

Annual Report 2018/2019

(April 2018 – March 2019)

Overview



"for investors, with investors"

August 2019

Securities and Exchange Surveillance Commission

1. About the SESC

Chairman and Commissioners (2017-2019)



Yasushi Hamada, Commissioner

Yasushi Hamada was appointed as SESC commissioner in December 2016. Previously, he served as the professor of Graduate School of Professional Accountancy, Aoyama Gakuin University.

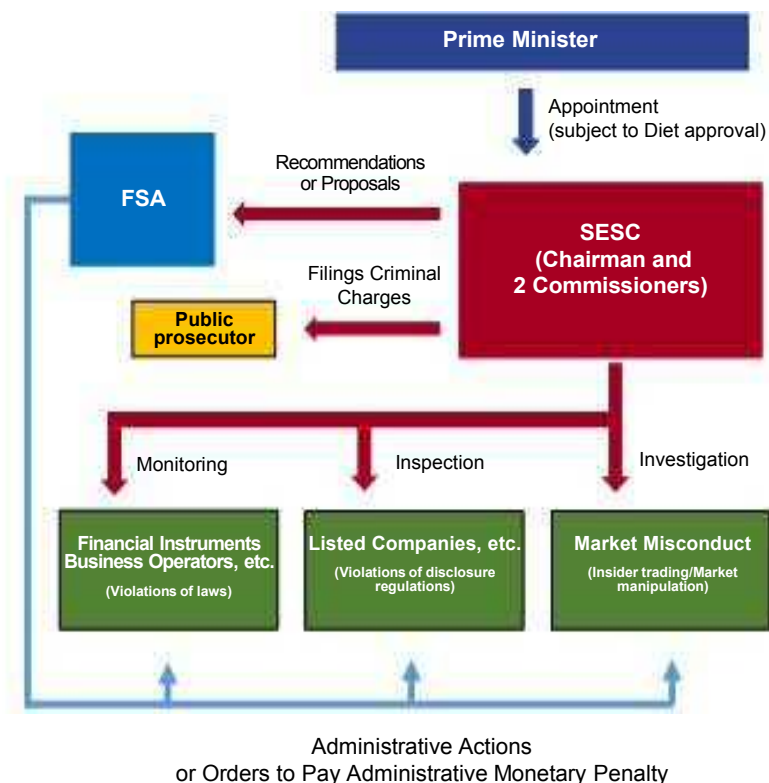
Mitsuhiro Hasegawa, Chairman

Mitsuhiro Hasegawa was appointed as SESC chairman in December 2016. Previously, he served as the Superintending Public Prosecutor of Hiroshima High Public Prosecutors Office.

Mami Indo, Commissioner

Mami Indo was appointed as SESC commissioner in December 2016. Previously, she served as the Senior Executive Director of Daiwa Institute of Research, Ltd.

Overview of the SESC



1. About the SESC (continued)

Strategy & Policy of the SESC 2017-2019

- Building on a Quarter-Century of Achievement -

Mission

1. Ensuring market integrity/protection of investors
2. Contributing to sound development of markets
3. Contributing to sustainable economic growth

SESC's Vision on Market Integrity

Compliance with rules and trust from all market participants

< Key elements >

1. Proper disclosure by listed companies and issuers
2. Appropriate conduct and practices by market intermediaries
3. Self-discipline by all market participants
4. Effective market oversight with a high degree of professionalism

