Annual Report
2005/2006

Securities and Exchange Surveillance Commission

JAPANESE GOVERNMENT

Message from the Chairman

Chairman: Takeo TAKAHASHI

The Japanese Securities and Exchange Surveillance Commission (SESC) is carrying out its mission of ensuring fair trade in both securities and financial futures markets in Japan and maintaining the confidence of investors in these markets.

This annual report covers the SESC's main activities in Business Year 2005 (July 1, 2005-June 30, 2006).

Recently, the environment surrounding securities markets has undergone significant changes, including the increase of Internet transactions, cross-border transactions and complicated transactions involving investment funds. Facing such situations, the SESC's function of market surveillance has been enhanced and strengthened for example through delegation of authority to conduct investigation to impose administrative civil monetary penalties and expansion of the scope of inspection. The SESC's organizational framework has also been reinforced as seen in the increase in the number of divisions from the previous two to five, which took place in July 2006.

In addition, when the Financial Instruments and Exchange Law which passed the Diet this June takes effect (scheduled for next summer), the scope of financial products will expand dramatically, and our authority to conduct inspections for sellers and composers of these financial products will be reinforced as well. Thus, the roles expected of the SESC in watching the market are getting more and more important, and we intend to continue to conduct inspections with a view to protecting investors and also to construct organizational structures appropriate for our tasks.

On the other hand, in order to manage healthy markets, it is definitely important that self-regulatory organizations (SROs) conduct inspections based on self-regulating rules. We will further strengthen the cooperation with SROs.

Corresponding to the changing environments in the markets and amendment of the system, the SESC will continue to do its utmost to establish sound markets, which are fair

and highly transparent, and to maintain the confidence of investors in the markets.

This report takes summarizes the SESC's activities in the last Business Year for maintaining investors' confidence in the securities markets in face of these challenges.

I hope that this report will be useful for securities companies and others operating in Japanese markets in further enhancing the level of their compliance with the market rules. In addition, I expect the report to become instrumental for investors, securities regulatory authorities and market participants overseas in having a better understanding of the activities of the Japanese SESC.

December 2006

Takeo Takahashi
Chairman
Securities and Exchange Surveillance Commission

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1. Investigations of Criminal Offenses and Filing of Complaints

1) Outline

1. Authority to Investigate Criminal Offenses

The authority to investigate criminal offenses on securities transactions is given to the SESC under the Securities and Exchange Law (SEL), the Law on Foreign Securities Firms (LFSF) and the Financial Futures Trading Law (FFTL). The SESC's scope of investigations under that authority is not limited to securities companies, but reaches all parties involved in securities transactions, including the investors themselves. With the SEL being applied similarly, the SESC is also given the authority to investigate criminal offenses under the Personal Identity Verification Law (PIVL).

Noncompulsory investigations conducted by the SESC on criminal offenses include making inquiries about suspects of criminal acts or related parties (hereinafter referred to jointly as "suspects"), inspection of materials in the possession of or left behind by suspects and holding materials supplied by suspects on a voluntary basis or left behind by them (Article 210 of the SEL, Article 53 of the LFSF, Article 170 of the FFTL and Article 18 of the PIVL). Compulsory investigations conducted by the SESC with warrants from judges include visiting and searching the premises of suspects and seizing related evidences (Article 211 of the SEL, Article 53 of the LFSF, Article 170 of the FFTL and Article 18 of the PIVL).

2. Scope of Criminal Offenses and Others

Criminal offenses are defined as hampering fair securities trading, and their scope is prescribed under cabinet orders (Article 45 of the SEL Enforcement Order, Article 23 of the LFSF Enforcement Order and Article 33 of the FFTL Enforcement Order).

Notable offences include the providing of benefits to select clients by securities companies in compensation for losses, the submitting false financial statement, etc., insider trading, the spreading rumors on stock markets and the market manipulation.

Criminal offenses subject to investigations under the PIVL include the presentation of false names and addresses by customers uncovered when the securities company in question verifies their identity.

Investigators of the SESC report the results of criminal investigations to the SESC (Article 223 of the SEL, Article 53 of the LFSF, Article 183 of the FFTL and Article 18 of the PIVL). When the SESC is convinced of case to be a criminal offence, the SESC files complaints to public prosecutors, and sends them the evidences, if any, it gathered in its probe, including materials left behind by the suspect and seized materials (Article 226 of the SEL, Article 53 of the LFSF, Article 186 of the FFTL and Article 18 of the PIVL).

2) Criminal Offense Investigations and Filing of Complaints

1. Criminal Offense Investigations

In Business Year 2005, the SESC conducted compulsory search of the homes and related offices of the suspects and necessary non-compulsory investigations in connection with the suspected criminal offenses, such as the submission of false financial statement by Kanebo, Ltd., the market manipulation of shares in Sokkia Co., Ltd., the spreading rumors on stock markets and deceptive means of shares in Livedoor Marketing Co., Ltd. and insider trading of shares in Nippon Broadcasting System, Inc.

(Note) In connection with the suspected criminal offense of false financial statement by Kanebo, Ltd., a compulsory investigation is conducted against (i) Kanebo, Ltd. and former Chairman cum President, and (ii) certified public accountants belonging to Chuo Aoyama

Audit Firm which conducted an audit of accounts of Kanebo. Ltd.

2. Filing of Complaints

Based on the results of investigations of the criminal offenses, the SESC filed a total of 11 complaints involving 32 individuals with the public prosecutors on charges of violations of the SEL. These complaints consisted of four cases involving 16 individuals on charges of filing false financial statements, one case involving one individual on charges of market manipulation, one case involving six individuals on charges of spreading rumors on stock markets and deceptive means, and five cases involving nine individuals on charges of insider trading.

Since its establishment, the SESC has filed a total of 85 complaints involving 272 individuals with the public prosecutors on charges of violations of the SEL. These complaints consisted of 23 cases involving 87 individuals on charges of filing containing false information, seven cases involving 44 persons on charges of compensation for trading losses, nine cases involving 22 individuals on charges of spreading rumors and use of fraudulent activities, ten cases involving 24 individual on charges of market manipulation, and 38 cases involving 98 individuals on charges of insider trading.

The outline of these filed complaints is provided as follows.

3. Outline of Filed Complaints

(1) Kanebo, Ltd. Case (1: Submission of false financial statements)

In connection with business operations, former Chairman cum President and other persons of Kanebo, Ltd. as suspected company conspired to inflate consolidated net assets for the two terms ending in March 2002 and March 2003 by approximately 80.0 billion yen, respectively, by removing a subsidiary whose performances were deteriorated due to the large amount of dead stock from the consolidated financial statements. Then, the company submitted financial statements that included consolidated balance sheets and consolidated income statements containing false information.

(2) Kanebo, Ltd. Case (2: Submission of false financial statements)

In connection with business operations of Kanebo, Ltd., licensed public accountants belonging to Chuo Aoyama Audit Firm engaged in the audit of accounts of the company conspired with former Chairman cum President and other persons of the company to submit financial statements that included consolidated balance sheets and consolidated income statements containing false information for the two terms ending in March 2002 and March 2003 by removing a subsidiary whose performances were deteriorated due to the large amount of dead stock from the consolidated financial statements.

(3) Sokkia Co., Ltd. Case (Market manipulation)

For a period from mid-April to early May, 2002, the suspect conducted the following acts in connection with shares in Sokkia Co., Ltd. listed on the first section of the Tokyo Stock Exchange.

(i) In an attempt to raise the price of Sokkia share and induce active trading in the share, the suspect, using his own name and through multiple securities companies, manipulated the price of Sokkia share. In concrete terms, the company purchased a total of approximately 2.48 million shares by such means as successively placing market orders or price limit buy orders to drive up the price, sold a total of approximately 2.67 million shares, total of approximately 1.14 million shares of massive buy orders were placed to hold up the lows and a total of 1,000 shares were sold again. As a result, the price of the share sharply rose from 405 yen to 530 yen.

(ii) With an aim of misleading others to believe that shares were being traded actively, the suspect bought a total of approximately 710,000 shares in his own name and sold the same volume of shares in separate transactions over the same period of time. These sales and purchases were sham transactions that were not intended for the actual transfer of ownership.

(4) Livedoor Marketing Co., Ltd. Case (Spreading rumors on stock markets and deceptive means)

Four persons, including President, of Livedoor Co., Ltd. as suspected company attempted as follows. Livedoor Co., Ltd. acquires the shares in Livedoor Marketing Co., Ltd. through stock swap between Money Life Inc. (this company was already acquired in effect by Livedoor Co., Ltd.) and Livedoor Marketing Co., Ltd. (in this swap, a stock swap ratio that overvalues Money Life Inc was used). Then, Livedoor Co., Ltd. announces that said stock swap will be made at a rate of 1:100, and at the same time publicizes false business performance of Livedoor Marketing Co., Ltd. by recording such net profit in the third quarter ending December 2004 that is created by fictitious sales. Then, Livedoor Co., Ltd. will gain profit by selling off the shares in Livedoor Marketing Co., Ltd. after the price of Livedoor Marketing Co., Ltd. rose.

(i) On October 25, 2004, Livedoor Co., Ltd. made an announcement containing false statement that "the stock swap rate of 1:1 was determined by mutual consultation between Money Life Inc. and Livedoor Marketing Co., Ltd. based on the results of computation made by a third party institution." However, the truth was that the stock swap between Money Life Inc. and Livedoor Marketing Co., Ltd. was made as mentioned above, the quantity of shares in Livedoor Marketing Co., Ltd. that far exceed the corporate value of Money Life Inc. was issued, and Livedoor Co., Ltd. acquired such shares under the name of VLMA No.2 Investment Business Partnership with an aim of gaining profit by selling off such shares.

(ii) On November 9, 2004, Livedoor Co., Ltd. announced that said stock swap ratio would be changed to 1:100 for a reason that the division of one share of Livedoor Marketing Co., Ltd. into 100 shares has been publicized on November 8, 2004.

(iii) On November 12, 2004, Livedoor Co., Ltd. announced, "For the third quarter ending in December 2004, sales totaled 759 million yen, ordinary profit reached 72 million yen, and net profit stood at 53 million yen. Sales and profit for the term increased over the corresponding term of the previous year. Livedoor Marketing Co., Ltd. achieved net profit for the first time since the semi-annual fiscal term of the previous year" However, the truth was that for the third quarter ending in December 2004, Livedoor Marketing Co., Ltd. recorded sales of 654 million yen, ordinary loss of 32 million yen and net loss of 21 million yen and Livedoor Marketing Co., Ltd. pretended to have recorded ordinary profit and net profit by recording fictitious sales.

Thus, Livedoor Co., Ltd. used deceptive means and spreading rumors in an attempt to conduct securities transactions, etc. and to change the price of shares in Livedoor Marketing Co., Ltd.

(5) Livedoor Co., Ltd. Case (1: Submission of false financial statement)

In connection with business operations, five persons, including President, of Livedoor Co., Ltd. as suspected company conspired to submit a financial statement for the term ending in September 2004, including the consolidated income statement containing false statement that consolidated net profit was approximately 5.0 billion yen by recording gain from the sale of Livedoor Co., Ltd. share in the amount of approximately 3.8 billion yen as sales (this gain cannot be recorded as sales) and by recording fictitious sales of approximately 1.6 billion yen.

(6) Livedoor Co., Ltd. Case (2: Submission of false financial statement)

In connection with the business operations of Livedoor Co., Ltd., licensed public accountants of Koyo Audit Firm that audited accounts of Livedoor Co., Ltd. and the suspect, who was former Representative Partner of the audit firm and was involved in the audit for Livedoor Co., Ltd. by making instructions or advice as de facto responsible person even after he had quitted from the audit firm in December 2003, in conspiracy with President /CEO and other persons of Livedoor Co., Ltd., submitted a financial statement, including consolidated income statement containing false information with regard to certain materials facts, to Director-General of the Kanto Local Finance Bureau on December 27, 2004. In concrete terms, they recorded consolidated ordinary profit of 5,034,210,000 yen in the consolidated income statement for the term from October 1, 2003 to September 30, 2004 by recording gain from the sale of Livedoor Co., Ltd. share in the amount of 3,766,990,000 yen as sales (this gain cannot be recorded as sales) and by recording fictitious sales of a total of 1,580,000,000 yen to Royal Credit Co., Ltd. and Cues Net Co., Ltd., despite the fact that Livedoor Co., Ltd. should have recorded consolidated ordinary loss of 312,780,000 yen for the term.

(7) Tohoku Enterprise Co., Ltd. Case (1: Insider trading)

Tohoku Enterprise Co., Ltd. decided to file a petition for the commencement of a civil rehabilitation procedure, and announced its intention in May 2004.

In the course of performing his job duties, the suspect, who was an employee of the company, came to know the material fact the company made the above-mentioned decision, and sold off 26,625 shares in the company at approximately 3.45 million yen in May 2004 in an attempt to prevent a loss before the company announced the decision.

(8) Tohoku Enterprise Co., Ltd. Case (2: Insider trading)

Tohoku Enterprise Co., Ltd. decided to file a petition for the commencement of a civil rehabilitation procedure, and announced its intention in May 2004.

In the course of performing his job duties, the suspect, who was an employee of the company, came to know the material fact the company made the above-mentioned decision, and sold off 9,625 shares in the company at approximately 1.24 million yen in May 2004 in an attempt to prevent a loss before the company announced the decision.

(9) Tohoku Enterprise Co., Ltd. Case (3: Insider trading)

Tohoku Enterprise Co., Ltd. decided to file a petition for the commencement of a civil rehabilitation procedure, and announced its intention in May 2004.

In the course of performing his job duties, the suspect, who was an employee of the company, came to know the material fact that the company made the above-mentioned decision, and sold off 27,000 shares in the company at approximately 4.29 million yen in May 2004 in an attempt to prevent a loss before the company announced the decision.

(10) Allied Telesis K.K. Case (Insider trading)

Allied Telesis K.K. decided to execute a share split, and announced its intention in April 2004.

In the course of performing his job duties, the suspect A, who was a senior operating officer of the company, came to know the material fact that the company made the above-mentioned decision.

(i) On April 20, 2004 before the company disclosed the above-mentioned material fact, the suspects A and B conspired to purchase 1,000 shares in the company in the name of the suspect B.

(ii) On around April 15, 2004, the suspect B was informed of the material fact that the suspect

A came to know in the course of performing his job duties, and on April 20, 2004 before the company disclosed the above-mentioned material fact, the suspects B purchased 1,000 shares in the company in his own name.
(iii) On April 23, 2004 before the company disclosed the above-mentioned material fact, the suspects A and C conspired to purchase 1,500 shares in the company in the name of an acquaintance of the suspect C.
(iv) On around April 16, 2004, the suspect D was informed of the material fact that the suspect A came to know in the course of performing his job duties, and on April 19 and 20, 2004 before the company disclosed the above-mentioned material fact, the suspects D purchased 2,000 shares in the name of his acquaintance.
(v) On around April 17, 2004, the suspect D was informed of the material fact that the suspect A came to know in the course of performing his job duties, and on April 19, 2004 before the company disclosed the above-mentioned material fact, the suspects D purchased 1,000 shares in his own name.

(11) Nippon Broadcasting System, Inc. Case (Insider trading by Murakami Fund)

Livedoor Co., Ltd. decided to acquire the number of shares accounting for 5% or more of the outstanding voting shares in Nippon Broadcasting System, Inc., which is referred to as "act equivalent to take over bid."

The suspect, who was Director and de facto manager of the suspected company, was informed of above-mentioned material fact by executives of Livedoor Co., Ltd. purchased approximately 1.93 million shares in Nippon Broadcasting System, Inc,. at approximately 9.95 billion yen in an attempt to gain profit for a period from November 2004 to January 2005 before the fact was disclosed.

2. Administrative Civil Monetary Penalties Investigation

1) Outline

1. Purpose of and Authority for Investigation

In the past, criminal penalties were main measures to ensure the effectiveness of regulations. In addition to criminal penalties, however, the administrative civil monetary penalty system was introduced in April 2005 as a result of the revision of the SEL in 2004.

