

1 Overview of activities in Fiscal Year 2018

In FY 2018 (April 2018–March 2019), various changes took place in the domestic and global economic environment surrounding Japan's securities markets. Domestically, the Japanese economy has been in a moderate recovery. Domestic demand, including consumption and investments, remained robust due to high levels of corporate earnings and improved employment and income environments. Despite the strong domestic economy, however, the outlook remained increasingly uncertain due to trade issues between large economic powers, Brexit and other causes.

Given such circumstances, in FY 2018, the Securities and Exchange Surveillance Commission (SESC) engaged in market surveillance on a timely basis, such as gathering and analyzing information from macro-economic perspectives with a focus on potential risks. In performing its monitoring and investigation duties, the SESC not only made recommendations for administrative actions and filings criminal charge against violations of regulations, but also analyzed the root-causes of the violations of regulations to prevent recurrence.

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

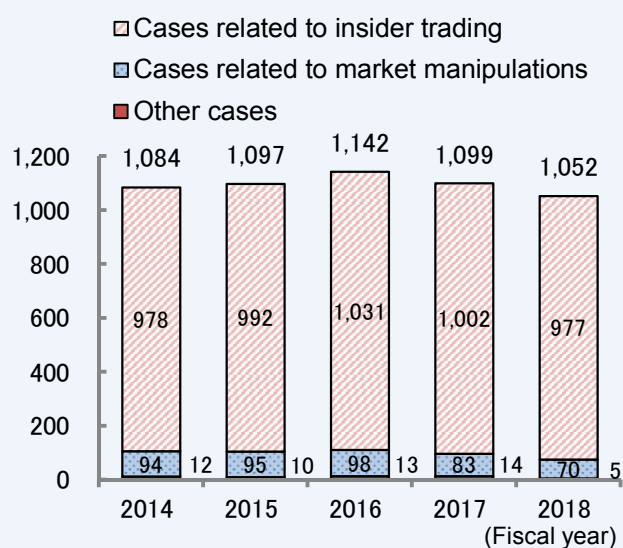
(1) Recommendations for administrative monetary penalty payment orders and filings of criminal charges against market misconduct

In FY 2018, the SESC made recommendations for administrative monetary penalty payment orders in 33 market misconduct cases (of which, 23 were insider trading, 7 were market manipulations and 3 were uses of fraudulent means) and filed criminal charges against 5 cases.

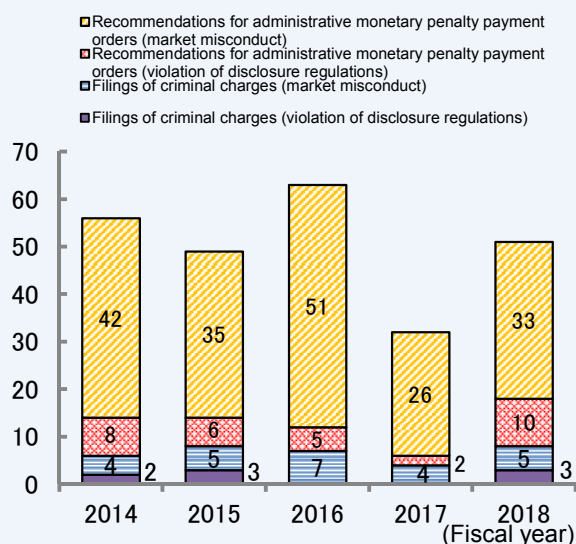
(2) Case examination for detecting market misconduct

The total number of cases examined for detecting market misconduct was 1,052 in FY 2018; over 1,000 examinations have been made for 6 consecutive years.

Examined Cases for Market Misconduct



Recommendations and Filings of Criminal Charges



(3) Trends in market misconduct

Listed companies continued to reorganize themselves in various ways to improve earnings in severe business environments or as countermeasures against drastic changes in the economic situation. Under such circumstances, the SESC made numerous recommendations against insider trading where TOB, business transfer and demerger were material facts. It also made several recommendations against insider trading

where the petition for rehabilitation procedures was a material fact.