Values

<p>Fairness Fair and independent oversight</p>	<p>Accountability Holistic and root-cause analysis coupled with public outreach</p>	<p>Forward-looking Perspective Early detection of signs of market misconduct</p>	<p>Effectiveness and Efficiency Effective use of resources</p>	<p>Strong Collaboration Working closely with SROs and other competent authorities, both domestic and overseas</p>	<p>Commitment to Excellence Committing to achieve highest standards of oversight</p>
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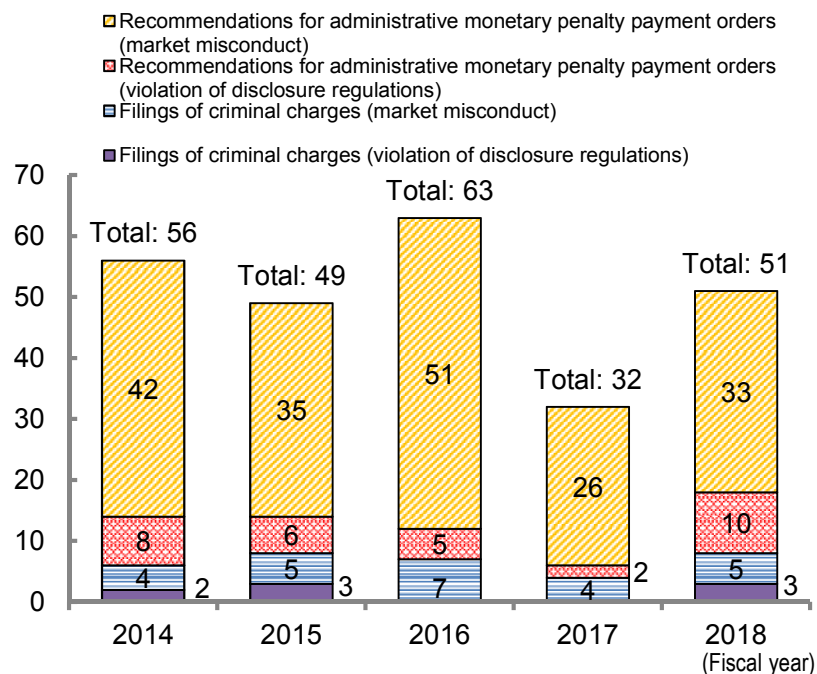
2. Overview

- Timely market surveillance with a focus on potential risks from macro-economic perspectives
- On-site monitoring based on risk assessment
- Effective use of the administrative monetary penalty system, rigorous enforcement of criminal charges against market abuse
- Root-cause analysis and dialogues with the management of companies to prevent recurrence of violations
- Proactive communication with stakeholders (website, casebooks, articles, lectures, etc.)
- Policy proposals to the Prime Minister and the Commissioner of the FSA

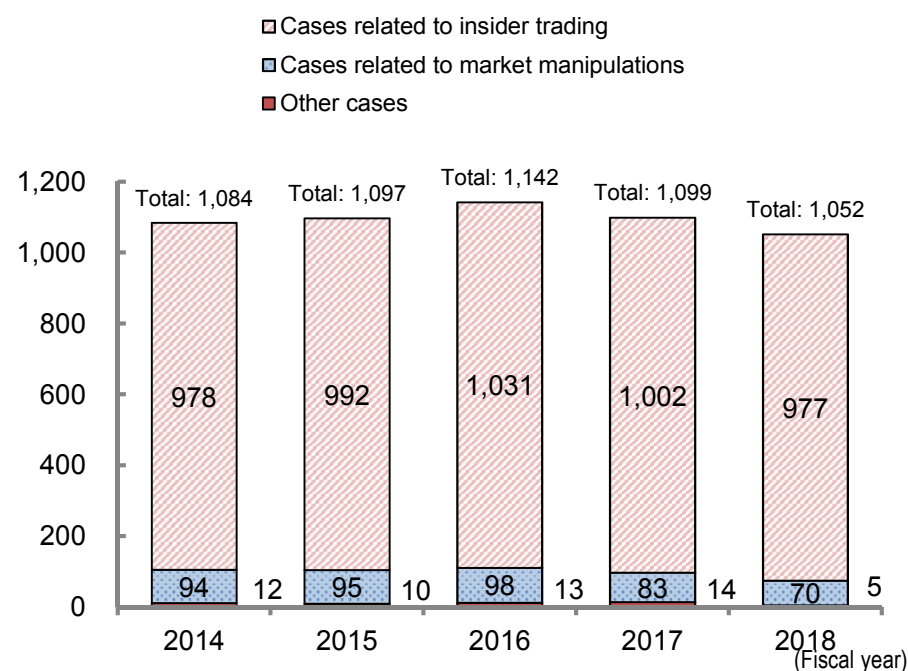
3. Market Misconduct

- 33 recommendations for administrative monetary penalty payment orders
 - ✓ Insider trading: 23 cases
 - ✓ Market manipulations: 7 cases
 - ✓ Fraudulent means: 3 cases
- 5 filings of criminal charges against criminal offense (Insider trading)
- Over 1,000 cases were examined for 6 consecutive years