The system is an administrative measure that imposes monetary burdens on violators of certain provisions of the SEL to achieve the administrative goals of curbing violations and ensuring the effectiveness of regulations. The level of monetary burdens is determined by law based on the amount equivalent to the economic interests that violators gain from their violations.

On April 1, 2005 when the administrative civil monetary penalty system was introduced, the SESC established Civil Penalties Investigation and Disclosure Documents Examination Office (this office was reorganized as "Civil Penalties Investigation and Disclosure Documents Inspection Division" in July 2006) with the aim of investigating violations on which administrative civil monetary penalties are to be imposed. The SESC is authorized to conduct penalty investigations, and if violations are found, the SESC will recommend that the Prime Minister and the Commissioner of the Financial Services Agency (FSA) issue an order for the payment of administrative civil monetary penalty. (Article 20 of the FSA Establishment Law)

If a recommendation for the issuance of an order for the payment of administrative civil monetary penalty, the Commissioner of the FSA (delegated by the Prime Minister) will determine the commencement of procedure for judgment. A Administrative law judge examiner will then follow the procedure for judgment and prepare a decision proposal for a violation. Then, the Commissioner of the FSA (delegated by the Prime Minister) will make a decision on the issuance of the order for payment of the administrative civil monetary penalty based on the decision proposal. The authority to conduct penalty investigations pertaining to unfair transactions is set forth in Article 177 of the SEL, which grants the SESC the power to:
(1) Question suspects or persons of interest, or demand opinions or reports from such individuals;
(2) Enter business offices of suspects and other sites that are necessary for investigation, and inspect accounting documents and other items.
The authority to conduct penalty investigations pertaining submission of financial statements, etc. containing false statement is set forth in Article 26 of the SEL, which grants the SESC the power to take the following actions:
(1) To order a person who filed has a securities registration statement, a person who has filed an issued securities registration statement, a person who has filed a financial statement, a person who has filed a report of treasury share purchase, a person who has filed a report of conditions of parent company, etc., an underwriter of securities, any other involved party or person of interest to submit reports or data that are helpful for investigations;
(2) To inspect accounting records and other items of the individuals being investigated.

2. Acts Subject to Administrative Civil Monetary Penalties

Specific acts subject to administrative civil monetary penalties are as follows:
(1) Submission of registration statement, etc. containing false statements (public disclosure of document, secondary disclosure) (Article 172 of the SEL)
(2) Submission of false financial statements, etc. (which should be submitted for each Business Year) (Article 172-2 of the SEL)

(3) Spreading rumors on stock markets (Article 173 of the SEL)
(4) Market manipulation (Article 174 of the SEL)
(5) Insider trading (Article 175 of the SEL)

2) Recommendations for Issuance of Orders for Payment of Administrative Civil Monetary Penalties

In Business Year 2005, the SESC made nine recommendations for the issuance of orders for payment of administrative civil monetary penalties (eight against individuals and one against a corporation), including its first recommendation for the issuance of an order for payment of administrative civil monetary penalty after the introduction of the administrative civil monetary penalty system (in connection with insider trading of stocks in Gala Inc.) in January 2006. and the first recommendation for the issuance of an order for payment of administrative civil monetary penalty against a corporation (in connection with insider trading of stocks in Fujipream Corporation) in April 2006.

The recommendations made in Business Year 2005 were all related to insider trading. However the contents of the violations have diversified even in first several cases of the administrative civil monetary penalty system, such as committed by employees of issuing companies, an issuing company itself or employees of customers of issuing companies.

The introduction of the administrative civil monetary penalty system has enabled stricter surveillance of violations, in addition to criminal complaints. Paragraph 1 of Article 6 of the supplementary provisions to a law revising a section of the SEL states that "In approximately two years, the government shall examine the way in which the administrative civil monetary penalty system is administered, including the methods for computing the sum of the penalty, the levels of penalties and methods for monitor violations, in consideration of the implementation of the system under the revised law and changes in socio-economic conditions, and shall take necessary measures based on the results of such examination.

Recommendations for issuance of orders for payment of administrative civil monetary penalties [Article 175 of the SEL].

The recommendations made in Business Year 2005 were all related to insider trading [Article 175 of the SEL].

Pursuant to the provisions of Article 175 of the SEL, the sums of administrative civil monetary penalty for violations related to insider trading will be computed as follows.

- The Case of Purchase:

  (Closing price on a day immediately following the day of announcement of important facts)×(Number of shares purchased)
  - (Purchase price)×(Number of shares purchased)

- The case of sale:

  (Sale price)×(Number of shares sold)
  - (Closing price on a day immediately following the day of announcement of important facts)×(Number of shares sold)

○ Recommendation for issuance of order for payment of administrative civil monetary penalty based on the results of investigation of insider trading of shares in **Gala Inc.**

An employee engaged in sales, etc. at Gala Inc. (person A subject to order for payment

of penalty) and an employee engaged in accounting, etc. (person B subject to order for payment of penalty) came to be aware that the company would allocate new shares to third parties and conclude a business collaboration agreement, and an employee engaged in operating management (person C subject to order for payment of penalty) came to know that the company would conclude a business collaboration agreement, during the performance of their business operations, and each of these persons purchased one share in the company at 1,190,000 yen, 1,200,000 yen and 1,200,000 yen on June 14, 16 and 16, respectively, before June 21, 2005 when the company announced these facts.

- Date of recommendation: January 13, 2006
- Penalty
  Person A subject to order for payment of penalty: 320,000 yen
  Persons B and C subject to order for payment of penalty: 310,000 yen
- Action following recommendation
  Date when decision on the commencement of procedure for judgment was made: January 13, 2006
  Date when order for payment of penalty was issued: February 8, 2006

Since the persons subject to orders for payment of penalty submitted written replies admitting the facts, no trial was conducted.

○ Recommendation for issuance of order for payment of administrative civil monetary penalty based on the results of investigation of insider trading of shares in **Tone Geo Tech Co., Ltd.**

During the performance of business operations, a then employee holding a managerial position at Tone Geo Tech Co., Ltd. came to be aware that the company had decided to file a petition for the commencement of rehabilitation procedure under the Civil Rehabilitation Law, and sold 9,000 shares in the company at the total price of 2.071,000 on May 16 before May 19, 2005 when the company announced this fact.

- Date of recommendation: February 1, 2006
- Penalty: 720,000 yen
- Action following recommendation
  Date when decision on the commencement of trial procedure was made: February 1, 2006
  Date when order for payment of penalty was issued: February 15, 2006

Since the person subject to orders for payment of penalty submitted a written reply admitting the facts, no trial was conducted.

○ Recommendation for issuance of order for payment of administrative civil monetary penalty based on the results of investigation of insider trading of shares in **Fujipream Corporation**.

Before October 6, 2005 when Fujipream Corporation announced that it would conduct a share split, Fujipream Corporation and its officer committed the following violations.

1) Relating to the performance of business operations, Fujipream Corporation became aware that its officer has decided to conduct share splitting, and purchased 1,000 shares in the company for its own account at a total price of 3,916,000 yen on October 3.

2) Relating to the performance of business operations, the officer became aware that the company has decided to conduct share splitting, and purchased a total of 6,100 shares in the company for his own account at a total price of 24,343,000 yen on September 8, 16, 22, 27, 29 and 30, and October 4, 5 and 6.

- Date of recommendation: April 17, 2006
- Penalty
  Fujipream Corporation: 420,000 yen
  The officer : 2,130,000 yen
- Action following recommendation
  Date when decision on the commencement of trial procedure was made: April 17, 2006
  Date when order for payment of penalty was issued: May 9, 2006

Since the persons subject to orders for payment of penalty submitted written replies admitting the facts, no trial was conducted.

○ Recommendation for issuance of order for payment of administrative civil monetary penalty based on the results of investigation of insider trading of shares in **INES Corporation.**

During the performance of business operations, an employee engaged in legal affairs at INES Corporation became aware that there were differences between recently-publicized estimated net profits and dividends and newly-calculated estimated figures, and sold 500 shares in the company at the total price of 494,500 yen at around 0:30 p.m. on September 22, 2005, immediately before 3:00 p.m. on the same day when the company announced this fact.

- Date of recommendation: May 11, 2006
- Penalty: 50,000 yen
- Action following recommendation
  Date when decision on the commencement of trial procedure was made: May 11, 2006
  Date when order for payment of penalty was issued: May 26, 2006

Since the person subject to orders for payment of penalty submitted a written reply admitting the facts, no trial was conducted.

○ Recommendation for issuance of order for payment of administrative civil monetary penalty based on the results of investigation of insider trading of shares in **Nihon Plast Co., Ltd.**

An employee (person B subject to order for payment of penalty) of Company-A, which had a business relationship with Nihon Plast Co., Ltd., became aware that Nihon Plast Co., Ltd. had decided to issue new shares through private placement in connection with the implementation of a contract concluded between Company-A and Nihon Plast Co., Ltd., and purchased 7,000 shares in Nihon Plast Co., Ltd. at a total price of 4,200,000 yen on June 17 before July 7, 2005 when Nihon Plast Co., Ltd. announced this fact.

The person who was informed of this important fact (person C subject to order for payment of penalty) by the employee purchased a total of 5,000 shares in Nihon Plast Co., Ltd. at a total price of 3,121,000 yen on June 28 and July 5, before July 7, 2005 when Nihon Plast Co., Ltd. announced this fact.

- Date of recommendation: May 24, 2006
- Penalty
  Person B subject to order for payment of penalty: 820,000 yen
  Person C subject to order for payment of penalty: 460,000 yen
- Action following recommendation
  Date when decision on the commencement of trial procedure was made: May 24, 2006
  Date when order for payment of penalty was issued: June 9, 2006

Since the persons subject to orders for payment of penalty submitted written replies admitting the facts, no trial was conducted.

3. Disclosure Document Inspection

1) Outline

With the aim of protecting public interests and investors by ensuring the appropriateness of disclosure documents, the SEL provides that if deemed necessary and appropriate, the Prime Minister may order a person who has filed a securities registration statement, an issued securities registration statement or a financial statement, a tender offeror, or a person who has filed a substantial shareholding reports to submit reports or data, and may inspect their accounting records and other items (hereinafter referred to as "Disclosure Document Inspection").

Since mid-October 2004, inappropriate cases of disclosure under the SEL have taken place one after another, and the Prime Minister and the Commissioner of the FSA have delegated the authority to conduct disclosure documents inspection to the SESC with effect from July 2005 with the aim of ensuring the effectiveness of the disclosure system by enhancing the system of financial statements inspection, etc.

Under the SEL, the Prime Minister must order any persons, etc. who have submitted disclosure documents to pay an administrative civil monetary penalty, if documents are found to contain false entries pertaining to important matters (refer to paragraphs (1) and (2), section 1 "2. Acts Subject to Administrative Civil Monetary Penalties," Chapter 2), and may order the person to submit amended documents, etc. (paragraph 1 of Article 10 of the SEL, etc.).

If a disclosure document inspection has revealed that certain disclosure documents contain such false entries, the SESC recommends that the Prime Minister and the Commissioner of the FSA issue an appropriate administrative disposition, and advises the company that submitted false documents to voluntarily amend them (hereinafter referred to as "Voluntary Amendment").

2) Implementation of Disclosure Document Inspection

Since July 2005, the SESC has properly conducted disclosure document inspection based on the delegated power. In Business Year 2005 as the first year of implementation of disclosure document inspection, the SESC conducted 22 disclosure document inspections for persons who were obligated to submit disclosure documents. As a result, the SESC made one recommendation for the issuance of order for the submission of an amended financial statements, and ten amended financial statements were voluntary submitted (including one amended financial statements submitted after the expiration of Business Year 2005).

When recommendations are made, outlines of the results of disclosure document inspections are publicized. In the case of voluntary amendment, main contents of amended documents are publicized for the reason that all companies obligated to submit disclosure documents may enhance their awareness of compliance and disclosure of documents may be more properly conducted.

3) Recommendation for the Issuance of Order for the Submission of Amended Financial Statements

Order for the Submission of Amended Financial Statements [Application of paragraph 1 of Article 10 of the SEL to the case falling under paragraph 1 of Article 24-2 of the same law]

Recommendation for the Issuance of Order for the Submission of Amended Financial Statements by **PAINTHOUSE Co. Ltd.**

In the financial statements for the term ending in August 2005, which was submitted by PAINTHOUSE Co. Ltd. to the Director-General of the Kanto Local Finance Bureau on November 30, 2005, the company entered a figure for approximately 2.7 billion yen in the column of "total capital" (which corresponds to consolidated net assets) of the consolidated balance sheet despite the fact that the figure for consolidated net assets was negative at approximately 8.9 billion yen, and the company entered a figure of approximately 3.3 billion yen in the column of consolidated net profit of the consolidated income statement despite the fact that they must report their consolidated net loss of approximately 8.3 billion yen.

- Date of recommendation: May 29, 2006
- Actions after recommendation: On June 8, 2006 before the issuance of order for the submission of an amended financial statement, amended financial statement was submitted to, and accepted by, Director-General of the Kanto Local Finance Bureau.

4) Main Contents of Voluntary Amendment Made After Disclosure Documents Inspection

(1) Company-A (listed in the first section of the Tokyo Stock Exchange and Osaka Securities Exchange)

The company over-reported sales, etc. by manipulating unit selling prices at the end of a term, and reported fictitious profits and losses due to business restructuring. Since the company actually reported fictitious profits in the preceding term, it was found necessary to amend their financial statement, etc.

Company-A accepted the findings of the SESC. The amended financial statement, etc. were submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

(2) Company-B (listed in the first section of the Tokyo Stock Exchange)

Since extraordinary loss from an illegal transactions made by an employee, which was discovered in the term ending March 2006, should have been reported in the preceding term and the preceding interim term, it was found necessary to amend their financial statement, etc.

Company-B accepted the findings of the SESC. The amended financial statement, etc. were submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

(3) Company-C (listed on Jasdaq Securities Exchange)

For the last five fiscal years:

1) The company had not included a corporation, which was for all practical purposes controlled by the company through a subsidiary, in its consolidated financial statements;
2) The company had reported a loan to a related party as "cash" and has not disclosed related party transactions;
3) The company had guaranteed debts of its affiliated companies, but had not included explanatory notes;
4) Although the business of the corporation for all practical purposes controlled by

the company was deemed important, the company had not disclosed relevant information.

For above reasons, it was found necessary to amend their s financial statement, etc.

Company-C accepted the finding of the SESC. The amended financial statement, etc. were submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

(4) Company-D (listed in the second section of the Tokyo Stock Exchange)

For the last five fiscal years:

1) The company had adopted inappropriate accounting treatment for transactions with related parties, and had not included explanatory notes thereon in many cases;
2) The company had not included explanatory notes on contingent liabilities, although there existed disputes over guarantee obligations for its affiliated companies.

For above reasons, it was found necessary to amend their financial statement, etc.

Company-D accepted the findings of the SESC. The amended financial statement, etc. were submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

(5) Company-E (listed on Jasdaq Securities Exchange)

The company had not disclosed information concerning some loans to related parties and the size of these loans. For this reason, it was found necessary to urge the company to amend their financial statement, etc.

Company-E accepted the findings of the SESC. The amended financial statement, etc. were submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

(6) Company-F (listed in the first section of the Tokyo Stock Exchange)

The company reported contributions to a anonymous association of choice as an "investment." As a result of the revision of the SEL in 2004, however, the company was required to report such contributions as "investment in securities" in and after the term ending March 2005. For this reason, it was found necessary to amend their financial statement, etc.

Company-F accepted the finding of the SESC. The amended financial statement was submitted to, and accepted by, the Director-General of the Local Finance Bureau concerned.

4. Inspections of Securities Companies

1) Outline

The SESC conducts on-site inspections of securities companies, etc., under the authority delegated by the Prime Minister and the Commissioner of the FSA under the SEL, etc.