Insider trading regulations which prohibited persons from providing the insider information or making trade recommendations to others were introduced in April 2014. Since then, the first cases where the trade recommendations were the sole act of violation of the regulations were recommended for administrative monetary penalty payment orders. With regard to the regulations on the trade recommendations, quite a few listed companies still lack sufficient understandings of the regulations.

The scheme of market manipulation becomes increasingly complicated and sophisticated. The SESC made recommendations for administrative monetary penalty payment orders against cases where: in order to avoid the detection, a wrongdoer executed some spoofing orders instead of cancelling them all; in order to avoid the detection, a wrongdoer raised share prices by repeatedly buying at the basic minimum units of trade; and in order to avoid the detection, institutional investors placed spoofing orders in a night session of long-term JGB futures.

The SESC also made recommendations for monetary penalty payment orders against a unique trade method of spoofing that was aimed at eliminating trading by other investors. The method is contrary to the general spoofing, which is aimed at inducing trading orders from other investors. The

SESC deemed the method to be a use of fraudulent means.

(4) Policy going forward

Going forward, the SESC will continue to improve its market-monitoring systems and review the methods of examination and investigation in order to keep pace with the changing economic situations and trade methods as well as to ensure flexible and efficient examinations and investigations.

The SESC will also post 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 recommendations. The casebook will also identify issues regarding internal control system that can be improved to prevent insider trading at listed companies. This effort is aimed at preventing both occurrences and recurrences of market misconduct.

3 Identifying and addressing violations of disclosure regulations and prevention of both occurrences and recurrences

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

The SESC made recommendations for administrative monetary penalty payment

orders against 10 cases of violations of disclosure regulations and filed criminal charges against 3 cases in FY 2018.

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

Among the 10 cases of violations of disclosure regulations against which the SESC made recommendations for administrative monetary penalty payment orders, there were misstatements in securities reports due to excessive accountings of fictitious trades in 9 cases. Of these, 3 cases involved listed companies joining the fictitious trades without appropriate confirmation and examination of the actual state of trades, resulting in the accountings of the fictitious excessive sales.

The remaining case was a violation of disclosure regulations related to non-financial information in which a wrongdoer offered stock acquisition right certificates without submitting an amendment statement for changes in a material matter concerning the offering in the securities' registration statement.

(3) Policy going forward

The SESC will continue to gather information on listed companies and conduct analysis with a focus on the risk of fraud occurrence. It will also carry out continuous monitoring of large companies by market capitalization which are considered to have relatively large market impacts. Furthermore, the SESC will continue to gather information

and conduct analysis in light of the actual state of business, such as value chains and business customs in different industries, after selecting industries from broad perspectives in view of changes in the business environment, etc.

In addition, the SESC will engage in dialogues and enhance mutual understandings on the background and causes of the violations with the managements of listed companies that have committed violations of disclosure regulations, so as to help them build internal systems for proper information disclosure. The SESC will also proactively communicate with listed companies and audit firms regarding the details of the actual violations of disclosure regulations detected in inspections of disclosure statements. Such efforts will collectively contribute to prevent both occurrences and recurrences of violation of disclosure regulations.

4 Seamless on-site/off-site monitoring of FIBOs¹

(1) Basic monitoring policy for securities business

Since the 2016 business year², the SESC has been conducting risk assessments of all FIBOs through off-site monitoring involving analyses of the business environment covering economic and industrial trends, as

¹ In this document, "FIBOs" stands for any business operator subject to securities monitoring, including Financial Instruments Business Operators, registered financial institutions, financial instruments intermediary service providers, Qualified Institutional Investor

well as the FIBOs' business models. Based on the respective risk assessments of FIBOs in the off-site monitoring, the SESC has engaged in actions to select FIBOs for on-site monitoring (on-site inspections) in collaboration with the Local Financial Bureaus.

