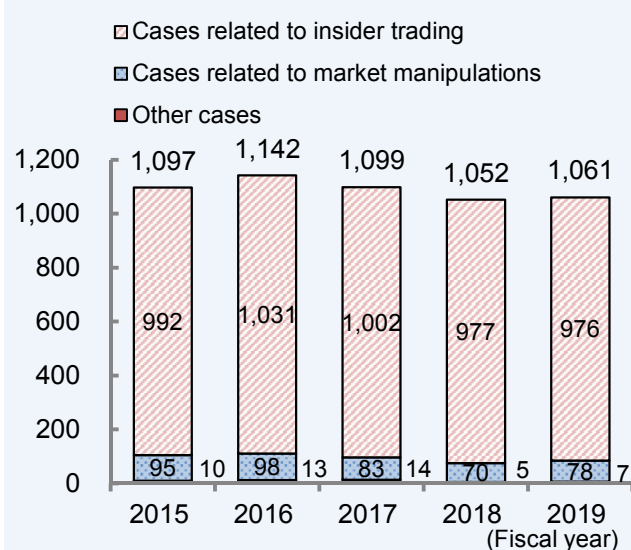
(2) Case examination for detecting market misconduct

The total number of cases examined for detecting market misconduct was 1,061 in FY2019; over 1,000 examinations have been conducted in 7 consecutive years.

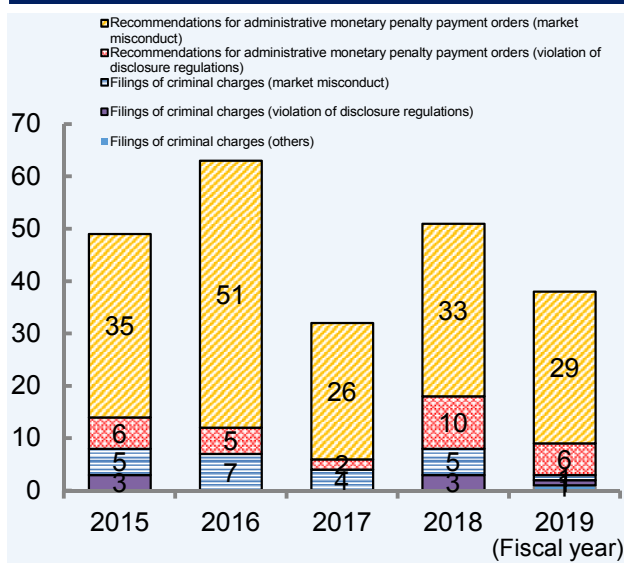
including strict enforcement of restrictions on short selling."

² The 10th Term (2020-2022) started on December 13, 2019.

Examined cases for market misconduct



Recommendations for Administrative Monetary Penalty Payment Orders and Filings of Criminal Charges



(3) Trends in market misconduct

With rapid changes in the business environment as a background, the SESC made a number of recommendations in insider trading cases where business alliances and new share issuances were material facts. It also made several recommendations in insider trading cases

where a petition for rehabilitation procedures was a material fact.

Since April 2014, insider trading regulations have prohibited persons from providing insider information or making transaction encouragement to others. This transaction encouragement includes both for gaining profits and for avoiding losses. This year, the SESC made the first recommendation for administrative monetary penalty payment orders in a case of transaction encouragement for avoiding losses. With regard to the regulations on transaction encouragement, quite a few listed companies still lack sufficient understanding of the regulations.

The scheme of market manipulation becomes increasingly complicated and sophisticated. The SESC made recommendations for administrative monetary penalty payment orders in cases where, in order to avoid detection; (a) wrongdoers executed some spoofing orders instead of canceling them all; (b) a wrongdoer placed multiple spoofing orders across a wide range of prices covering the 10 highest bid prices; and (c) a wrongdoer raised share prices by repeatedly placing minimum unit orders.

(4) Policy going forward

Going forward, the SESC will continue to improve its surveillance systems and review the methods of examination and investigation in order to keep pace with the changing economic situations and trading methods as

well as to ensure flexible and efficient examinations and investigations.

The SESC will also announce recommendations for administrative monetary penalty payment orders on its website as well as publish a casebook of administrative monetary penalty payment orders, which will provide information on trends and overviews of the cases. The casebook will also identify issues regarding internal control systems that can be improved to prevent insider trading at listed companies. This effort is aimed at preventing recurrences of market misconduct.

3 Identifying and addressing violations of disclosure regulations and prevention of recurrence of violations

(1) Recommendations for administrative monetary penalty payment orders and filings of criminal charges of violations of disclosure regulations

The SESC made recommendations for administrative monetary penalty payment orders in 6 cases of violations of disclosure regulations and filed criminal charges in 1 case in FY2019.

(2) Trends and causes of the violations of disclosure regulations

Among the 6 cases of violations of disclosure regulations in which the SESC made recommendations for administrative monetary penalty payment orders, there

were 2 cases of misstatements concerning non-financial information in the securities reports. Specifically, there were false statements with respect to the corporate governance system, internal control system and officers' compensation in the corporate governance section of annual securities reports.

As for the other 4 cases, there were misstatements concerning financial information in the securities reports, including premature revenue recognition and overstating of net profits through fraudulent accounting schemes, such as understating of loan loss provisions. Of the 4 cases, one was seen with the absence of "notes regarding transactions with relevant parties" in the annual securities reports.