Until the end of June 2005, the SESC had conducted inspections to monitor whether securities companies, etc. comply with laws and regulations for ensuring fairness in securities and financial futures transactions. Since July 2005, however, the market monitor functions and system of the SESC have been enhanced, and the scope of inspections has been significantly expanded so as to further improve the effectiveness and efficiency of inspections of securities companies, etc. For example, the SESC was accorded the authority to inspect financial solvency, etc. of securities companies, etc. and the authority to inspect Investor Protection Funds, securities clearing organizations, securities investment trust companies, investment advisors, securities depository institutions, etc., all of which had previously been exercised by the Inspection Bureau of the FSA.

In addition to the inspections based on the above-mentioned authorities, the SESC conducts inspections under the authority delegated by the Prime Minister and the Commissioner of the FSA, as prescribed under the Law on Customer Identification and Retention of Records by Financial Institutions and Prevention of Unlawful Use of Deposit.

This law aims at preventing securities companies, etc. from being utilized for money laundering by urging securities companies, etc. to develop appropriate customer management systems.

The SESC delegates part of its authorities to inspect and collect reports/materials to Director-Generals of the Local Finance Bureaus, etc. (If necessary, the SESC may exercise these authorities by itself.)

These inspections are conducted to protect public interests and investors, etc. The Prime Minster and the Commissioner of the FSA may utilize the results of inspection and the recommendation by the SESC in deciding on necessary administrative actions and measures for securities companies, etc.

If a recommendation for an administrative disciplinary action against a securities company, etc. has been made, the Prime Minster, the Commissioner of the FSA, Director-General of the Local Finance Bureau or other party concerned will hold a hearing for the securities company concerned based on the inspection results of the SESC. If deemed necessary, they will take administrative disciplinary action. Against a securities company, etc., including revoking of registration, and issuance of order for suspension of business and business improvement.

The authority to take disciplinary action against a securities company sales representative is delegated from the Prime Minister to the Japan Securities Dealers Association (paragraph 1of Article 64-7 of the SEL). The Japan Securities Dealers Association will hold a hearing for the representative concerned based on the inspection results of the SESC, and if deemed necessary, the Association will take a disciplinary action against the representative, such as revoking of registration or suspension of performance of duties.

2) Basic Inspection Policy and Basic Inspection Plan

Inspections are planned and executed on a one-year cycle beginning on July 1 every year and ending on June 30 of the following year.

For each year, the SESC and Directors-General of the Local Finance Bureaus establish a basic inspection policy and a basic inspection plan to manage and conduct inspections in an

organized manner.

The basic policy determines priority items and other basic matters for inspections for the year, while the basic plan specifies the number and types of companies that will be subject to inspections for the year.

3) Results of Inspections

Outline of Inspections Conducted

During Business Year 2005, inspections were initiated for 88 domestic securities companies, ten foreign securities companies, 28 financial institutions registered for securities business, one sales agents for securities companies, 13 financial futures companies, 41 securities investment trust companies and investment advisors, etc., and two self-regulatory organizations.

4) Outline of Inspection Results

1. Inspections of Securities Companies

The inspections of the 81 securities companies (including special inspections but excluding branch inspections) were completed in Business Year 2005. Problems were found in 51 of these companies. The SESC found problems concerning unfair trading at 14 companies, investor protection in 21 companies, financial soundness or accounting in 18 companies and other business operations in 35 companies. (The total number of companies for which problems were found does not tally with the total number of problems because one company may have two or more problems. The details of the recommendations made in response to these problems are described in paragraph 1 "Recommendations for Administrative Disciplinary Action against Securities Companies" and paragraph 3 "Recommendations for Administrative Disciplinary Action against Securities Company Sales Representatives" of Section 5). Notifications were sent to securities companies where the SESC found problems.)

2. Inspections of Registered Financial Institutions for Securities Business

The inspections of 27 financial institutions registered for securities business were completed in Business Year 2005. Problems were found in ten financial institutions. The SESC found problems concerning unfair trading in one financial institution, investor protection in six institutions, financial soundness or accounting, etc., in two institutions, and other business operations in four institutions. (The details of recommendations made in response to these problems are described in paragraph 3 "Recommendations for Administrative Disciplinary Action against Securities Company Sales Representatives" of Section 5).)

3. Inspections of Sales Agents for Securities Companies

The inspection of one stock brokerage company was completed in Business Year 2005. The SESC found the problem concerning investor protection at this company. (The details of the recommendation made for this problem is discussed in Paragraph 2 of the "Recommendations for Administrative Disciplinary Actions against Sales Agents for Securities Company" in Section 5).)

4. Inspections of Financial Futures Companies

The inspections of 12 financial futures companies were completed in Business Year 2005. Problems were found in ten of these companies. The SESC found problems concerning

unfair trading in three companies concerning investor protection in eight companies, financial soundness and accounting in four companies and other business operations in four companies. (The details of the recommendations made in response to these problems are discussed in paragraph 4 "Recommendations for Administrative Disciplinary Action against Financial Futures Companies" in Section 5).

5. Inspections of Securities Investment Trust Companies, Investment Advisors, etc.

The inspections of 29 securities investment trust companies, and investment advisors, etc. were completed in Business Year 2005. Problems were found in 21 of these parties. The SESC found problems concerning investor protection in 14 parties, financial soundness and accounting in one party and other business operations in 17 parties. (The details of the recommendations made in response to these problems are discussed in paragraph 5 "Recommendations for Administrative Disciplinary Actions against Securities Investment Trust Companies, Investment Advisors, etc." of Section 5).)

5) Recommendations for Administrative Disciplinary Actions against Securities Companies, etc.

1. Recommendations for Administrative Disciplinary Actions against Securities Companies

a. Act to conclude a contract for discretionary account transactions [Violation of item 5, paragraph 1 of Article 42 of the SEL]

○ Deputy General Manager, Shima Business Office, **Ise Securities Co., Ltd.,** concluded with two customers on June 19, 2003 and December 2, 2004 respectively, a contract that the company may determine the number and prices of shares for purchase orders without obtaining approval of the customer for each transactions, and conducted transactions sixty-six times in total for a period from June 19, 2003 to December 29, 2005.

- Date of recommendation: June 7, 2006
- Details of administrative disciplinary action: Order for business improvement

* This also includes recommendation for actions against one securities company sales representative.

○ A securities company sales representative on commission, Osaka Branch, **Tsuyama Securities Co., Ltd.**, concluded with a customer concerning Nikkei 225 Futures and with other customer concerning Nikkei 225 Futures and Nikkei 225 Option in March 2003, and with another customer concerning buying and selling of shares in around July 2003, a contract that the company may determine the type of transaction (in the case of Nikkei 225 Futures, the selection of becoming either paying party or receiving party if actual index exceeds executed index; in the case of Nikkei 225 Option, the selection of becoming either party to sell option or party to buy option), shares, number and prices (in the case of Nikkei 225 Futures, executed index; in the case of Nikkei 225 Option, option premium) without obtaining approval of the customer for each transaction, and conducted transactions for the period from March 24, 2003 to October 27, 2005.

One employee other than the above-mentioned person concluded a contract for a discretionary account transaction.

- Date of recommendation: June 26, 2006

- Details of administrative disciplinary action: Order for business improvement

* This also includes recommendation for actions against one securities company sales representative.

b. Act to make false representation or make misleading representation of important matters in connection with securities and other transactions [Violation of item 1 of Article 4 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under the item 10, paragraph 1 of Article 42 of the SEL (including item 9 of the preceding paragraph before the revision by Law No. 97 of 2004)]

○ In soliciting for general margin transactions from July 2003 to April 2005, **Matsui Securities Co., Ltd.** made such a representation maturity date which is important matter in general margin transactions in its company brochure that may mislead customers in believing that no maturity date will be established despite the fact that a maturity date may be established in certain conditions, including share split.

- Date of recommendation: October 26, 2005
- Details of administrative disciplinary action: Order for business improvement

○ From February 17, 2005 to February 24, 2006, the former President of **AIM Securities Co., Ltd.** made false representation by explaining the treatment of yen-denominated private-placed bonds delivering soliciting materials containing false entries concerning the use, etc. of funds to be collected through the sale of such bonds to 188 or more customers in total.

- Date of recommendation: April 25, 2006
- Details of administrative disciplinary action:

(i) Order for suspension of operations related to all securities business by all offices for about one month

(ii) Order for business improvement

* This includes recommendation against one securities company sales representative.

c. Act of entering into a series of future contracts in stock index to create an artificial market, which does not reflect the actual state of the market. [Violation of item 3 of Article 4 of Ordinance of Cabinet Office concerning Regulation, etc. of Conducts of Securities Company (before amended in 2005), which prohibited "Act of making a series of future contracts in stock index to create an artificial market, which does not reflect the actual state of the market."]

○ From 13:57 to 15:10 on November 4, 2004, an employee of Equity Derivative Trading Department in **J.P. Morgan Securities** placed in the TSE market a series of sell orders for TOPIX future contracts for December 2004 against buy orders placed by him immediately before the above sell orders, both of which were placed at the same security index point, and vice versa, and consequently entered into a series of TOPIX future contracts in the account of an overseas affiliate of J.P. Morgan Securities, which contracts would not cause any transfer of rights. By entering into a series of such contracts, the employee created an artificial market stock index points in TOPIX futures contracts, which did not reflect the actual state of the market.

- Date of recommendation: March 2, 2006
- Details of administrative disciplinary action:

(i) Order for suspension of operations related to transactions in stock index futures on its

own account for 15 days
(ii) Order for business improvement
* This includes recommendation against one securities company sales representative.

d. Act of promising compensation for losses which have incurred or may incur from buying, selling, etc. transactions in securities, and act of offering property benefit to compensate for losses [Violation of item 1,2 and 3 of paragraph 1 of Article 42-2 of the SEL]

○ A then-member of the First Sales Department of **Tsukamoto Securities Co., Ltd.** (hereinafter referred to the "then-member") (i) promised a customer on around September 14, 2001 that the company would compensate the customer for all losses incurred in connection with stock index futures transactions on July 6 and September 13, 2001; and (ii) further promised the customer on around September 26, 2001 that the company would compensate the customer for all losses which may incur in connection with stock index futures transactions in and after October 2001.

Furthermore, the then-member (iii) provided the same customer with property benefits of 2,700,000 yen by remitting money to the customer's securities and bank accounts on September 27, 2001 and June 21, 2002 to compensate the customer for all losses from above-mentioned transactions, and provided another customer with property benefits of 1,463,000 yen by remitting money to the customer's securities accounts on February 6 and 14, 2001 to compensate the customer for part of his loss from stock transactions.
- Date of recommendation: February 16, 2006
- Details of administrative disciplinary action:
(i) Order for suspension of operations related to receiving customers' orders of transactions of stocks and stock index futures for 3 days
(ii) Order for business improvement
* This includes recommendation for actions against one securities company sales representative.

e. Conditions that management of security transactions, etc. by customers is not deemed sufficient to prevent unfair transactions [Violation of item 4 of Article 10 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under item 2 of Article 43 of the SEL]

○ Head of Transaction Examination Office, Compliance Department, **SMBC Friend Securities Co., Ltd.** has not fully performed his duty to direct or supervise insider registration work at the company's departments and offices, and has not established a proper internal control system for verifying whether or not insider registrations of customers are being adequately made. As a result, insider registrations of customers as parties of listed companies, etc. were conducted with many lack and the company conducted business operations under conditions in which examinations to prevent insider trading were in place with many lack. In other words, the company conducted business operations under conditions in which its management of securities transactions by customers was not sufficient to prevent unfair transactions.
- Date of recommendation: April 5, 2006
- Details of administrative disciplinary action: Order for business improvement
* This includes recommendation for actions against one securities company sales

representative.

○ (i) Operating Officer-cum-General Manager of Compliance Department, **Monex Securities Co., Ltd.** has not established a system to register a customer as insider of the listed company if the customer works for parent company or subsidiary of a listed company.
(ii) The person responsible for managing the insider registration system in Compliance Department has not completed the insider registration procedure for customers working for listed companies, etc.

As a result, the company conducted business operations under the conditions in which, insider registration of customers as parties of listed companies, etc. were conducted with many lack. In other words, the company conducted business operations under the conditions in which its management of securities transactions by customers was not sufficient to prevent unfair transactions.

- Date of recommendation: May 31, 2006
- Details of administrative disciplinary action: Order for business improvement

* This includes recommendation for action against two securities company sales representatives.

(Note) The above-mentioned administrative disciplinary action is based on the recommendation above and "h. Conditions in which management of electronic information processing organization in securities business is not deemed sufficient," for which recommendations.

f. Conditions in which the company is deemed not to notify customers of necessary information in proper manner in connection with overseas securities [Violation of item 7 of Article 10 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under item 2 of Article 43 of the SEL]

○ **Nippon Investors Securities Co., Ltd.** prepares statutory "transaction balance reports" for overseas securities and deliver them to customers. However, many of the necessary entries were not made in such reports, which constituted conditions in which necessary information was not notified to customers in proper manner in connection with customers' transactions.

- Date of recommendation: June 23, 2006
- Details of administrative disciplinary action: Order for business improvement

(Note) The above-mentioned administrative disciplinary action is based on the recommendation above and "j. Failure to entrust segregated customers' Funds for overseas securities transactions to trust company" and "k. Failure to maintain statutory books for overseas securities transactions"

g. Condition in which transaction management to prevent securities transactions to create an artificial market which does not reflect the actual state of the market is deemed not sufficient [Violation of item 10 of Article 10 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company (before the revision by Cabinet Office Ordinance No.6 of 2005) under item 2 of Article 43 of the SEL]

○ (i) The Managing Director and then-Operating Officer in Charge of Transaction Examination Department-cum-General Manager of the Audit Department of **Nihon-Kyoei Securities Co., Ltd.** knew that the transaction management system had detected, at several times, internet transactions resembling securities

transactions of the sort that are to create artificial markets without reflecting actual state of market, such as “continuous buying with an intention to raise prices of specific shares” and “cross transactions with the dealing positions,” (hereinafter referred to as “inappropriate internet transactions”). Since they failed to give the persons in charge of transaction examination adequate guidance, such as the detailed standards for reporting transactions to then-General Manager of Audit Department, the said persons did not report to the General Manager. Thus, inappropriate internet transactions were left unexamined.

(ii) Then-Operating Officer in Charge of Transaction Examination Department-cum-General Manager of Audit Department gave advice to customers who conducted the inappropriate internet transactions after the Tokyo Stock Exchange surveyed. However, even when such customers explained their motives behind these transactions not reflecting actual conditions or admitted that they had intended to create artificial markets, the Operating Officer did not verify such problems and overlooked them. Subsequently, the company continued to release similar transaction orders made by customers until the Tokyo Stock Exchange and the Japan Securities Dealers Association conducted on-site inspections.

(iii) Managing Director was in a position to improve transaction management to prevent unfair transactions, and received reports about the attention to customers who conducted inappropriate internet transactions. However, the Managing Director left the condition without directing to verify the details of transactions of the customers concerned, and ignored the problems. Then, the company continued its business with the conditions above.

- Date of recommendation: January 20, 2006
- Details of administrative disciplinary action: Order for business improvement

* This includes recommendation for action against one securities company sales representative.

○ (i) The General Manager of the Sales Department of **H.S. Securities Co., Ltd.** was informed by an employee of the Department before market opening, about a release of a market order for large block cross transactions which increase buying order at the market because the number of buying shares exceeded the number of selling shares (hereinafter referred to as the “irregular cross transactions”). Since the General Manager did not understand the impact of said transactions on the prices of the share, however, he failed to conduct routine transaction management including surveying the intention of the customer in conducting said transactions and considering to set restriction of similar orders.

(ii) The then-Superintendent for Internal Control was in a position to improve the company’s transaction management to prevent unfair transactions, and knew that the company’s transaction examination system had detected the irregular cross transactions. Since the Superintendent did not understand the impact of said transactions on the prices of the share, however, he failed to direct subordinates to examine the details of the transactions. Furthermore, although the company was examined by the Tokyo Stock Exchange regarding said transactions, he failed to examine said transactions, and did not suspend them. The company continued to release orders for similar transactions.