In carrying out on-site monitoring, the SESC aims not only to point out legal problems and make recommendations for administrative actions, but also to analyze the whole picture of the problems to identify their root-causes, so that the FIBOs can design effective measures to prevent their recurrences.

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

(2) Recommendations for administrative actions against FIBOs

In FY2018, the SESC made 11 recommendations for administrative actions against FIBOs.

These cases involved FIBOs that conducted highly problematic business practices, lacking awareness for compliance

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

² The 2016 business year refers to the period from July 1, 2016, to June 30, 2017.

and investor protection. In one case, a securities company was engaged in misstatements and misleading representations upon soliciting elderly clients to conduct switching trades of U.S. stocks. In other cases, Type II FIBOs made misstatements on their websites to solicit funds investing in loan business. There was also a case in which an investment advisor/agent made purchase recommendations simultaneously to several customers in order to trigger a sharp rise in the stock price.

(3) Policy going forward

While business operators subject to the SESC's monitoring total approximately 7,200, their size, businesses and products are diverse. Furthermore, there are business operators that are still short of the fundamental awareness and controls for compliance and investor protection. The SESC will take such circumstances into consideration and endeavor to accurately identify where risks exist through effective and efficient monitoring.

In cases where the SESC identifies the necessity for early, in-depth examinations with regard to possible violations of relevant regulations or deficiencies in the internal control, the SESC will conduct on-site monitoring to verify the situation.

5 New challenges for the SESC: Initiatives for SupTech³

(1) Studying the trends of financial technologies, and information gathering on the use of IT by domestic and foreign regulatory authorities

Advancements in IT and the convergence of finance and technology (FinTech) in recent years have brought dramatic changes to the transactions subject to the SESC's monitoring, which may lead to the emergence of new risk factors. In light of the situation, the SESC has set a "development of SupTech" as one of its important initiatives. Under the initiatives, the SESC studied the trends of financial technologies and gathered information on the use of IT by domestic and foreign regulatory authorities, etc. The SESC also discussed specific preparations to introduce new market surveillance systems that involve the potential use of advanced technologies such as AI (artificial intelligence).

(2) Policy going forward

The SESC will advance discussions on introducing new market surveillance systems including potential use of advanced technologies such as AI, so as to ensure effective market surveillance, by responding to changes in business processes and business models resulting from the developments of IT in financial markets.

³ "SupTech" stands for supervisory technology.

Furthermore, the SESC will carefully monitor new IT advancements, such as the entry by listed companies and FIBOs into the crypto-asset business and the funding via ICOs⁴ (Initial Coin Offerings), as these developments could affect markets in various ways.

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 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 FY 2018, the SESC had such periodic discussions with SROs (18 times) as well as FIBOs and relevant authorities to exchange views.

In terms of cooperation with foreign authorities, the SESC participates in a variety of multilateral discussions at IOSCO and actively engages in exchanges of views on a bilateral basis. On top of that, in the cases of investigations into market

misconduct using cross-border transactions, the SESC made a total of 23 requests for information to foreign authorities through the IOSCO MMoU (Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information) in FY 2018.

(2) Proactive communication with stakeholders

The SESC continuously endeavors to enhance its external communications by making the information more specific and easier to understand. The SESC provides retail investors and other market participants with significance and root-causes of the cases as well as activities of the SESC at various occasions. This includes the publication of individual cases at the time of recommendations, publication of casebooks of administrative monetary penalty payment orders and FIBOs monitoring results, as well as the contribution of articles and lectures. In FY2018, the SESC proactively communicated through the website, etc., and the SESC representatives also spoke at a total of 28 seminars to market participants, certified public accountants, lawyers, and other attendees.

⁴ “ICOs” are generally regarded as a catch-all term for the electronic issuance of tokens by companies in

order to procure currency or crypto-assets (cryptocurrency) from the general public.