(3) Policy going forward

Transactions are increasingly complex, corporate operations are more globalized, and the business models are being diversified and transformed. In these circumstances, early detection and preemptive actions against violations of disclosure regulations are essential. For doing this, the SESC will continue to gather information on listed companies and conduct analysis with a focus on the risk of the violations, as well as conduct timely and multifaceted inspections of disclosure statements.

In addition, the SESC will engage in dialogues and enhance mutual understanding on the background and

causes of violations with the management and outside directors of listed companies that have committed violations of disclosure regulations, to assist them in building internal systems for proper information disclosure. The SESC will also proactively communicate with listed companies and their audit firms regarding the details of the actual violations of disclosure regulations detected in inspections of disclosure statements. Such efforts will collectively contribute to preventing recurrences of violation of disclosure regulations.

4 Risk-based and integrated monitoring of FIBOs³

(1) Basic monitoring policy for securities business

Since the 2016 business year,⁴ the SESC has been conducting risk assessments of all FIBOs through off-site examination involving analyses of the business environment including economic and industrial trends, as well as FIBOs' business models. Based on the respective risk assessments of FIBOs in off-site examination, the SESC has selected entities for on-site inspections in collaboration with the Local Financial Bureaus.

In carrying out on-site inspections, the SESC aims not only to point out legal problems and make recommendations for administrative actions, but also to assess the

problems in a holistic manner and pursue the root causes to assist FIBOs in preventing recurrences of the problems.

In cases where the SESC identifies issues in business control environments that need to be improved but that have yet to become serious problems, the SESC has shared its views on the issues with the management of the FIBOs under inspection to encourage them to build effective internal control environments.

(2) Recommendations for administrative actions and filing of criminal charges against FIBOs

In FY2019, the SESC made 14 recommendations for administrative actions against FIBOs and filed criminal charges in 1 case.

These cases involved FIBOs that conducted seriously problematic business practices as they were lacking in awareness about compliance and investor protection. In one case, a securities company compensated customers for their losses, while in another case, an investment management firm failed to faithfully conduct investment management business for the interests of beneficiary owners. There was also a case where an investment adviser/agent provided seriously misleading advertisements to customers in relation to

³ In this document, "FIBOs" refers to any business operator subject to securities monitoring, including Financial Instruments Business Operators, registered financial institutions, financial instruments intermediary service providers, Qualified Institutional Investor Business

Operators ("QII Business Operators"), and credit rating agencies.

⁴ The 2016 business year refers to the period from July 1, 2016, to June 30, 2017.

solicitation for the conclusion of financial instruments contracts.

(3) Policy going forward

While business operators subject to the SESC's monitoring total approximately 7,500, their size and businesses, and the products offered by them are diverse. Furthermore, there are business operators that are still lacking the fundamental awareness and controls for compliance and investor protection. The SESC will endeavor to accurately identify potential risks through its effective and efficient monitoring.

Especially in cases where the SESC identifies the necessity for early, in-depth examinations with regard to possible violations of relevant regulations or problems related to business control environments, the SESC will conduct on-site inspection to clarify the problems.

Following the enactment of the revised Financial Instruments and Exchange Act in May 2019, the SESC will monitor FIBOs handling derivatives trading related to crypto-assets⁵ and electronic records transfer rights (e.g. securities token offering).

5 Response to the advance of digitalization

(1) Use of digitalization for market surveillance

In recent years, rapid digitalization is having a significant impact on all capital markets and market participants. For example, the market landscape is being transformed as a result of the proliferation of high-speed algorithmic trading. In addition, new products and transactions, such as crypto-assets are emerging. Keeping up with such rapid changes in the environment, the SESC is promoting the use of digitalized technologies for a more effective and efficient surveillance mechanism.

(2) Policy going forward

The SESC will continue discussions with a view to keep up with possible changes in the environment and make increased use of digitalized technologies for a more effective and efficient surveillance mechanism.

6 Cooperation with relevant authorities and proactive communication with stakeholders

(1) Cooperation with relevant authorities

The SESC works with self-regulatory organizations (e.g., Financial Instruments Firms Associations, Financial Instruments Exchanges, and Japan Exchange

⁵ As a result of the revision of the Payment Services Act (put into force on May 1, 2020), the legal term

representing "virtual currency" has been changed to "crypto-asset."

Regulation; hereinafter “SROs”) on a daily basis in examining market transactions and in monitoring the appropriateness of members’ operations. The SESC further strengthened its cooperative relationship with SROs through periodic discussions to share emerging issues related to market surveillance. In FY2019, the SESC had such periodic discussions with SROs 19 times as well as discussions with FIBOs and relevant authorities to exchange views.

Regarding the cooperation with foreign authorities, the SESC participates in various multilateral discussions at IOSCO⁶ and actively engages in exchanges of views on a bilateral basis. In addition, in the cases of investigations into market misconduct using cross-border transactions, the SESC made a total of 26 requests for information to foreign authorities through the IOSCO MMoU (Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information) in FY2019.

recommendations and various casebooks, contribution of articles, and holding lectures for the purpose of enhancing self-discipline in the market. In FY2019, the SESC proactively conducted external outreach through its website, media outlets and a total of 26 seminars to market participants, certified public accountants, lawyers, and other stakeholders.

(2) Proactive communication with stakeholders

The SESC continuously endeavors to enhance its communications with retail investors and other market participants with respect to the significance, details and root causes of the cases as well as other activities of the SESC on various occasions. The means of communication include the publication of individual cases at the time of

⁶ International Organization of Securities Commissions