- Date of recommendation: May 23, 2006
- Details of administrative disciplinary action: Order for business improvement

* This includes recommendation for action against two securities company sales representatives.

h. Conditions wherein management of electronic information processing organization in the securities business is not deemed sufficient [Violation of item 11 of Article 10 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under item 2 of Article 43 of the SEL]

○ (i) On February 27, 2006, the "Monex Nighter" system for night-time transactions in **Monex Securities, Inc.** experienced an error in the computation of transactions prices of part of the shares listed primarily on the Osaka Stock Exchange. This error resulted from the fact that the company did not properly examine the scope of impact of changes in the trading system of the Osaka Stock Exchange and did not conduct necessary revision of its own system.
(ii) Since system error had occurred frequently at this company, the FSA ordered the company, on October 12, 2005, to report the causes of such error and measures to prevent the repetition of them. On December 28, 2005, the company submitted to the FSA a report that the company would establish a procedure for examining the scope of impact of changes in external systems without fail and thoroughly verify whether system modifications are required or not and whether the modified system has any defects.

The cause of the error mentioned above (i) was similar in nature to that of the error which took place on August 29, 2005 (this error took place because the company had failed to examine the scope of impact of adoption of a new system by the JASDAQ.),the Operating Officer-cum-General Manager of System Department could have easily detected program errors, if only he had fully examined the test results of the company's program that had been revised in response to changes in the trading system of the Osaka Stock Exchange. However, he failed to conduct the sufficient examination, and has not implemented measures to prevent the recurrence of the similar error which result from not having examined the scope of impact of changes in external systems.

* This includes recommendation for actions against one securities company sales representative.

(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "e. Conditions that management of security transactions, etc. by customers Is not Enough for Preventing unfair transactions"

i. Violation of the firewall receipt of undisclosed information related to customers from parent company, etc.) [Violation of item 7, paragraph 1 of Article 12 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under item 3 of Article 45 of the SEL]

○ The then-General Manager attached to the Market Sales Department, the Deputy General Manager of the Market Sales Department and two other employees of **Shinsei Securities Co., Ltd.** acquired customers' undisclosed information, including customers' outstanding borrowings, from the parent company, etc. without obtaining the consent of customers, through bringing materials they used when they had worked for parent company, etc., transfer of data contained in PCs belonging to the parent company, etc. to the company's PCs, and receiving e-mails from employees of the parent company, etc.

- Date of recommendation: January 20, 2006
- Details of administrative disciplinary action: Order for business improvement

* This recommendation also sought disciplinary action against two securities company

sales representatives.

j. Failure to entrust segregated customers' fund for overseas securities transactions to trust company [Violation of paragraph 3 of Article 47 of the SEL]

○ The Senior Managing Director of **Nippon Investors Securities Co., Ltd.** continued business without entrusting customers' fund for subscription to a trust company when the company solicited customers to subscribe overseas securities.

As of the base date of inspection, the segregated customers' fund was short by approximately 74,000,000 yen.

* This includes recommendation for action against one securities company sales representative.

(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "f. Condition in which the company is deemed not to Notified customers of necessary information in proper manner in connection with overseas securities."

k. Failure to maintain statutory books for foreign securities transactions [Violation of Article 188 of the SEL]

○ Based on the inspection with the base date of July 10, 2001, the Director-General of the Kanto Local Finance Bureau pointed out, in connection with the statutory books specified in paragraph 1 of Article 60 of the Cabinet Office Ordinance Concerning Securities Companies (hereinafter referred to as the "Cabinet Office Ordinance") under Article 188 of the SEL (hereinafter referred to as the "statutory books"), that for overseas securities transactions, **Nippon Investors Securities Co., Ltd.** (i) did not prepare the "customer account ledger" and the "schedule of securities in custody" and (ii) didn't fill in some items of the "daily journal of transactions." Then, Nippon Investors Securities Co., Ltd. submitted a report of improvement measures dated February 25, 2002 to the Director-General of the Kanto Local Finance Bureau.

As for above (i), the SESC's inspection revealed that the company did prepare and maintain the statutory books for foreign securities transactions the "customer account ledger" and the "schedule of securities in custody" but did not fill in many of the entry items of the statutory books as are specified in the Schedule 8 under paragraph 2 of Article 60 of the Cabinet Office Ordinance (hereinafter referred to as the "required entry items").

As for above (ii), the SESC's inspection also revealed that the company did prepare and maintain the statutory book for foreign securities transactions the "daily journal for transactions" but did not fill in many of the required entry items.

Furthermore, the inspection revealed that the company did not fill in many of the required entry items of the statutory books for foreign securities transactions the "order slip" and the "transaction balance report."

(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "f. Conditions in which the company is deemed not to notify customers of necessary information in proper manner in connection with overseas securities."

2. Recommendations for Administrative Disciplinary Actions against Sales Agents for Securities Company

Act to make false represent action in connection with brokerage of securities transactions, etc. [Violation of item 1, paragraph 1 of Article 13 of the Cabinet Office Ordinance Concerning Sales Agents for Securities Companies under item 3 of Article 66-13 of the SEL]

○ From May 10, 2005 to February 25, 2006, **MMG Arrows Co., Ltd.** made false representation for 45 customers in total by delivering them soliciting materials containing false entries of the use of funds collected by the private placement of yen-denominated bonds when the company was asked by AIM Securities Co., Ltd. to handle the private placement of the bonds.

- Date of recommendation: April 25, 2006
- Details of administrative disciplinary action:

(i) Suspension of all brokerage business at all offices for one month
(ii) Order for business improvement

3. Recommendations for Administrative Disciplinary Actions against Securities Company Sales Representatives

Recommendations for administrative disciplinary action against persons who are registered as securities company sales representative among officers and employees of securities companies, etc., was made for the following types of violations (limited to the cases that a recommendation only for administrative disciplinary action against securities company sales representative was made; excluding the cases in which a recommendation for administrative disciplinary action against both securities company and securities company sales representative was made.)

a. Securities transactions, etc. With the intention to seek speculative profits by employees of securities companies [Violation of item 5 of Article 4 of the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company under item 9, paragraph 1 of Article 42 of the SEL (before the revision by Law No.97 of 2004, and item 6, paragraph 1 of Article 50 of the Law before the revision by Law No.107 of 2004) (item 5 of Article 4 of the Ordinance Concerning Regulation, etc. of Conduct of Securities Company, and item 5, paragraph 1 of Article 2 of the Ministry of Finance Ordinance Concerning Regulations, etc. of Integrity of Security Companies before the revision by the Prime Minister's Office Ordinance of 1998/the Ministry of Finance Ordinance No.33)]

In seeking his own interests, the securities company sales representative conducted share transactions many times for his own account by utilizing a customer' s account. (A recommendation for administrative disciplinary action was made against one person of a securities company.)

b. Act to provide property benefits to compensate for losses [Violation of item 3, paragraph 1 of Article 42-2 of the SEL which is applicable by reference made in paragraph 6 of Article 65-2 of the SEL]

When terminating a beneficiary certificate of securities investment trust for a certain customer, the securities company sales representative offered property benefits to the customer to compensate for the entity of the loss of the customer in connection with the certificate. (A recommendation for administrative disciplinary action was made against one person of a securities company.)

4. Recommendations for Administrative Disciplinary Actions against Financial Futures companies

a. Failure to represent matters which should be represented in its advertisement [Violation of item 1 and 2 of Article 13 of the Financial Futures Trading Law Enforcement Order under item 3, 4 and 5 of Article 68 of the FFTL]

○ From August 25, 2005 to March 7, 2006, **Excel Trade Co., Ltd.** had placed its advertisements in newspapers on 32 occasions, but had not represent the following matters.
(i) Funds for certain financial futures transactions to be made by customers should be larger than the sums of those margins or other guarantee funds that are required to be deposited by customers for those transaction.
(ii) When customers make financial futures transactions, there is a risk that losses may be incurred due to fluctuations of the values of currencies, etc. or those of figures of financial indexes, and there is a risk that such losses may exceed the sums of these margins or other guarantee funds.
(iii) A difference between selling and buying prices of currencies, etc. that is indicated by financial futures traders in connection with over-the-counter financial futures transactions, if any
(iv) Rates or sums of margins or other guarantee funds that are required to be deposited by customers for financial futures transactions

- Date of recommendation: May 24, 2006
- Details of administrative disciplinary action: Order for business improvement

b. Delivering Insufficient documents before conclusion of contracts [Violation of paragraph 1 of Article 70 of the FFTL]

○ From July 1 to October 11, 2005, **Nihon Forex Co., Ltd.** delivered documents not outlining matters that should have been contained in accordance with the provisions of paragraph 1 of Article 70 of the FFTL before having concluded contracts on financial futures transactions to all related customers.

- Date of recommendation: November 18, 2005
- Details of administrative disciplinary action:

(i) Order for suspension of acceptance of new orders for one month
(ii) Order for business improvement
(Note) The above-mentioned administrative disciplinary action is also for "Unrequested soliciting,"

○ From July 1 to October 11, 2005, **Nihon FX Co.,** Ltd. delivered documents not outlining matters that should have been contained in accordance with the provisions of paragraph 1 of Article 70 of the FFTL before having concluded contracts on financial futures transactions to all its customers.

- Date of recommendation: November 18, 2005
- Details of administrative disciplinary action:

(i) For for suspension of acceptance of new orders for one month
(ii) Order for business improvement
(Note) The above-mentioned administrative disciplinary action is also for "Unrequested soliciting,"

c. Conclusion of discretionary account contracts [Violation of item 3 of Article 76 of the

FFTL]

○ On July 28, 2005, **Sanyu Torex Co., Ltd.** concluded with a customer a contract for overseas exchange margin transactions that enabled the company to determine the transaction volume, contractual figures and other matters specified by the Cabinet Office Ordinance without obtaining the prior consent of the customer. On July 28 and 29, 2005, the company accepted and executed the customer's orders for transactions.

- Date of recommendation: December 6, 2005
- Details of administrative disciplinary action:

(i) Order for suspension of all business operations for one month
(ii) Order for business improvement

d. Unrequested Soliciting [Violation of item 4 of Article 76 of the FFTL]

○ Since July 1, 2005, the Osaka head office of **Nihon Forex Co., Ltd.** has been soliciting random customers who had not requested for the explanation of the contents of contracts, for the purpose concluding such contracts over the phone.
(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "b. Delivering insufficient documents before conclusion of contracts."

○ Since July 1, 2005, the Second Sales Department at the head office and the Yaesu Branch of **Nihon FX Co., Ltd.** have solicited random customers who had not requested for explanations of the contents of contracts, for the purpose of the concluding such contracts over the phone.
(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "b. Delivering insufficient documents before conclusion of contracts."

○ Since July 1, 2005, **Sanyu Torex Co., Ltd.** has been soliciting random customers who had not requested for explanations of the contents of contracts, for the purpose of concluding such contracts at their homes or over the phone.
(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "c. Conclusion of discretionary account contracts."

○ Since July 1, 2005, **Forex International Inc.** has been soliciting random customers who had not requested for explanations of the contents of contracts, for the purpose of concluding said contracts over the phone.

- Date of recommendation: December 13, 2005
- Details of administrative disciplinary action:

(i) Order for Suspension of soliciting new customers and of opening of new accounts for one month
(ii) Order for business improvement

e. Canvassing for double-faceted transactions [Violation of item 6 of Article 25 of the Financial Futures Trading Law Enforcement Rule under item 9 of Article 76 of the FFTL]

○ Since July 1, 2005, **Sanyu Torex Co., Ltd.** has been soliciting customers for double-faceted currency transactions, etc., and accepted and executed the

customer's order.
(Note) As for the date of recommendation and particulars of administrative disciplinary action, refer to "c. Conclusion of discretionary account contracts."

f. In light of business operations or conditions of assets, condition suggestive of likelihood of company bankruptcy and failing to manage separately and margins or other guarantee funds deposited by customers, etc. from company property [Violation of item 1, paragraph 1 of Article 87, and paragraph 1 of Article 91, of the FFTL]

○ As of September 30, 2005, **Forex Star Co., Ltd.** was insolvent, and had no plan to resolve its insolvency problem. In light of its business operations or the conditions of its assets, the company was likely to become bankrupt and margin or other guarantee funds deposited by customers, etc. were not managed separately from its own property. It was clear that as of September 30, 2005, its cash and deposit funds were not sufficient for making reimbursement to customers.

- Date of recommendation: October 18, 2005

○ As of September 30, 2005, **Japan Delix Inc.** was insolvent, and had no plan to resolve its insolvency problem. In light of its business operations or the conditions of its assets, the company was likely to become bankrupt and margin or other guarantee funds deposited by customers, etc. were not managed separately from its own property. It was clear that as of September 30, 2005, its cash and deposit funds were not sufficient for making reimbursement to customers.

- Date of recommendation: November 1, 2005
- Details of administrative disciplinary action:

(i) Orders for suspension of all business operations for six months
(ii) Order for business improvement

5. Recommendations for Disciplinary Actions against Securities Investment Trust Companies, Investment Advisors, etc.

a. Noncompliance with the duty of the care of a good manager[Violation of paragraph 2 of Article 14 of the Law Concerning Investment Trust and Investment Corporation(LITIC)]

○ On 25th March 2004, **Merrill Lynch Investment Managers Co., Ltd.(MLIM),** in managing assets under the discretionary investment agreement (Asset A), assumed that MLIM instructed the execution of sell orders of stocks incorporated in the assets by conducting a reciprocal transaction between Asset A and the other asset under a different discretionary investment agreement (Asset B); however on 29th March 2004, MLIM became aware that the transaction was executed between Asset A and an entirely different investment trust asset (Asset C) by error order. On 30th March 2004, it therefore amended the error by conducting corresponding transaction between the sell order of Asset A and the buy order of Asset C.

The error order was placed without sufficient examination of the account that the sell order was supposed to be placed. This lack of the sufficient examination resulted in the error transaction; however, MLIM conducted an amendment of the error transaction mentioned above without conducting a good analysis of the effect of the transaction on the asset C. MLIM made the beneficiaries of Asset C bear the loss originating from the amendment deal, which must be borne by MLIM itself primarily. In addition, MLIM failed to provide the beneficiaries of Asset C with explanations about the occurrence of the error transaction and the amendment

deal.
- Date of recommendation: May 31, 2006
- Details of administrative disciplinary action: Order for business improvement

(Note) The above-mentioned administrative disciplinary action is also for "b. Act to direct transactions between investment trust assets and assets under discretionary investment contract," for which recommendations were made.

b. Act to instruct to conduct reciprocal transactions between investment assets [Violation of item 2, paragraph 1 of Article 15 of the LITIC, and of (a) and (b) of Article 5 of the decision by the Executive Board of the Japan Securities Investment Advisers Association "Standards for management of the business." This act meets the condition of paragraph 1 of Article 40 of the LITIC]

○ (i) From 14th April 2003 to 31st August 2005, while managing investment assets, **MLIM** instructed the trustee company to execute six reciprocal transactions between the investment trust assets and other investment trust assets, that are managed by MLIM in order to adjust the ratios of stocks incorporated into the investment trust assets.
(ii) From 14th April 2003 to 31st August 2005, while managing investment assets and assets under discretionary investment agreements, MLIM conducted 38 reciprocal transactions between assets under the separate discretionary investment agreements, or between the investment trust assets and assets under the discretionary investment agreement, which are managed under separate agreements, in order to adjust the ratios of stocks incorporated into the assets, without disclosing to its clients he adjustments and without obtaining their written consents with respect to the adjustments.

(Note) As for the date of recommendations and the contents of administrative disciplinary action, refer to "a. Nonperformance of good manager's duty of care."

c. Noncompliance with the duty of the care of good manager in asset management business of investment corporation [Violation of paragraph 2 of Article 34-2 of the LITIC]

○ **ORIX Asset Management Corporation** has managed the assets of ORIX JREIT Inc. under the assets management contract concluded between them. From December 2001 to March 2006, the company did not conduct proper examination, etc. when the company acquired real estate that was to be included in the assets of ORIX JREIT Inc.

