

transaction records at the OSE and information obtained by relevant divisions of the OSE.

2) Measures taken based on inspections

The OSE failed to clarify standards used to decide what measures to take based on inspections. The OSE also did not make efforts to establish such standards in a systemic manner while continuing to take actions against member companies.

3) Market administration business

The OSE failed to devise long-term plans to foster the ability of its officers in charge of market administration. The OSE also did not act to improve its ineffective system of taking out samples of transactions for the detecting of illicit trading practices. Standards currently used by the OSE in extracting such samples do not accurately reflect the actual state of the market, resulting in the number of samples taken becoming excessive-sometimes enormous and other times zero. The OSE did not take measures to review these standards.

Even though the OSE took out trading samples for the detecting of illicit trading practices, such as fictitious trading and coordinated trading, the exchange did not look into records of own-account transactions in question made by securities companies involved in cross-trade transactions relationship with transaction counterpart of customers identified.

4) Cooperation between relevant sections

The OSE failed to make efforts to promote in-house cooperation and information-sharing among relevant sections. Due to the lack of this in-house cooperation, information obtained separately by different sections was not used effectively in the OSE's overall inspection and market administration business.

- Recommendation date: August 5, 2003
- Administrative disciplinary measures: Three-month suspension of business related to the listing of stocks on the OSE securities market, three-month suspension of business related to the new listing of stock options on the OSE securities market, business improvement order, submission of a report on the implementation of measures under the business improvement order and checks of the implementation

4. Policy Proposals

1) Outline

Based on the results of inspections or investigations of criminal offenses, the SESC may, if necessary, present policy proposals to the Prime Minister, the FSA Commissioner or the Minister of Finance in order to ensure fairness in securities transactions (Article 21 of the FSA Establishment Law).

Policy proposals are put forward by the SESC after its comprehensive analysis of the results it obtained through the inspections and investigations. Such proposals are intended to clarify the SESC's view on laws, regulations and self-regulatory trading rules and have it reflected in policy measures being taken by other government agencies and self-regulatory organizations. Proposals by the SESC serve as important yardsticks for relevant government authorities in formulating certain policies.

The SESC has proposed reviewing or revising existing laws or regulations on securities trading and related matters, and self-regulatory rules, when such rules and laws are found unfit to deal with issues found in actual transactions. The SESC has also pointed out problems inherent in the current legal framework for securities transactions and specific areas

to be studied and reviewed from the viewpoint of ensuring fairness in trading.

2) Forwarded proposal and measures taken based on the proposal

In the 2003 SESC year, the SESC put forward a proposal to the FSA Commissioner, asking him to take adequate steps to ensure fairness in securities trading.

The following are the outline of the proposal and measures taken based on the proposal.

1) Forwarded proposal

Inspections of securities companies showed the following:

- (a) A securities company concluded contract with a securities analyst not employed by the company for the compilation of analysts' reports used in soliciting business from investors. In reports compiled based on the contracts, the analyst newly assigned good ratings to stocks of particular companies. The analyst repeatedly bought the stocks of this company before the release of the reports to investors and repeatedly sold the stocks after the release of the reports. The situation indicated that the securities companies failed to take sufficient measures to control the compilation of analyst's reports and activities of securities analyst.
- (b) A securities company asked an information-providing firm to prepare analyst's reports after selecting particular stocks to be dealt with in the reports and paid money for the firm's compilation of the reports. However, the reports were released to investors without any reference to such arrangement.

The conduct by analysts and the securities company's oversight of the analyst's reports shown in (a) were deemed inappropriate because the reports did not touch on the interest of the analyst involved in the securities transactions in question, hurting investors confidence in analysts reports. The conduct by a securities company shown in (b) was deemed as making statements that would mislead investors regarding the independence of analyst's opinion from those of the securities company. It is recognized that both conducts above undermined investors' confidence in the securities market.

As long as securities companies ask securities analysts to prepare reports and use such reports to solicit business from investors, they should also take adequate steps to screen such reports and control the activities of securities analysts.

From the viewpoint of increasing investor protection and the fairness and transparency of markets, it is necessary to prevent interest-conflicting conduct among the relevant parties from occurring in connection with the compilation of analysts' reports used by securities companies in soliciting business. Specifically, it is necessary for securities companies to require analysts to disclose their holdings of shares analyzed by themselves in their reports, and examine if the analysts' declaration of the stocks held by them are accurate in their reports. It is also necessary to make it well-understood that any conduct against 2) below will be deemed violations of laws. Based on these proposals, it is necessary to build an adequate system to supervise analysts' reports and the analysts who prepared them.

2) Measures taken based on the proposal

Based on proposals made by the SESC to the FSA Commissioner on December 16, 2003, the Japan Securities Dealers Association partially revised a resolution adopted by its board that concerns the handling of analysts' reports by securities companies on March 17, 2004, and added some other clauses to it. One of the clauses says that when a member securities company uses a report prepared by an analyst not employed by the company based on a contract between the securities company and a firm employing the

analyst or a contract between the securities company and the analyst, the member securities company must take steps to ensure that interest-conflicting relations between the analyst and the companies analyzed by the analyst in the report will be clearly stated in the report (Article 7, Paragraph (1)).

Another clause stipulates that when a member securities company uses a report prepared by an analyst not employed by the company based on a contract between the securities company and a firm employing the analyst or a contract between the securities company and the analyst, the member securities company must ensure that steps will be taken to make sure that the analyst will implement his or her business duty in a fair and appropriate manner in connection with the analyst's securities trading or ownership of securities (Article 15, Paragraph (2)).

5. Market Surveillance

1) Outline

1. Outline of market surveillance

The SESC conducts market surveillance on a broad range of securities transactions on a daily basis, including unfair securities deals, such as manipulation of stock prices and insider trading, as well as inspections of securities companies and investigations of criminal-offense cases.

Specifically, the SESC takes out stocks showing irregular movements, as the samples below show, based on the day-to-day surveillance of market movements and information obtained from various sources, and asks securities companies or SRO's that have engaged in the securities transactions in question to prepare detailed reports on the trading or submit relevant data.

Subject to market surveillance are the following:

- (1) stocks whose prices surged or plunged during a short-period of time;
- (2) stocks about which important incidents that would significantly affect investors' investment judgment occurred;
- (3) stocks that have drawn major attention in newspapers, magazines and Internet bulletin boards; and
- (4) stocks which were reported as involved in possible misconducts to the SESC by general public.

Based on the reports or data submitted, the SESC makes a careful and intensive analysis of dubious securities transactions that may involve price manipulation, insider trading and other violations of law in order to unearth what had actually happened. In addition, the SESC checks if securities companies involved in these dubious deals have committed acts that constitute violations of laws.

If the initial surveillance found problems in the securities transactions in questions, the cases will be reported to relevant SESC sections to be made clear.

2. Legal basis

To conduct market surveillance, the SESC is authorized to ask securities companies or SROs to submit reports and data on particular securities transactions if doing so is deemed necessary and appropriate from the viewpoint of maintaining fairness in trading and protecting investors' interests. Such authority delegated to the SESC and the scope of that authority are prescribed under the SEL, LFSF, FFTL and ordinances as with the SESC's authority on inspections.