Date of Recommendation (Category)	Violations Subject to Recommendation	Administrative Disciplinary Measures
August 19, 2003 (Inspection)	○ Act of making misleading statements about important matters in securities and other financial transactions as well as securities options trading (Recommendation in which disciplinary measures were sought against a securities company and executives and other employees of the company) The general manager of the sales department at the head office of Mizuho Investors Securities Co. prepared a document to publicize an investment technique combining the trading of exchange-traded funds (ETFs) and stock index options that would boast an annual yield of 27% on a simulation basis without showing any investment preconditions even though such a high return of profit was least likely to be achieved. The general manager also compiled a customer-by-customer list of investment achievements that did not accurately reflect actual trading results because the list did not take into account each customer's latent profits or losses on ETF holdings. The manager then distributed or presented the document between July 2001 and January 2003 to a large number of individual investors who had little experience with options trading, which amounted to the act of making misleading statements about important matters in securities trading.	Administrative disciplinary measures taken against the company Business improvement order (• Improving and strengthening the in-house supervision of business operations • Establishing new marketing and supervisory systems by drastically reviewing the current systems (The preparation of appropriate documents for business solicitation is included.) • Devising measures to avert future violations • Improving and strengthening employees' observance of laws and rules and clarifying where the responsibility lies) Administrative disciplinary measures taken against executives and other employees (registered securities traders) of the company Five-week suspension from business

○ **Data on the recommendation issued to Mizuho Investors Securities Co.**

1. Outline of investment technique

The securities company devised an investment technique combining the trading of exchange-traded funds (ETFs) linked to the 225-issue Nikkei Stock Average and the trading of call options linked to the 225-issue Nikkei Stock Average and solicited investments under this technique, called a "covered call strategy," from prospective customers.

This investment technique works in the following manner:

1) A customer purchases 1,000 lots of ETFs as one unit while selling one unit of call options that will expire in the following month and have an exercise price that is higher than the price at which the ETFs were bought and is the closest to the ETF price.
2) If the Nikkei Stock Average is higher than the exercise price immediately before the final trading day for the call options in the expiring month, the customer will settle the options trading by placing orders for opposing trade and sell the ETFs for the purpose of liquidating all trading positions. The customer will then repeat the investment shown in 1).
3) If the Nikkei Stock Average does not exceed the exercise price before the final trading day for the call options in the expiring month, the customer will settle the options trading by placing orders for opposing trade and will continue to hold the ETFs. The customer will then sell call options with an exercise price that is higher than the underlying ETF prices and is the closest to that ETF prices.

2. Misleading statements–1

The general manager of the sales department at the securities company's head office prepared written material to solicit investments for the financial product in question from customers. The material entitled "An investment proposal based on the covered call strategy using ETFs" (hereinafter referred to as the "proposal") was shown to the company's customers to explain the mechanism of the financial products in question. According to a trading example shown in the proposal, a customer buys 1,000 lots of ETFs for a market price of ¥10,500 while selling one unit of call options having an exercise price of ¥11,000, which is higher than the ETF purchase price of ¥10,500 as one unit and is the closest to that price. The investment will earn the customer ¥250,000 in proceeds as a premium for selling the options, according to the proposal. The material listed investment yields that are expected if the Nikkei Stock Average does not exceed the exercise price of ¥11,000, as shown below.

3) In cases where the Nikkei Stock Average does not exceed ¥11,000 by the final trading day of the call options in the expiring month or the day for fixing the special quotation (SQ) used for the settlement of the options trading

Call options premiums earned as a result of making opposing trade (or the automatic expiration of options rights) are counted as a profit (miscellaneous income).

Transactions shown in 2) are repeated. (In view of the ETF prices at that time, which are almost the same as the Nikkei Stock Average, call options with exercise prices of ¥10,500 and ¥11,000 will be subject to selling.)

Given that a total of 12 options transactions are possible every year, with each option contract expiring on a monthly basis, a customer can earn ¥2,842,500 a year from an investment under the covered call strategy. This figure is calculated by multiplying ¥236,875—the monthly proceeds of ¥239,500 from trading minus ¥2,625 charged both as options trading commission fees (for opposing trade or the automatic expiration of options rights) and consumption tax—by 12 (months).

After taxation, the investment yields about 27% a year, which means risks can be hedged against the Nikkei Stock Average's fall to as low as the ¥7,600 level.

However, in cases where the Nikkei Stock Average does not exceed ¥11,000, as shown above, an annual yield of 27% under this investment strategy could be realized only if three preconditions are met simultaneously. These conditions are that options trading is settled via SQ instead of opposing trade, the Nikkei Stock Average happens to trade at around ¥10,500 on the final trading day of each month of options trading for 12 consecutive months, and call options with an exercise price of ¥11,000 can be sold at ¥250,000 every month throughout the year.

The proposal shown to customers did not mention any of these preconditions. Therefore, the investment strategy boasted by the securities company misled its customers by convincing them that an investment using the covered call strategy would earn them an annual yield of 27% if the Nikkei Stock Average does not exceed ¥11,000.

In light of the actual movements of the Nikkei Stock Average and other elements shown below, the possibility of the three preconditions materializing simultaneously is almost zero.