- Date of recommendation: June 16, 2006
- Details of administrative disciplinary action:

(i) Prohibition of conclusion of new asset management contracts for three months
(ii) Order for business improvement

(Note) The above-mentioned administrative disciplinary action is also for "f. Noncompliance with the duty of the care of good manager as trustee of general business operations,".

d. Inappropriate response to subscriptions for investment trusts [This act meets the conditions of paragraph 1 of Article 40 of the LITIC]

○ **Nikko Asset Management Co., Ltd.** offered an open-end investment trust to investors through securities companies, etc. and delivered a "list of dates on which subscriptions cannot be accepted" to securities companies, etc. However, the date

of December 28, 2004, on which the company cannot accept subscriptions for, or requests for cancellation of, investment trusts under the terms and conditions of investment trusts, was not included in the list. On December 28, 2004, therefore, the company accepted subscriptions made by many investors.

The company should have been very careful in handling said subscriptions for the open-end investment trust to ensure fairness among all investors. However, the company determined that no problems would occur so long as the date of acceptance of subscriptions was changed to December 29, 2004. The company reimbursed price difference which is originated from the change of the date of acceptance of subscriptions from December 28 to December 29, 2004 only to investors who submitted subscriptions through a certain securities company. However, the company did not inform other investors who submitted subscriptions through other securities companies of the possibility of this special treatment. As a result, the company accepted subscriptions forcing those customers bear the price difference. In conclusion, there emerged a significant economic benefit gap among investors, and fairness among investors was not maintained.

- Date of recommendation: June 8, 2006
- Details of administrative disciplinary action: Order for business improvement

e. Non-holding of officers' meeting [Violation of paragraph 1 of Article 260-2 of the Commercial Law which is applicable under Article 108 of the LITIC before the revision by the Law No.87 of 2005; and Violation of Article 87, item 2, 3, 7 and 8, paragraph 2 of Article 97, Article 120 and Article 131 of the LITIC]

○ From September 2001 to February 2006, officers' meetings at **ORIX JREIT Inc.** were said to have held 130 times. In the case of 88 such cases, however, the meetings were not held in reality. In these cases, operating officers and a supervising officer (three in total) who were the members of the meeting were not asked to attend the meeting, and ORIX Asset Management Corporation, as the trustee of general business operations for ORIX JREIT Inc., sent a draft of minutes to these officers, or explained the details of the meeting to these officers in advance, and then asked these officers to sign the minutes as if they had attended the meeting and resolve even for the matters that should have been approved at the meeting under laws and regulations, without holding the meeting, the officers approved these matters.

- Date of recommendation: June 16, 2006
- Details of administrative disciplinary action: Order for business improvement

f. Noncompliance with the duty of the care of good manager as trustee of general business operations [Violation of paragraph 2 of Article 112 of the LITIC before the revision by the Law No.87 of 2005]

○ From September 2001 to February 2006, **ORIX Asset Management Corporation** as the trustee of general business operations for ORIX JREIT Inc. maintained the officers' meetings of ORIX JREIT Inc. for 130 times. In the case of 88 such cases, however, the meetings were not held in reality. In these cases, operating officers and a supervising officer (three in total) who were the members of the meetings were not asked to attend the meeting, and the company, as the trustee of general business operations for ORIX JREIT Inc., sent a draft of minutes to these officers, or explained the details of the meeting to these officers, in advance, and then these

officers signed the minutes as if they had attended the meeting resolved.

Even for matters that should have been approved at the meetings under laws and regulations, the officers approved these matters without holding the meetings.

Although the company was entrusted to perform business operations as the trustee of general business operations for ORIX JREIT Inc., the company has not adequately performed its duty of the care of the good manager. In addition, operating officers and supervising officer of ORIX JREIT Inc. carelessly cooperated with the business operations of the company. As a result, the meetings, important decision-making functions of an investment corporation, have not been held in a proper manner.

(Note) As for the date of recommendations and the contents of administrative disciplinary action, refer to "c. Noncompliance with the duty of the care of good manager in asset management business of investment corporation."

g. False entries, etc. in the minutes of officers meeting [This act meets with the condition of paragraph 1 of Article 214 of the LITIC (Violation of paragraph 2 of Article 260-4 of the Commercial Law which is applicable under Article 108 of the LITIC; Violation of item 4, paragraph 1 of Article 12 of the Cabinet Office Ordinance Concerning Disclosure of Contents, etc. of Specified Securities under paragraph 5 of Article 5 of the SEL which is applicable under Article 27 of the SEL; and Violation of Article 7 of the Tokyo Stock Exchange Rule "Exemption of the Securities Listing Rule Applicable to Real Estate Investment Trust Securities")]

○ (i) **Japan Retail Fund Investment Corporation** has determined that the officers' meetings should be held to approve financial statements and to make a decision on the additional issuance of investment securities and the minutes thereof should be taken. From February 2002 to August 2005, the corporation held 35 such meetings (at 16 of which, proposals that needed to be disclosed at the appropriate time were referred to 16 such meetings). The minutes of nine out of 35 such meetings (all of which involved proposals that needed to be disclosed at the appropriate time were referred to), however, was prepared and maintained dated the next day of the actual date of the meeting.

As mentioned below, the corporation undertook this practice so as to pretend to have conducted disclosure at the appropriate time in accordance with the provisions of the rules of the Tokyo Stock Exchange where the corporation is listed.

(ii) The corporation prepared the minutes of the meetings in above-mentioned manner. Although a proposal concerning the "additional issuance of investment securities through public offering" was resolved. At the meeting held on February 14, 2005, the corporation filed their financial statement together with a copy of the minutes of the meeting containing a false entry that the proposal was resolved at the meeting held on February 15, 2005.

(iii) When the meeting of the corporation has approved financial statements or has made a decision on the additional issuance of investment securities, the corporation is obliged to immediately disclose such facts in accordance with the provisions of the disclosure rule of the Tokyo Stock Exchange where the corporation is listed. However, the corporation prepared the minutes containing false information stating that the meeting had been held on the day of disclosure despite the fact that the meeting was in reality held on or before the previous day. Thus, the corporation pretended to have made the disclosure at the appropriate time by making a press

release that the resolution was made on the day of disclosure.
- Date of recommendation: April 18, 2006
- Details of administrative disciplinary action: Order for business improvement

h. Act of making advertisement containing information strikingly contrary to fact [Violation of paragraph 2 of Article 13 of the Securities Investment Advisory Business Law]

○ From around April 2004 to November 11, 2005, in connection with a delivery by post of documents before the conclusion of contracts prescribed in the Article 14 of the Securities Investment Advisory Business Law, **E CAPITAL Co., Ltd.** sent an advertisement documents, representing as if strikingly contrary information to fact existed although it was not available in reality, such as the "secret information concerning the changeover of shares, private placement of CB, private allotment of shares available only by the company" and the "selection of shares with confidential information," and representing that led persons to considerably misunderstand the contents of the advice, to at least 2,146 persons who asked for materials or free security analysis by accessing the company's website (hereinafter referred to as "potential customers"). Thus, the company solicited these potential customers for the conclusion of investment advisory contracts.

- Date of recommendation: April 7, 2006
- Details of administrative disciplinary action:
(i) Suspension of all business related to investment advisory business for one month
(ii) Order for business improvement

i. From around January 2004 to December 2, 2005, in connection with a delivery by post of documents before the conclusion of contracts prescribed in the Article 14 of the Securities Investment Advisory Business Law, Commodore Investment Co., Ltd. sent a "list of recommendable shares" representing strikingly contrary to its actual advice records pretending the company had advised many shares whose prices increased sharply company had advised, to many potential customers. Thus, the company canvassed these potential customers for the conclusion of investment advisory contracts.

- Date of recommendation: April 7, 2006
- Details of administrative disciplinary action:
(i) Orders for suspension of all business related to investment advisory business for one month
(ii) Order for business improvement

j. Act to use a fraudulent means in concluding investment advisory [Violation of item 1, paragraph 1 of Article 22 of the Securities Investment Advisory Business Law]

○ When soliciting a customer for the conclusion of an investment advisory contract on February 5, 2005 (this contract was concluded on February 6, 2005), Toyo **Soken Co., Ltd.** made a groundless and fraudulent representation of information with the intention of making the customer to profoundly misunderstand, claiming that "the accurate prediction ratio of the company is 99%" with an aim to increase income from investment advisory services by acquiring new customers and to increase the sales person's own commissions.

- Date of recommendation: March 22, 2006
- Details of administrative disciplinary action:
(i) Orders for suspension of all business related to investment advisory business for one

month
(ii) Order for business improvement
(Note) The above-mentioned administrative disciplinary action is also for “k. Act to promise to offer special benefit to customers,”.

k. Act to promise to offer special benefits to customers [Violation of item 3, paragraph 1 of Article 22 of the Securities Investment Advisory Business Law]

○ On July 31, 2005, **Toyo Soken Co., Ltd.** solicited a customer for a switchover from the existing contract to a contract for members of higher status with an aim to increase income from investment advisory services and the sales person’ s own commissions, while the existing contract was still in force. At this time, the company promised to provide the customer with advisory services for free for a period from next date of expiration of the new contract to the date of expiration of the old contract because the term of the new contract would end earlier shorter than the old contract.

(Note) As for the date of recommendations and the contents of administrative disciplinary action, refer to “j. Act to use a fraudulent means in concluding investment advisory.”

5. Policy Proposals

1) Outline

To help establish a sound securities market with high levels of fairness and transparency and to maintain investors' confidence in the market, the rules governing the market must adapt to changes in the environment surrounding it. To contribute to the efforts to keep securities market rules effective reflecting the realities of the market, the SESC may submit policy proposals to the Prime Minister, the Commissioner of the FSA or the Minister of Finance, calling for measures to ensure fairness in securities transactions, to protect investors, or to maintain other public interests, when it is deemed necessary, based on the results of securities inspections, disclosure document inspections, administrative civil monetary penalties investigations or investigations of criminal offenses (Article 21 of the FSA Establishment Law).

Policy proposals are made by the SESC after its comprehensive analysis of the issues recognized through inspection and investigation results. Such proposals are intended to clarify the SESC's views on laws/regulations or self-regulating rules and have them reflected in policy measures undertaken by other government agencies and SROs. The proposals made by the SESC serve as important inputs for supervisory branches in formulating policies.

When current laws/regulations or self-regulating rules on securities trading are found to be insufficient, the SESC points out such facts as well as problems inherent in the current laws/regulations or self-regulating rules and proposes reviewing them so as to protect investors and maintain public interests.

2) Specific Policy Proposals and Measures Reflecting Policy Proposals

1. Specific Policy Proposals

Contents of specific policy proposals in Business Year 2006 are as follows (not adjusted for the passage of time after submission of proposals).

(1) Imposition of administrative civil monetary penalty on market manipulation by customers through "false buying or selling offers" (November 29, 2005)

"False buying or selling offers" are offers made without any intension of concluding contracts, so as to manipulate market prices (these offers are canceled before making contracts), and are categorized as acts of market manipulation.

The provision of item 1, paragraph 2 of Article 159 of the SEL prohibits acts of market manipulation including customers' "false buying or selling offers." However, Article 174 of the current SEL, which provides for the imposition of administrative civil monetary penalty on market manipulation acts, only covers the transactions with actual buying and selling contracts. Such being the case, "false buying or selling offers," where no actual buying and selling takes place, are not subject to the administrative civil monetary penalty. Therefore, rules should be amended to make "false buying or selling offers" punishable by administrative civil monetary penalties in order to ensure the effectiveness of regulations on unfair transactions including acts of market manipulation.

(2) Imposition of criminal penalty and administrative civil monetary penalty on "false buying or selling offers" by securities companies for their own accounts (November 29, 2005)

If a customer of a securities company makes a "false buying or selling offer," the customer will be subject to punishment because the act is considered a "request for

brokerage" of such transaction under item 1, paragraph 2 of Article 159 of the SEL. On the contrary, if a securities company that is a member of a securities exchange makes a "false buying or selling offer" for its own account, it will not be punished as the act does not fall under the category of either transaction or "request for brokerage" of such transaction under the same item.

As there is no legitimate reason to differentiate sanctions on market manipulation through "false buying or selling offer" depending on whether it is done by a securities company or its customer, "false buying or selling offers" by securities companies for their own accounts should be prohibited under the same item and also made subject to criminal penalties under item 7, paragraph 1 of Article 197 of the SEL.

"False buying or selling offers" by securities companies for their own accounts should also be made punishable by administrative civil monetary penalty under Article 174 of the SEL.

(3) Customer protection in response to the review of scope of business operations (November 29, 2005)

With respect to the scope of business operations, the "Interim Report" released by The First Subcommittee of the Sectional Committee on Financial System under the Financial System Council pointed out the following.

"The Investment Services Law should regulate as innate businesses, in a comprehensive manner, such operations as sales and solicitation of a broad range of financial products considered as investment products and providing services of asset management investment advice and asset custody concerning such financial products. Under the existing laws, for example, if a company desires to simultaneously conduct securities business and discretionary investment management business, the company must register itself as securities company, submit a notification that it will also conduct investment advisory business, register itself as investment consultant, acquire an authorization for discretionary investment management business, and acquire an authorization for simultaneous conduct of discretionary investment management business and securities business. Furthermore, the SEL and the Securities Investment Advisory Business Law, respectively, have provisions to prevent abuses stemming from a company conducting both securities business and discretionary investment management business. Therefore, attention should be paid to the fact that it is pointed out that these vertically separated laws prevent companies from conducting securities business and discretionary investment management business in a sound manner."

On the other hand, the results of inspections of securities companies by the SESC suggest that even today, these are cases where customers are forced to pay unreasonable commissions due to discretionary account transactions.

As a result of a review of business operations, the Investment Services Law will regulate sales and solicitation of a broad range of financial products as well as providing services of asset management, investment advice and asset custody concerning such products in a comprehensive manner. If the prohibition of concluding contracts on those discretionary account transactions are to be reviewed, necessary and appropriate measures should be taken in consideration of regulations on discretionary investment contracts under the current Securities Investment Advisory Business Law to ensure investor protection and prevent securities companies from compromising customers' interests.

(4) Enhancement of the information control system concerning pre-hearing (pre-marketing) procedures (April 14, 2006)

When listed companies intend to issue new shares or warrant bonds (hereinafter

referred to as the "shares"), a securities company acting as the lead manager or its affiliated company sometimes conducts a survey of potential demand for the shares directed to domestic and overseas institutional investors before the disclosure of the issuance by the issuing company (hereinafter referred to as "issue information"). Such a survey is called a "pre-hearing (pre-marketing)". There were some cases in which overseas investors who had acquired the issue information of a listed company during the process of a pre-hearing had sold the company's ordinary shares before the information on the new issue was publicized.

On finding these cases, the SESC requested overseas authorities to conduct investigations into the overseas investors suspected of insider trading. The overseas authorities subsequently punished the investors based on their findings.

With regard to pre-hearing, the inspection of securities companies revealed the following.

1) Some securities companies did not have rules on procedures for disclosing the issue information to third parties during the pre-hearing.

2) Some securities companies were suspected of not having informed and alerted third parties of the fact that the issue information fell on "important fact before disclosure" category when they provided the issue information to such parties.

3) Some securities companies did not keep record of the disclosure of issue information to third parties.

Leaving these kinds of information control systems unattended could result in further cases of insider trading.

Therefore, measures should be taken to prevent insider trading induced by the securities companies' act to disclose issue information to third parties during the process of pre-hearing before they are released, with a view to ensuring the fairness in securities transaction.

(5) Responsibilities of auditing firms (April 21, 2006)

In a number of criminal cases where listed companies submitted financial statements containing false information on important matters, certified public accountants of auditing firms responsible for the companies' accounting audits were deeply involved.