Recommendations and Filings of Criminal Charges



Examined Cases for Market Misconduct

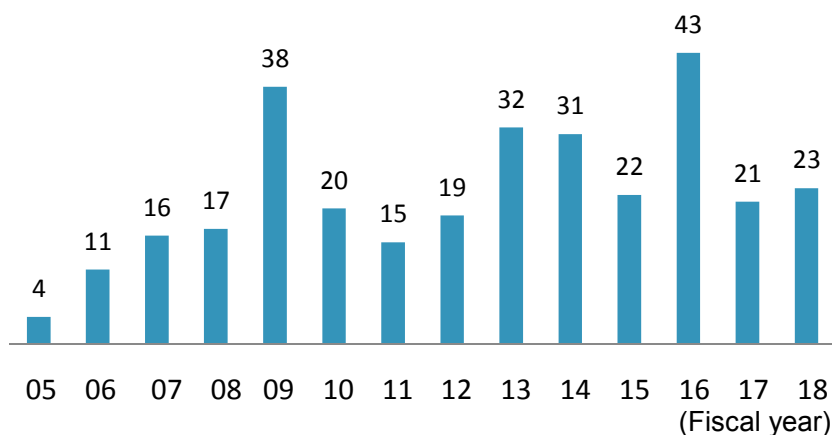


3. Market Misconduct (continued)

- Insider trading
 - ✓ Cases concerning TOB or earnings revision are still prevalent (①)
 - ✓ First cases concerning business transfer and concerning demerger were penalized (②)

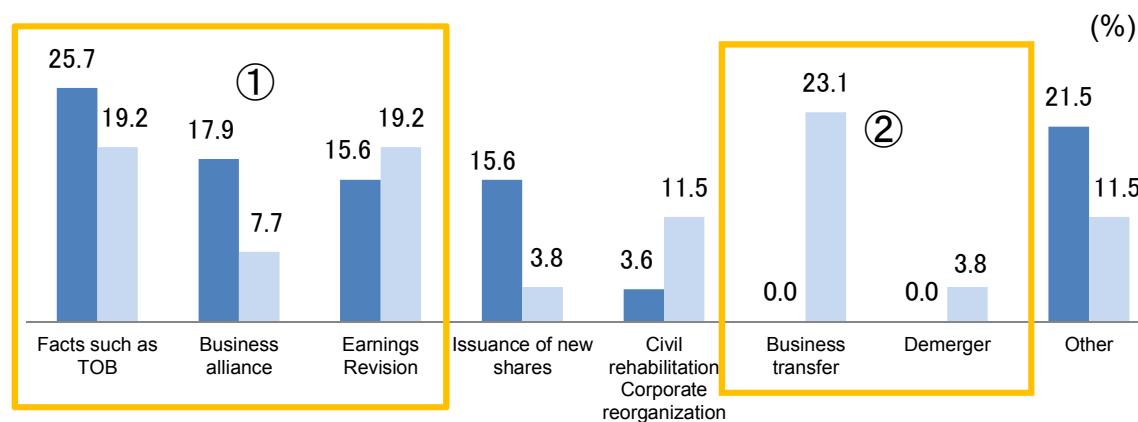
- Market manipulation
 - ✓ First case of manipulation in listed derivatives by an offshore institution

Number of Cases of Insider Trading



Note: The numbers include cross-border cases.

Breakdown of Cases by Insider Information as a Material Fact



■ Total from April 2005 (when the administrative monetary penalty system was introduced) to March 2018

■ FY2018

4. Violation of Disclosure Regulations

- 10 recommendations for administrative monetary penalty payment orders
- 3 filings of criminal charges
- Conducted dialogues on the background and causes of the violations with the management of listed companies to prevent recurrence of violation
- Continuous monitoring of large cap, etc., from macro-economic perspectives
- In-depth examination and analysis considering the changes in the business environment

Results of the Inspections of Disclosed Statements

Number of inspected cases		20	Overview	Backgrounds
(of which)	Recommendations for administrative monetary penalty payment orders	10	Offer of stock acquisition right certificates without submitting an amendment statement	<ul style="list-style-type: none"> ➤ Problems in internal control ➤ the former representative director had excessive influence on the policy decisions ➤ directors and corporate auditors lacked the awareness etc.
			Excessive accountings of fictitious trades	<ul style="list-style-type: none"> ➤ The first priority was the achievement of the sales target ➤ Some of the management members took the initiative in accounting excessive sales

5. Financial Instruments Business Operators (FIBOs)*

Risk Assessments

Analyzing the challenges and risks considering business scale and type



On-site Monitoring

- 68 cases of on-site monitoring
- 11 recommendations for administrative actions
- Encouraging to build effective internal control environments (e.g. Sharing the findings)

Challenges and Risks (Examples)	
Major securities companies	Further sophistication of risk management systems to support global business development
Banking groups	Potential risks such as conflict of interests related to the combined promotion by banks and securities companies
Regional securities companies, etc.	Risks arising from handling diversified financial instruments without establishing sufficient sales management systems when pursuing sales expansion

Typical Cases for Administrative Actions	
Securities companies	Misstatements and misleading representations upon soliciting elderly clients
Type II FIBOs	Misstatements to solicit funds investing in loan business
Investment advisor /agent	Purchase recommendations made simultaneously to several customers in order to trigger a sharp rise in the stock price

* "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 Business Operators, and credit rating agencies.