- When stocks prices are stuck in certain narrow ranges for one year, there is almost no possibility, in terms of an options trading theory, of call options with an exercise price of ¥11,000 being sold at a certain price any time of the year. (Market volatility forecasts by market participants tend to drop at a time when stock prices are stuck in narrow ranges. Under such circumstances, stock options prices will decline as well.)
- All customers who invested under the investment strategy engineered by this securities company were found to have settled their options trading through opposing trading instead of SQ when stock prices were stuck or entered a downward phase. (Fifty customers who bought back options did so at an average cost of approximately ¥180,000 per unit.) However, the calculation of investment returns shown in the proposal did not refer to the cost of buying back the options. Proceeds and yields estimated in the proposal could not possibly materialize in actual transactions using the investment strategy in question because they were presumably all based on SQ settlements.

3. **Misleading statements–2**

The general manager of the sales department at the securities company's head office compiled a ledger that listed customer-by-customer results of their investment in the financial product in question using the ETF covered call strategy (hereinafter referred to as the "ledger"; see the attached page). When asked about investment returns on the financial product by prospective customers in the course of soliciting business from them, the general manager presented them the ledger.

The ledger listed each customer's holding of ETFs and call options as well as their investment results since the start of the first transactions. However, the ledger's column that showed figures for combined profits or losses did not take into consideration the customers' latent profits or losses on ETF holdings. Therefore, figures in that column did not reflect the actual results of the investment under the covered call strategy. In addition, the ledger listed ETF prices at the time the ledger was compiled, ETF trading volume and unit price for each customer, and appraisal profits or losses sustained by all customers on ETFs, but did not list their latent profits or losses on ETF holdings.

The ledger, for instance, showed that 38 of the 50 customers, or more than 70%, made a net profit on the investment in question as of the end of January 2003. However, all 50 customers would suffer net losses from the investment under the covered call strategy if their latent losses on ETFs were taken into account.

The general manager is judged to have made misleading statements about investment results when he solicited business from prospective customers using figures shown in the ledger, which included misleading factors about important investment conditions.

The general manager compiled the ledger by himself, using spreadsheet software installed on his own personal computer, and kept the file under his control. The original spreadsheet listed not only the total options premium receipt, profit from ETF sale, and total profit or loss for each customer, but also latent profits or losses on ETF holdings and overall profits or losses, including the investment on ETFs; the latter-half of the items mentioned are shown in the far right of each customer's column. This indicated that the general manager intentionally removed items, including latent losses on ETF holdings, from the ledger before printing it out and presenting it to prospective customers.

4. **The nature of customers who make financial transactions using the investment method solicited by the securities company**

As of the end of January 2003, 50 individual customers invested in the options trading in question. None of them, however, had invested in options trading before. Customers up to and including the age of 59 accounted for 12 of the 50 customers; those from age 60 to 69 accounted for 22; those from age 70 to 79 accounted for 15; and those aged 80 or older accounted for only 1.

(Attachment)

Sales Department at Head Office

Confidential Data

Ledger for Investment Results under the ETF Covered Call Strategy

As of January 31, 2003

Transaction start date: August 1, 2001 8,360

Approval number	Transaction start date	Salesperson in charge	Section/ Outlet	Customer code	Customer name	Trading volume	Per unit purchasing price	Expiration month	Exercise price	!	Per unit selling price	Amount	Total premium receipt	Profit from ETF sale	Total profit or loss
Omitted															
0	2001/11/●	○○	0	— 0	○○○○	3,000	8,950	3	8,500		210	3	4,262,095	-7,792,788	-3,530,693
0	2001/11/●	○○	0	— 111111	XXXX Co., Ltd.	3,000	11,649	2	8,500		245	3	5,327,330	0	5,327,330
						2,000	9,820	2	8,500		245	2			
0	2001/11/●	○○	0	— 222222	○○○○	3,000	12,073	3	8,500		230	3	4,035,598	1,443,129	5,478,727
0	2001/11/●	○○	0	— 333333	○○○○	3,000	12,100	3	8,500		215	3	6,727,165	-3,576,972	3,150,193
						2,000	11,550	3	8,500		215	2			
0	2001/12/●	○○	0	— 444444	○○○○	14,000	11,920	2	8,500		245	14	20,560,083	8,237,007	28,797,090
						3,000	9,703	2	8,500		245	3			
						4,000	8,656	2	8,500		245	4			
0	2001/12/●	○○	0	— 555555	○○○○	14,000	11,920	2	8,500		245	14	20,792,817	7,303,632	28,096,449
						3,000	9,637	2	8,500		245	3			
						4,000	8,570	2	8,500		245	4			
0	2001/12/●	○○	0	— 666666	○○○○	2,000	11,160	3	8,500		215	2	1,075,960	1,876,567	2,952,527
0	2001/12/●	○○	0	— 777777	○○○○	3,000	11,750	3	8,500		210	3	3,651,575	1,255,178	4,906,753
0	2001/12/●	○○	0	— 888888	○○○○	2,000	11,690	3	8,500		270	2	2,155,595	2,340,410	4,496,005
Omitted															

-115,862,953 107,719,670

223,582,623 Total premium receipt

9.6% -5.0% 4.6%

223,000 10,433 Total contracts 215 2,326,637,000 Total purchase book value -19.9%

-462,357,000 Appraisal profit or loss on ETFs Margin buying balance

Margin trading balance 82,000 9,102 48,530,000 Total premium on contracts 746,399,000

Cumulative brokerage charges 126,970,043 4,426,010