The SESC filed complaints under the provisions of Article 226 of the SEL against not only those listed companies and their officers but also those accountants as co-principals (Article 60 of the Criminal Law).

Meanwhile, looking at the auditing firms to which those accountants belonged, it is difficult to hold them criminally accountable on the matter, as the current SEL has no applicable provision.

However, in addition to being the signatories to the audit contracts with those listed companies, the audit firms are responsible to establish a business management system to ensure that their affiliated accountants perform audits in a fair and proper manner.

While the Certified Public Accountants Law allows the imposition of administrative sanctions against auditing firms for false or unreasonable certifications by their employees, and the employees must assume civil liability, a comprehensive study should be conducted on the liabilities of auditing firms, including civil, administrative and criminal ones, and necessary and appropriate measures should be taken, to ensure that auditing firms will conduct strict audits.

2. Measures Taken Based on Policy Proposals

(1) Measures taken based on the policy proposal for the imposition of administrative civil monetary penalty on market manipulation by customers through "false buying or selling offers"

The proposal was reflected in the law which made amendments to the SEL and other related laws. The Law provides that administrative civil monetary penalty shall be imposed on those requests for brokerage (i,e., offers for intermediation, placing orders or acting as agency) of securities transactions aimed at inducing transactions by others and for which contracts are not concluded ("false buying or selling offers"). It was enacted on June 7, 2006 and the applicable provision came into force on July 4, 2006.

(2) Measures taken based on the policy proposal for the imposition of criminal penalty and administrative civil monetary penalty on "false buying or selling offers" made by securities companies for their own accounts

The above law also provides that "false buying or selling offers" by securities companies for their own accounts to induce transactions by others will be prohibited as acts of market manipulation, and that criminal penalty and administrative civil monetary penalty shall be imposed on such acts. The applicable provision came into force on July 4, 2006.

(3) Measures taken based on the policy proposal for the customer protection in response to the review of scope of business operations

The proposal was dealt with in the above amendment as well. The law provides that necessary regulations shall be implemented, such as those on various acts related to discretionary investment contracts and measures to prevent abuses stemming from simultaneous conduct of securities business and discretionary investment management business. The applicable provision will come into force from the day to be designated by a government ordinance, within one year and six months from the day of promulgation of the law (June 14, 2006).

(4) Measures taken based on the policy proposal for the enhancement of the information control system concerning pre-hearing (pre-marketing) procedures

The FSA is now conducting a study on the necessary revision of the ordinance of the Cabinet Office. (Subsequently, the ordinance reflecting the proposal was released on October 4, 2006 and came into effect on November 1)

(5) Measures taken based on the policy proposal for the responsibilities of auditing firms

The FSA reactivated the Subcommittee on Certified Public Accountant System under the Financial System Council on April 26, 2006. The subcommittee is now conducting a comprehensive study on the desirable system concerning auditing firms taking into account the issues presented by the SESC's policy proposal.

6. Market Surveillance

1) Outline

In addition to criminal offense investigation, administrative civil monetary penalties investigation, disclosure document inspection and inspection of securities companies, the SESC conducts market surveillance in which it monitors the trend of the markets on a daily basis, collects and analyzes various materials and information related to the securities markets and the securities transactions, and investigate the cases of unfair securities deals. Thus, the SESC endeavors to ensure fairness of transactions through the broad-based supervision of transactions in the markets.

2) Gathering of Information from the General Public

Information furnished by the general public reflects the raw voices of investors in the markets. Such information is highly useful as it often leads the SESC to launch criminal offense investigation, administrative civil monetary penalties investigation, disclosure document inspection, inspection of securities companies, and market surveillance.

For this reason, the SESC uses a variety of media, including telephone, letter, personal visits and the Internet, to receive information from as many people as possible.

In Business Year 2005, 7,526 pieces of information were collected from the general public, including investors. This was an approximately 60% increase over the preceding Business Year and the highest number of collection since the SESC was established in 1992. This may be attributed to the occurrence of cases of M&A and anti-take over measures that aroused great interest in society, and to the fact that the activities of the SESC were better understood by the general public.

The exact breakdown was 5,815 contacts via the Internet, 1,022 by phone, 377 in letter, 73 by personal visits, and 239 contacts that were referrals fro, the Local Finance Bureaus. A look at the breakdown of the means employed in information gathering reveals that the Internet and telephone account for over 90% of the total cases of information supplied. In particular, the number of contacts made over the Internet exceeded 5,000 for the first time, and much information continues to flow in.

In terms of information content, 5,390 cases related to specific shares, 1,296 cases were about sales practices of securities companies, and the remaining 840 cases were opinions on other matters.

Suspicions of market manipulation ranked the highest among the cases relating to specific shares. They accounted for approximately 30% (2,705 cases) of all cases. This figure is indicative of widespread doubts among investors about the way prices are formed in the market. The second-largest group was related to the suspicious spreading of rumors on stock markets, representing approximately 20% (1,614 cases) of all cases. Such information was for the most part about postings on Internet bulletin boards. This suggests the fact that unfounded rumors and investment analyses flood the Internet while tips from investors who read them are also increasing. Information about suspected false statements made in financial statements, etc. has also significantly increased.

The various types of information about securities companies' sales practices, etc. received include trading without customers' prior consent, discretionary account transactions, and solicitations based on assertive judgment. In addition, information concerning securities investment trust-related companies, investment advisors, currency margin trading companies, etc., whom the SESC has been given the authority to inspect, effective from this Business Year, was also received.

Information Received

	BY2001	BY2002	BY2003	BY2004	BY2005
Internet	1,282	1,804	2,061	3,251	5,815
Telephone calls	408	749	616	787	1,022
Letters	291	290	287	408	377
Visitation	58	50	75	80	73
Information forwarded from the FSA and the Local Finance Bureaus	142	163	178	143	239
Total	2,181	3,056	3,217	4,669	7,526

Note: The Business Year (BY) is from July 1 to the following June.

Content of the information

Category		BY2001	BY2002	BY2003	BY2004	BY2005
Specific stocks		1,208	1,848	2,015	3,339	5,390
	Market manipulation	601	759	680	1,435	2,705
	Spreading rumors on stock markets	294	576	787	1,029	1,614
	Insider trading	195	271	282	510	527
	False financial statements	48	73	67	142	290
	Profit guarantee and loss compensation	9	13	18	9	10
	Offer made by unregistered employee	42	29	34	24	69
	Others	19	127	147	190	175
Sales practices of securities companies		498	573	655	620	1,296
	Unauthorized transaction	65	88	66	63	97
	Solicitation with decisive predictions	49	30	27	19	28
	Solicitation against suitability rules	13	29	31	28	18
	Conclusion of discretionary account contracts	27	15	22	40	27
	Excessive solicitation to a large number of nonspecific customers	1	6	3	2	2
	Others	343	405	506	468	1,124
Other opinions		475	635	547	710	840
Total		2,181	3,056	3,217	4,669	7,526

3) Market Oversight

1. Outline of Market Oversight

In market oversight, the SESC takes out below-mentioned samples based on its oversight of market movements and information obtained from various sources, and asks securities companies, etc. to prepare detailed reports on transactions or submit relevant data.

(1) Shares showing irregular movements, including surges or drops in price;
(2) Shares which have been impacted by important incidents that would significantly affect investors' judgment;
(3) Shares that are often listed in newspapers, magazines or Internet bulletin boards;
(4) Shares about which information is readily obtainable from the general public.

Based on these reports and data, the SESC conducts a detailed analysis of those transactions that are suspected to impair the fairness of the market, such as market manipulation and insider trading, and investigates the facts. At the same time, the SESC examines if securities companies, etc. involved in these dubious deals have committed acts that violate the Ordinance of Cabinet Office Concerning Regulation, etc. of Conduct of Securities Company or other laws.

If such inspection has found that some cases have problems, such cases will be reported to the relevant SESC divisions for further investigation.

2. Legal Basis

In market oversight, the SESC is authorized to ask securities companies, etc. to submit reports and data on particular securities transactions if deemed necessary and appropriate from the viewpoint of maintaining fairness in transactions and protecting investors' interests. Such authority delegated to the SESC is prescribed in the SEL, LFSF, FFTL, etc.

3. Close Cooperation with Self-Regulatory Organizations

Market oversight, as conducted by the SESC, is also conducted by self-regulatory organizations such as stock exchanges and the Japan Securities Dealers Association. Their oversight has the important function of checking if market participants are implementing their business operations in an appropriate manner. The SESC maintains close cooperation with market-oversight sections of self-regulatory organizations by exchanging necessary information on regular and extraordinary bases, and also by making mutual inquiries about data and facts on transactions.

4. Oversight Results

Oversight Results

In Business Year 2005, the SESC conducted oversight in an efficient and flexible manner based on the policy of promptly taking the initial action for the early settlement of cases by categorizing oversight activities as follows.

(i) Oversight of price formation process
(ii) Oversight of insider trading cases
(iii) Oversight of other aspects

The number of oversight cases conducted by the SESC and the Local Finance Bureaus are as follows.

Number of oversight cases		Business Year 2005	(Reference) Business Year 2004
Total		875	674
	SESC	555	367
	Local Finance Bureaus	320	307
(Breakdown of oversight items)			
Market manipulation		169	153
Insider trading		693	506
Others		13	15

In Business Year 2005, broad-based oversight was conducted to investigate cases of unfair transactions or inappropriate canvassing by market intermediaries in the new market environment, such as the emergence of new financial products and transaction methods, accelerated globalization of financial transactions and increased Internet transactions conducted by individual investors.

7. Efforts to Strengthen Surveillance Activities and Functions

1) Reinforcement and Strengthening of the Market Surveillance System

1. Reinforcement of Organization

(1) Reinforcement of Organization

As for the staffing quota in the Business Year 2006, an increase of 11 officers was approved. As a result, the staffing quota as of the end of the Business Year 2006 stands at 318. As for the organization structure, the previous two-division system (Coordination and Inspection Division, Investigation Division) was reorganized into the five-division system (Coordination Division, Market Surveillance Division, Inspection Division, Civil Penalties Investigation and Disclosure Documents Inspection Division, and Investigation Division).

In addition, with an increase of 6 officers approved in the Securities Transaction Surveillance officers (department) at the Local Finance Bureaus, etc., the total number of officers stands at 246 as of the end of Business Year 2006. Combined with the staff quota of the SESC, the total number of officers stands at 564.

(2) Acceptance of Private-Sector Experts

In order to ensure proper market surveillance and boost the professional expertise among the officers, the SESC hired a total of 8 private-sector experts, consisting of individuals who are well versed in securities business etc. as well as lawyers and certified public accountants in Business Year 2005. As of the end of June 2006, 83 of such professionals were on the payroll.

2. Improvement of Collecting Information and Analysis

As a way to analyze complex and massive data on securities transactions and shed light on the fact relevance of these transactions, the SESC has been developing "the Securities Comprehensive Analyzing System (SCAN-System)" since 1993 in order to operate efficiently. The SCAN-System is a comprehensive computer system that is used widely in the operations of the SESC, including investigation of criminal cases, administrative civil monetary penalties investigation, disclosure document inspection, inspection of securities companies, market oversight and market surveillance. Though its basic development was completed by the Fiscal Year 2001, the SESC promotes to enhance the system functions in order to operate more efficiently.

Note: The SCAN-System consists of two parts, "the Securities Company Inspection System" and "the Market Surveillance System". In addition, there exists two Support systems under the SCAN-System ("the SCAN-Internet Patrol System (SCAN-IPS)" and "the SCAN-Surveillance by Technical Analysis of Corporation Finance System (SCAN-STAF)") as well as "the information control system" which is meant to process information supplied by the general public efficiently.

2) New Surveillance Functions

1. Outline

On December 22, 2005, the First Subcommittee of the Financial System Council compiled a report titled "Legislation for "the Investment Services Law (provisional title)"". Based on this report, the FSA prepared bills for amending the SEL, etc. and submitted them to the 164th ordinary Diet session. The bills passed the Diet on June 7, 2006.

The Law, as cross-sectional systems responding the changes in the environment

surrounding financial and capital markets and protecting investors, aims at thorough implementation of user protection rules and enhancement of users' convenience, ensuring market functions toward the policy goal of "encouraging funds from savings to investment", and responding to globalization of financial and capital markets by reforming the current SEL into "the Financial Instruments and Exchange Law (so-called "the Investment Services Law")", etc. and the policy proposals made by the SESC are also reflected.

With this Law, necessary systems, comprehensive and cross-sectional systems for a wide range of financial products, and the systems for tender offer, large shareholding reports, and other disclosure, etc. are established. Consequently, the coverage and scope of the SESC's authority will be expanded as follows.

2. Expansion of the SESC's Authority as a Result of the Promulgation of "the Financial Instruments and Exchange Law (so-called "the Investment Services Law")"

(1) Expansion of the coverage and scope of inspection as the establishment of comprehensive and cross-sectional systems

The coverage of regulations will be expanded such as the rights based on contracts for partnership will comprehensively be defined as securities. Furthermore, "sales and solicitation" operations of securities and derivative transactions, as well as "investment advisory", "investment management" and "customer asset administration" services will be regarded as "financial instruments business", and companies engaged in these activities will be required to be registered in principle, and necessary regulations, etc. on conduct of business will be reorganized at the same time. As a result, the coverage and scope of inspection will be expanded, including the so-called fund sellers, etc.

(2) Expansion of the coverage and scope of inspection as a result of the improvement of the disclosure system

As for the tender offer system, regulations will be established to expand the scope of regulations and to improve information service to investors, and as for the "reporting system for large shareholdings", regulations will be established to increase the frequency for reporting under the "special reporting system" for institutional investors and shorten its deadline. In addition, as for the disclosure of corporate information and so on, quarterly reporting system and evaluate system of the internal control of financial reporting will be established. As a result, the coverage and scope of disclosure document inspection will be expanded.

(3) Expansion of the coverage of criminal investigation and administrative civil monetary penalties investigation as a result of the establishment of regulations on market manipulation

Administrative civil monetary penalty is imposed on requests for brokerage (i.e; offers for intermediation, placing orders or acting as agency) of securities transactions for the purpose of inducing transactions by others, and those requests will be newly subject to the penalty even their contracts are not concluded ("false buying or selling offers"). "False buying or selling offers" by securities companies for their own accounts for the purpose of inducing transactions by others will be newly prohibited as market manipulation and criminal penalty and administrative civil monetary penalty will be imposed on such acts. Therefore, these acts will become subject to criminal investigation and administrative civil monetary penalties investigation.

(Amendments to legislation will come into effect as follows;

As for above item (3), on July 4, 2006.

As for above items (1) and (2),on the date to be designated by cabinet order not exceeding a certain period after the promulgation (June 14, 2006)).

3) Efforts to Communicate with Investors

The SESC exercises ingenuity to deepen the understanding of individual investors about the SESC and to enhance their confidence in the securities markets by holding lecture meetings and providing information on its activities, etc. via the Internet. In addition, the SESC encourage the investors to provide as many tips as possible to gather meaningful starting points for the SESC's activities through the lecture meetings and newspaper ads, etc.

4) Cooperation with the FSA and SROs

The SESC has been strengthening its cooperation with the FSA, the authorities to regulate Japanese securities market, through close exchanges of information, etc. And the SESC also tries to exchange information closely with SROs, such as the stock exchanges in Japan and the Japan Securities Dealers Association.

Due to the increase of cross-border transactions in the securities markets in recent years, it has become more and more important to cooperate and coordinate with foreign authorities on the enforcement issues. The SESC, together with the FSA, makes every effort to enhance coordination with foreign securities regulatory authorities through exchanging opinions and information and participation in major international conference on securities regulation, and continues to enhance mutual cooperation.