6. Initiatives for SupTech

- Studied the trends of financial technologies and the structural changes in the markets (IT and AI technologies)
- Gathered information on the use of IT by domestic and foreign regulatory authorities, etc.
- Advancing discussions on introducing new market surveillance systems including potential use of AI by examining technological challenges, etc.

Examples of Technologies Regarding New Market Surveillance System

Technologies that detect and analyze market misconducts from among a large volume of orders and transactions data

Technologies that detect a sign of fraud in the markets from big data, including macroeconomic trends and corporate financial information

Technologies that effectively gather data necessary for market surveillance from market participants

7. Cooperation with SROs, Proactive Communication and Policy Proposals

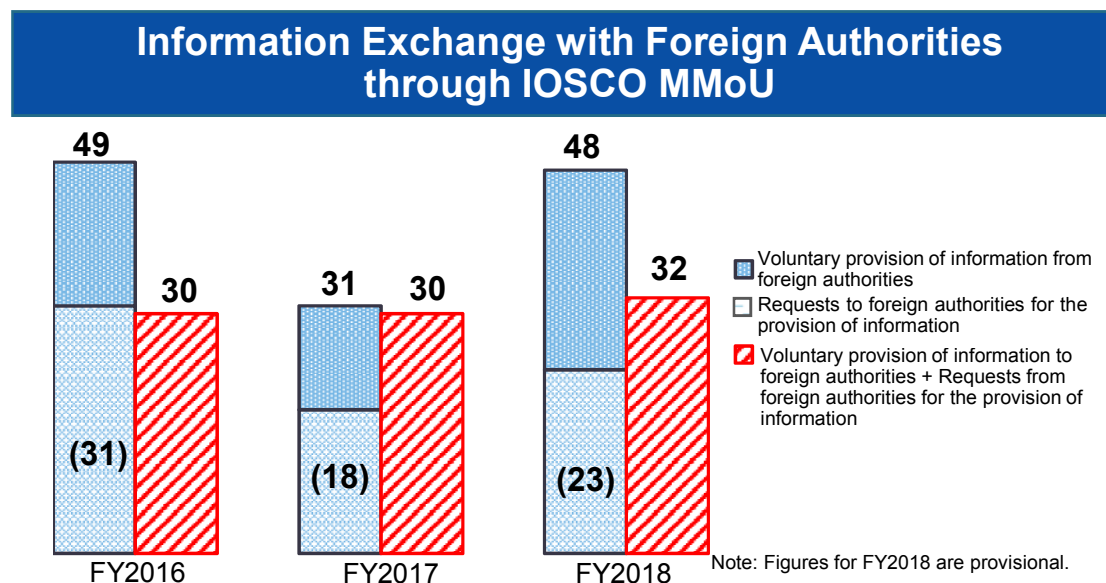
- Close cooperation with SROs in market surveillance
 - ✓ Information sharing on a daily basis
 - ✓ Periodical discussions to share emerging issues

- Proactive communication on the significance and root-causes of the cases with stakeholders
 - ✓ Website, casebooks, articles, lectures, etc.

- Policy proposals to the Prime Minister and the Commissioner of the FSA
 - ✓ More information provisions of borrowers for investors in the funds investing in loan business (December 7, 2018)
 - ✓ Authority to collect evidence including electromagnetic records (February 26, 2019)

8. International Coordination for Close Market Surveillance

- Proactively participated in the IOSCO discussions
 - ✓ IOSCO Annual Conference, APRC, C4, CER
- Better information exchange for enforcement actions against misconducts in cross-border transactions (IOSCO MMoU)
- Better knowledge sharing
 - ✓ Staff exchange, short-time training programs, etc.



9. Message towards Market Participants

- Emerging issues
 - ✓ Social lending (funds which invest in loan business)
 - ✓ Listed derivatives

- Messages from the SESC to market participants
 - ✓ FIBOs: "Report suspicious transactions!"
 - ✓ Corporate members: "Do you know regulations on the trade recommendation?"
 - ✓ Offshore investors: "We are also watching cross-border transactions closely."
 - ✓ Listed companies: "Before starting a transaction, do you recognize the reality of such transaction?"
 - ✓ All market participants: "Social media is under our market surveillance."