5) Cooperation with Foreign Securities Regulatory Authorities

1. Participation in the International Organization of Securities Commissions (IOSCO)

The IOSCO is an international organization whose objective is to establish international harmony of securities regulations and mutual cooperation among regulatory authorities, and is composed of 181 organizations representing countries and regions at present. The SESC became its member in October 1993 and the Chairman and other officers of the SESC participate in the IOSCO's Annual Conference where the top-level officials from various countries get together. In addition, the SESC joins in the Asia-Pacific Regional Committee (APRC), one of the Regional Committees of the IOSCO, and participates in its meetings and Enforcement Directors meetings to strengthen cooperation with foreign authorities.

For the purpose of discussing major regulatory issues that face the international market and proposing practical solutions to such issues, the IOSCO has established the Technical Committee that is made up of authorities of developed countries and regions, and five Standing Committees (SCs) under it. The SESC joins in the Fourth Standing Committee (SC4), dealing with the enforcement and exchange of information, and holds discussions on the issues among securities regulators from different countries in order to respond to international securities crimes. This year, the SC4 discussed the dialogues with non-cooperative jurisdictions and the systems for preservation and repatriation of property, etc. In addition, the SESC participates in the meetings of the Screening Group (SG) and verifies applications of other countries/jurisdictions to join the Multilateral Memorandum of Understanding (MOU), which is the exchange agreement between securities authorities adopted in the IOSCO Annual Conference in May 2002. At the IOSCO Annual Conference held in April 2005 in Colombo, it was resolved that the Multilateral MOU would be treated as the "international benchmark" for the cooperation and exchange of information concerning enforcement, and that the IOSCO members would sign, or make a commitment to become the signatory to sign the Multilateral MOU by January 1st, 2010 at the latest. In May 2006, Japan submitted an application to sign the Multilateral MOU.

2. Bilateral Cooperation with Foreign Securities Regulatory Authorities

(1) Sharing of Information and Exchange

The SESC has also promoted active information sharing and exchange with foreign securities regulators through bilateral MOU, etc. on exchange of information in an effort to establish cooperative relationships with them.

Specifically, the SESC has exchanged information with the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) of the United States, the Financial Services Authority (FSA) of the United Kingdom, the Monetary Authority of Singapore (MAS), and the Securities and Futures Commission (SFC) of Hong Kong regarding suspected cases of unfair transactions and compliance of securities companies that operate internationally.

In addition, the SESC has exchanged opinions with the high-level officials of foreign securities regulatory authorities. In the 2005 Business Year, Mr. Takahashi, the SESC Chairman met with Mr. Yang, Chairman of the Securities and Futures Commission of Korea in December 2005, Mr. Jeffery, Chairman of the U.S. CFTC in January 2006, and Mr. Sants, Managing Director of the UK FSA in May 2006, when they visited Japan.

(2) Signing Memorandum of Understanding (MOU) Concerning Exchange of Information

The exchange of information among securities regulatory authorities is quite essential since cross-border misconducts are expected to take place with a rise in the number of cross-border securities transactions. In order to exchange information smoothly with foreign securities regulators, the FSA of Japan has signed Memorandum of Understanding concerning exchange of information with the following countries/regions;

- China Securities Regulatory Commission (CSRC), China
- Monetary Authority of Singapore (MAS), Singapore
- Securities and Exchange Commission (SEC), the United States
- Commodity Futures Trading Commission (CFTC), the United States
- Australian Securities & Investment (ASIC), Australia
- Securities and Futures Commission (SFC), Hong Kong
- Securities Commission (SC), New Zealand

3. Seminar for Foreign Securities Regulators

In February 2006, the SESC invited thirty market regulators from Asian countries and held the "The 5th Tokyo Enforcement Seminar". The purpose of the seminar is to assist emerging Asian countries in developing human resources, thus contributing to the development of their securities administration and markets through the lectures and case studies on the SESC's role - investigations, inspections and market surveillance, etc. - and group discussion, given by the staff of the SESC and Japanese SROs and so on.

Supplements

Basic Principle

– On the Start of New Regime (July 2004) –

《Mission of Securities and Exchange Surveillance Comission (SESC)》

- To ensure fair trading in securities and financial future markets
- To maintain the confidence of investors in these markets

《Objective under the New Regime》

The most important objective of the SESC under the new regime is

to protect individual investors with all our force

, as former regime did.

《Main Targets》

Main targets of SESC in order to achieve the above objective include:

(1) Sweep out criminal activities which hamper the fairness of markets

Sweep out criminal activities, including market manipulations and insider trading, which deceive investors and hamper the fairness of markets. The SESC aims to, for instance, thoroughly detect the large-scale market manipulation by speculators.

(2) Detect the violations of laws or regulations by market intermediaries

Strictly detect the act of violating laws or regulations by market intermediaries including securities firms and their managements and employees who try to make profits at the expenses of investors.

(3) Detect false statements on securities reports

Exhaustively detect the issuers of securities reports with false information who try to raise funds in favor of themselves by deceiving investors.

《Priority Matters》

The SESC will put emphasis on the following activities:

(1) Proper implementation of investigation for imposing new administrative civil penalty

Administrative civil money penalty system will be introduced in April 2005 against unfair trading (e.g. insider trading) and the submission of financial statements containing false information, and the SESC will be granted the authority of conducting the investigation for imposing the penalty. The SESC will arrange our organizational and procedural structure for implementing this new authority properly.

(2) Appropriate response to integrated inspection

Further inspection authorities will be delegated from the Financial Services Agency to the SESC in July 2005. The SESC will prepare for exercising the newly integrated inspection authorities in an accurate way, and implement efficient and intensive inspection.

(3) Response to recent developments in the markets

New products that cannot be easily grasped by individual investors, such as complicated option trading, have recently been sold in a large quantity to individual investors. The SESC will implement surveillance and inspection timely to see whether there exist unfair trading and/or illegal solicitation by market intermediaries in such a new market environment where the new products and forms of trading mechanism have been emerged and Information Technology has been advanced.

The SESC will also respond appropriately once the inspection authority on foreign exchange margin transaction is granted.

(4) Response to cross-border transactions

As the globalization of financial transactions and the development of Information Technology are advanced, suspicious activities involving non-residents including foreign investment funds that may violate the laws or regulations have been found in the Japanese markets. The SESC will strengthen the detection of such activities and coordinate with foreign authorities in a closer manner than before.

(5) Reinforcement of human resources

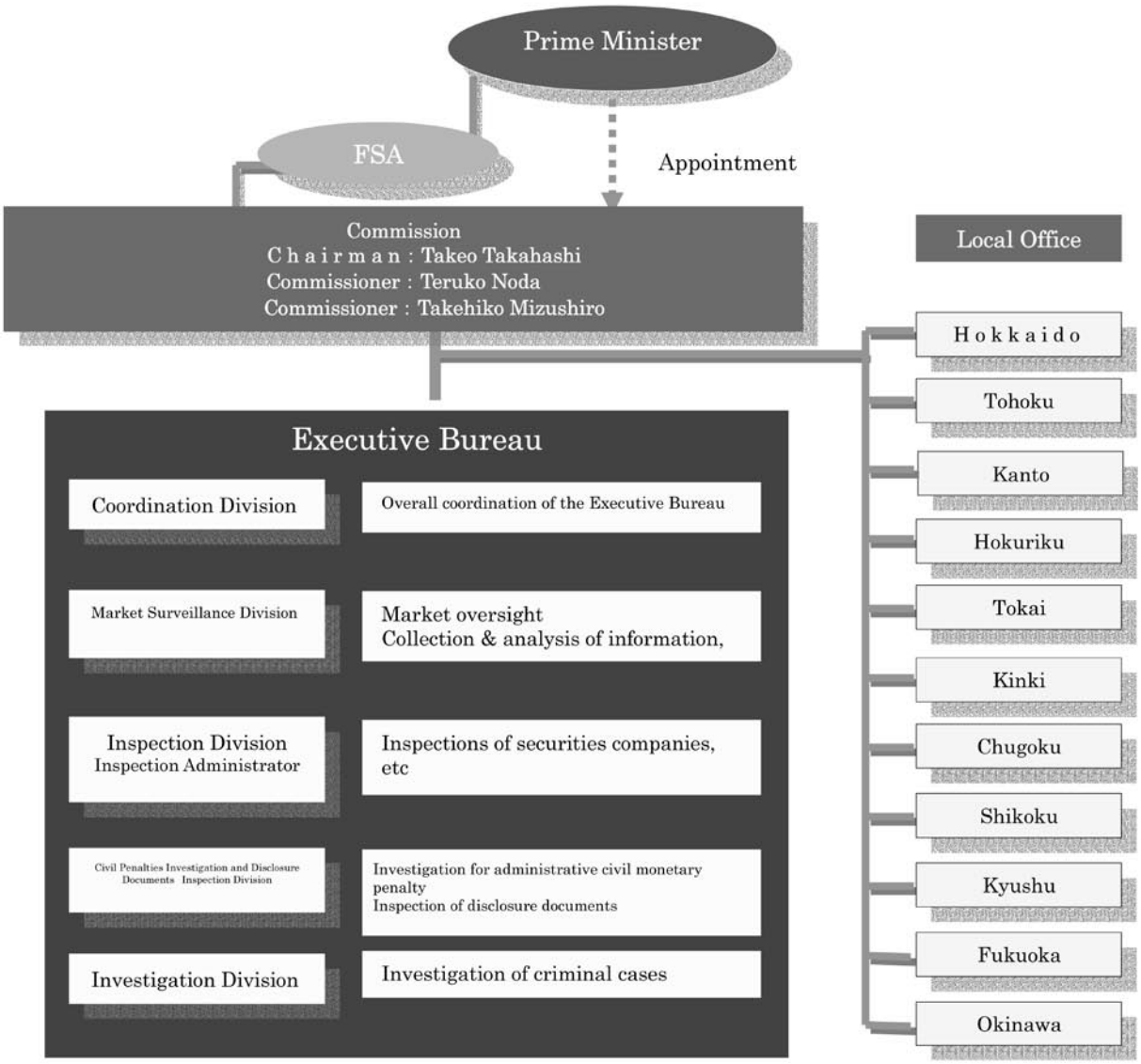
Further increase in human resources is needed in implementing the above targets, thus, the SESC continues trying to keep the necessary level of human resources in coordination with the authorities on the increase.

(6) Promotion of the presence of SESC

The SESC tries to increase its presence in the markets so that the existence of the SESC itself will serve as deterrence against unfair practices. The SESC also tries to further increase the credibility of the SESC, and consequently, of the securities markets, from investors. The SESC will thus make an effort to achieve higher performance in detecting criminal offences, as well as inform more people of the activities of the SESC through our website and seminars.

Table 1

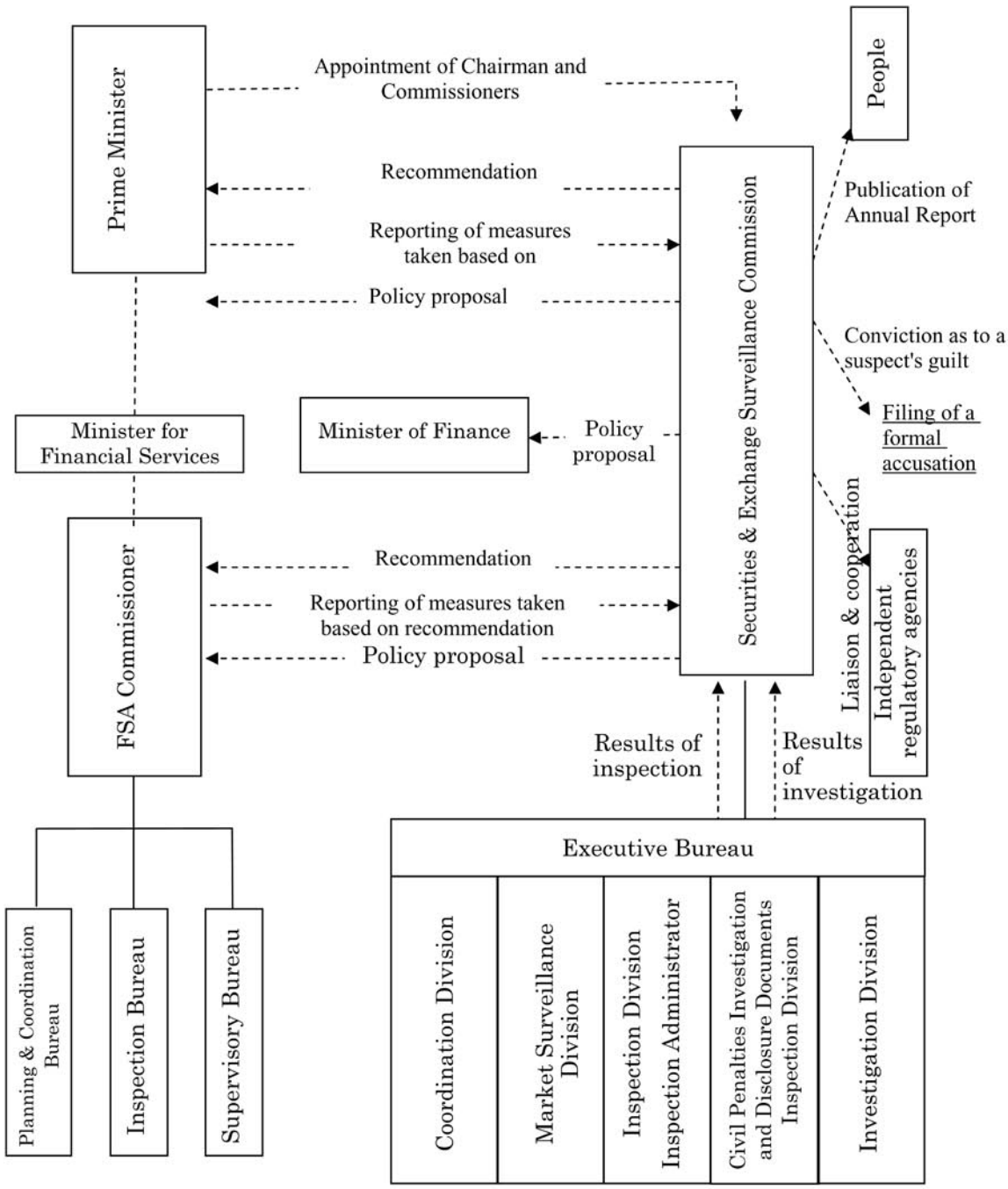
Organization of the SESC



Note: Until Business Year 2005 (July 2005～June 2006), the SESC was composed of two divisions (the Coordination and Inspections Division and the Investigation Division), and three offices (the Compliance Inspection Office, the Market Surveillance Office and the Office of Civil Penalties Investigation and Disclosure Documents Examination) under the Coordination and Inspections Division.

Table 2

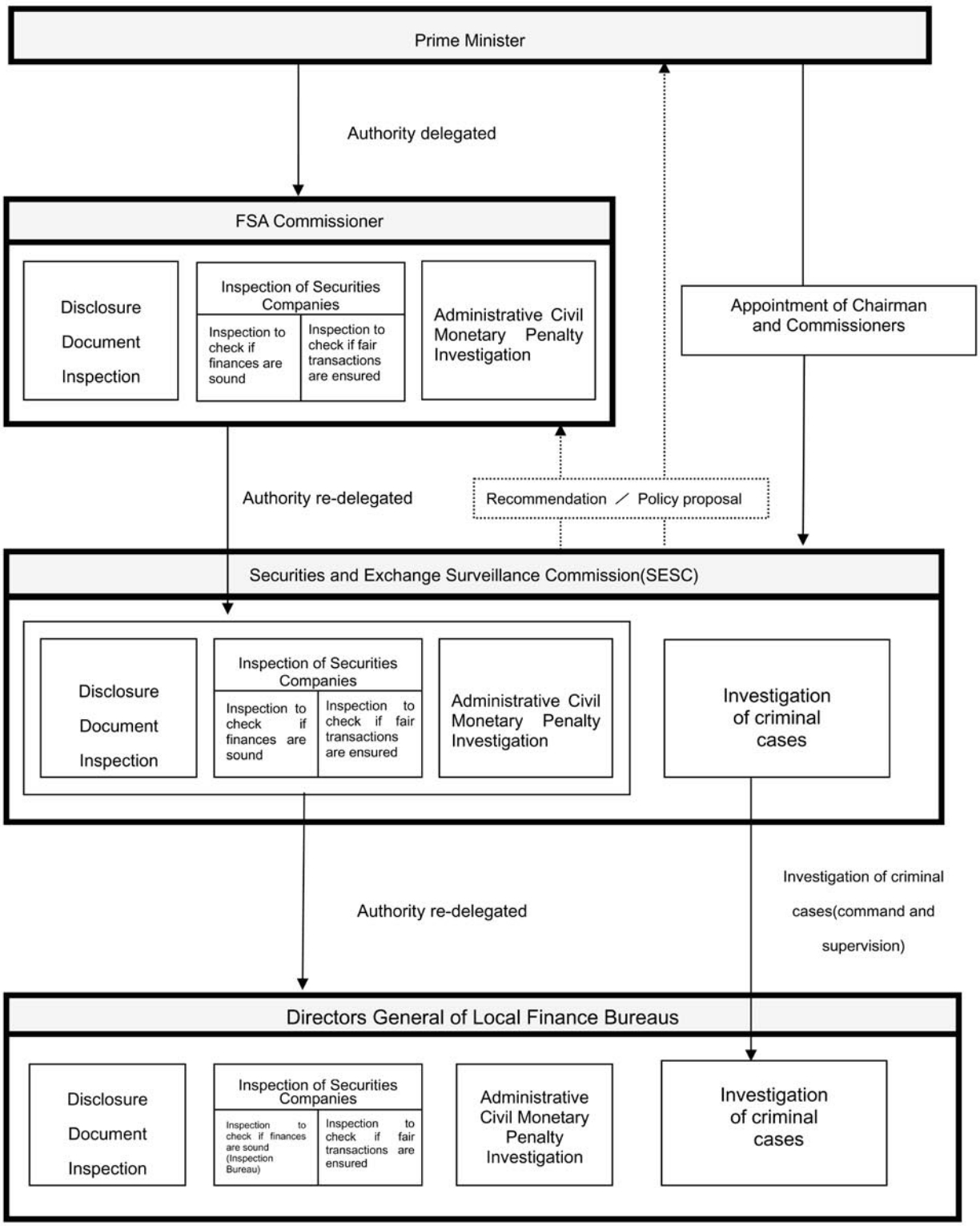
Conceptual Chart for Supervision of Securities Transactions



Note: Recommendations can be filed with the Prime Minister or the FSA Commissioner. Policy proposals can be filed with the Prime Minister, the FSA Commissioner or the Minister of Finance (Articles 20 and 21 of the Establishment Law).

Table3

Conceptual Chart of Relationship among the Prime Minister, FSA Commissioner, SESC, and Directors General of Local Finance Bureaus



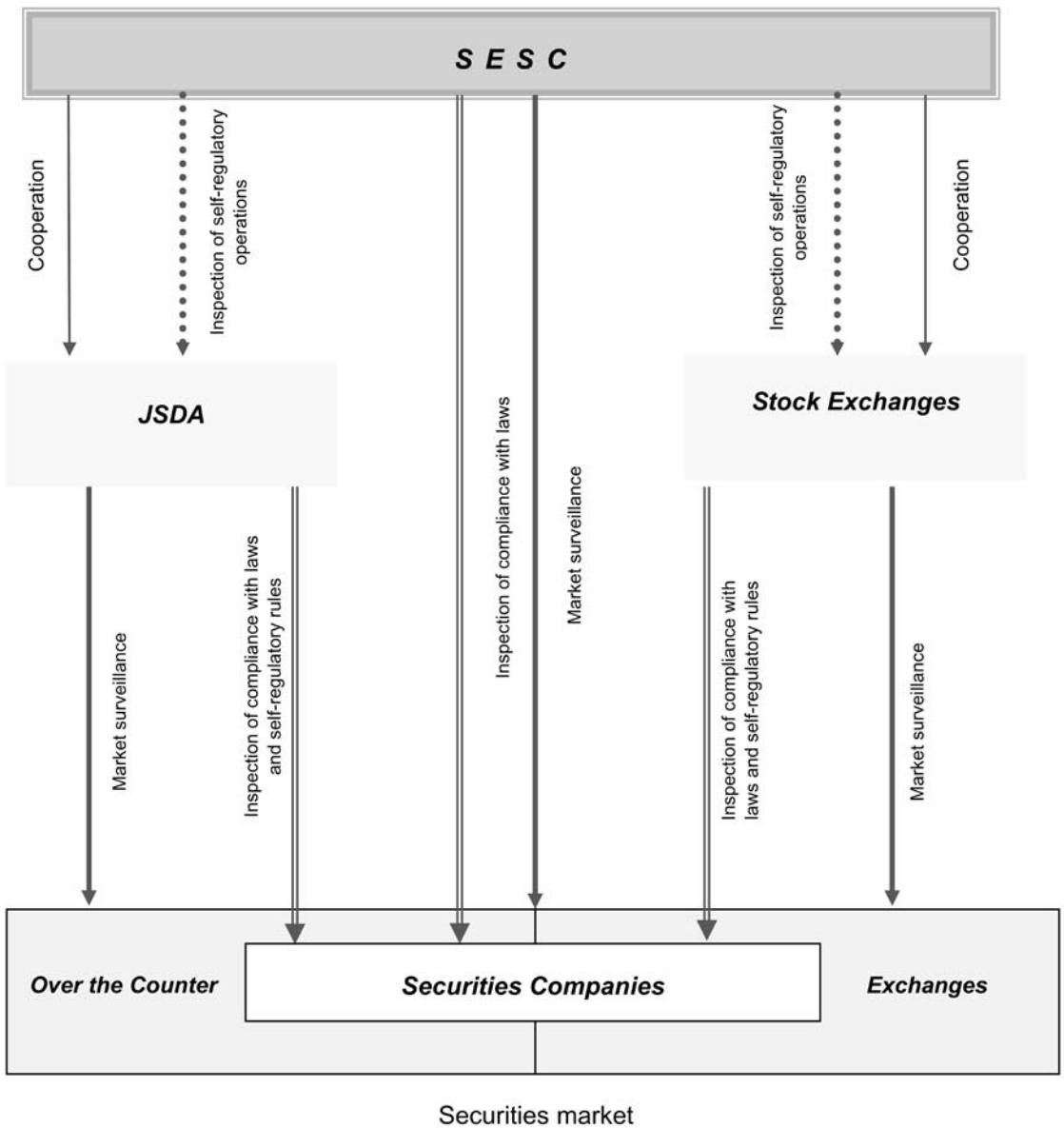
(Note1) SESC officials have the authority to investigate criminal cases.

- Authority to conduct noncompulsory investigation of criminal cases (Article 210 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 106 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)
- Authority to conduct compulsory investigation of criminal cases (Article 211 of the Securities and Exchange Law, Article 53 of the Foreign Securities Firms Law, Article 107 of the Financial Futures Trading Law, and Article 18 of the Personal Identification Verification Law)

(Note2) FSA Commissioner shall exercise part of delegated his powers. SESC shall exercise all powers delegated.

Table 4

Relationship to Self-Regulatory Organizations



Note: The same system applies to financial futures.

Supporting Facts of Main Cases for which Recommendations were Issued in the 2005 SESC Year

(1) Administrative civil monetary penalties investigations (Unfair Transactions)

○ **Data of recommendation made based on the results of investigation of insider trading concerning shares in Fujipream Corporation**

Formula to calculate administrative civil monetary penalty
Under paragraph 1 of Article 175 of the SEL, the sum of administrative civil monetary penalty can be calculated as follows.
(Closing price on a day immediately following the day of announcement of important facts)× (Number of shares purchased)
- (Purchase price)×(Number of shares purchased)
The closing price of the share in Fujipream Corporation on October 7, which is a day following the day when important facts were announced, was 4,340 yen. Therefore, the a sum of administrative civil monetary penalty can be calculated as follows.

1) Fujipream Corporation
4,340,000 yen (4,340 yen×1,000 shares) − 3,916,000 yen(Note) = 424,000 yen

⇒ Since the sum below 10,000 yen is discarded, the sum of administrative civil monetary penalty will be 420,000 yen.

(Note) Purchase price is the total of
- 3,890 yen × 100 shares
- 3,900 yen × 500 shares
- 3,920 yen × 100 shares
- 3,950 yen × 300 shares

2) The Company's officer
26,474,000 yen(4,340 yen×6,100 shares)
− 24,343,000 yen(Note) = 2,131,000 yen

⇒ Since the sum below 10,000 yen is discarded, the sum of administrative civil monetary penalty will be 2,130,000 yen.

(Note) Purchase price is the total of

3,850 yen × 200 shares	4,000 yen × 300 shares
3,880 yen × 300 shares	4,010 yen × 100 shares
3,890 yen × 600 shares	4,040 yen × 300 shares
3,920 yen × 100 shares	4,050 yen × 400 shares
3,930 yen × 100 shares	4,070 yen × 100 shares
3,940 yen × 400 shares	4,080 yen × 1,000 shares
3,950 yen × 1,100 shares	4,090 yen × 600 shares
3,960 yen × 300 shares	4,100 yen × 100 shares
3,970 yen × 100 shares	

○ **Data of recommendation made based on the results of investigation of insider trading concerning shares in Nihon Plast Co., Ltd.**

Formula to calculate administrative civil monetary penalty
Under paragraph 1 of Article 175 of the SEL, the sum of administrative civil monetary penalty can be calculated as follows.
(Closing price on a day immediately following the day of announcement of important facts)× (Number of shares purchased)
- (Purchase price)×(Number of shares purchased)

The closing price of the share in Nihon Plast Co., Ltd. on July 8, which is a day following the day when important facts were announced, was 718 yen. Therefore, the sum of administrative civil monetary penalty can be calculated as follows.

Person B subject to order for payment of administrative civil monetary penalty

(718 yen×7,000 shares) − Purchase price (600 yen×7,000 shares) = 826,000 yen

⇒ Since the sum below 10,000 yen is discarded, the sum of administrative civil monetary penalty will be 820,000 yen.

Person C subject to order for payment of administrative civil monetary penalty

(718 yen×5,000 shares) − Purchase price (3,121,000 yen) (Note) = 469,000 yen

⇒ Since the sum below 10,000 yen is discarded, the sum of administrative civil monetary penalty will be 460,000 yen.

(Note) Purchase price is the total of $\left\{\begin{array}{l}638 \text{ yen} \times 2{,}000 \text{ shares} \\ 617 \text{ yen} \times 1{,}000 \text{ shares} \\ 618 \text{ yen} \times 1{,}000 \text{ shares} \\ 610 \text{ yen} \times 1{,}000 \text{ shares}\end{array}\right\}$

(2) Inspection of Securities Companies etc.

○ **Data for Recommendation Against Matsui Securities Co., Ltd.**

Matsui Securities Co., Ltd. handles those transactions for which maturity date is indefinite in principle using the method of general margin transactions (Note 1) under the name of the "Margin Transaction with Indefinite Margin Trade Period."

The internal regulations of the company stipulate as follows: "For shares bought or sold on margin, if delisting, share consolidation, share split, merger, share exchange, share transfer or corporate separation has taken place, Matsui Securities Co., Ltd. may establish the maturity date for them."

When having canvassed many customers for "Margin Transaction with Indefinite Margin Trade Period" for a period from July 2003 to April 2005, however, Matsui Securities Co., Ltd. made below-mentioned explanations of said transactions in its "corporate brochure" (Note 2), which led customers to misunderstand that no maturity date would be established under any conditions.

Explanations of "Margin Transaction with Indefinite Margin Trade Period" in the "Corporate Brochure"
In the case of conventional margin transactions, there was a rule that "settlement of accounts should be made within six months." This means that a customer must make reversing trade within six months. Even if share price is at a certain level lower than a customer expected, the customer must settle the account by the maturity date and bear the loss. Every investor must have thought at least one time that the situation would be different only if there exists no maturity date. In the case of our "Margin Transaction with Indefinite Margin Trade Period," no maturity date will be established. Investors can make margin transactions through us without worrying about the maturity date.

(Note 1) Margin transactions that are made based on the conditions agreed with customers, including negative interest rate per diem, maturity ate and interest rate.
(Note 2) Materials distributed to those investors only who have asked for them for opening their accounts with Matsui Securities Co., Ltd.

○ **Data for Recommendation Against Shinsei Securities Co., Ltd.**

The person A, who belonged to parent company etc., took up a new post at Shinsei Securities Co., Ltd. (General Manager) in July 2005, and then he brought many customers' lists of parent company etc. to Shinsei Securities Co., Ltd.
These customers lists included many pieces of special information of customers of aren't company etc., including data on outstanding borrowings of customers, which he could obtain as he was an employee of parent company etc.,

In June 2005, Deputy General Manager B visited a branch of parent company etc., had a meeting with an employee of the branch, and orally asked the employee to send a "list of customer companies" direct to Deputy General Manager B by e-mail. On the same day, Deputy General Manager B received an e-mail, and read the content of the e-mail at a later day.

The "list of customer companies" contained pieces of information on outstanding borrowings etc. of customer companies by sales person of the branch, many of which were deemed to such special information of customer companies that Deputy General Manager B could know in the capacity of an employee of parent company etc.

Above-mentioned two employees and other two employees received non-disclosed information of customers by transferring the data contained in PCs of parent company etc. to PCs of Shinsei Securities Co., Ltd.

○ **Data for Recommendation Against ORIX Asset Management Corporation**

Cases That Examination etc. Were Not Properly Made When Real Estate Was Acquired

Acquisition of Illegally-Built Building

ORIX Asset Management Corporation acquired a building as assets of the investment corporation without conducting enough examination. For a portion of the building, a construction permit for warehouse had been obtained. The portion was converted into an

office. The total area of the office, including other unused area, was increased and used for unauthorized purpose. Therefore, the total area exceeded the applicable floor area ratio.

Acquisition of the Building Without Examining the Area of Leased Property

ORIX Asset Management Corporation acquired the building as assets of the investment corporation without measuring the area of the leased property occupied by a tenant, and leased the property to the tenant. The tenant pointed out, and it was found, that contractual area exceeds the actual one by approximately 55m^2.

Acquisition of the Building Based on Inadequate Appraisal

ORIX Asset Management Corporation has a rule that an appraisal report must be obtained from an outside appraisal company before acquiring real estate. To improve the objectivity of appraisal price made by an appraisal company, ORIX Asset Management Corporation asks another company to prepare an engineering report (concerning the conditions of buildings and equipment) and to submit it to the appraisal company. Although ORIX Asset Management Corporation received an engineering report as mentioned above, ORIX submitted to the appraisal company the old engineering report that ORIX received from the seller of the property and a tentative engineering report, and asked the appraisal company to compute an appraisal price of the property. Then, ORIX acquired the property as assets of the investment corporation at the appraisal price.

Acquisition of the Property with PCB-Containing Equipment

A condenser located in the premises contained polychlorinated biphenyl (PCB) as hazardous substance. Under the Special Measures Law for the Proper Treatment of PCB, the former owner was responsible for submitting a report on the existence of PCB and disposing it. However, when acquiring the property as assets of the investment corporation, ORIX Asset Management Corporation didn't know the regulations of the Law and submitted a report that the PCB-containing equipment would be managed by the investment corporation. In addition, ORIX assessed the cost of disposing PCB.

Introduction of Chairman and Commissioners

Chairman **Takeo Takahashi**

Before his appointment as commissioner of the SESC (1998), Mr. Takahashi served as chief prosecutor of the Tokyo District Public Prosecutors Office (1995-1997) and superintending public prosecutor of the Fukuoka High Public Prosecutors Office (1997-1998). In July 2001, he was appointed chairman of the SESC.

Commissioner **Teruko Noda**

Ms. Noda was appointed commissioner of the SESC in July 2001. Before being appointed to the commission, she served as a partner of Chuo Audit Corporation (now MISUZU Audit Corporation).

Commissioner **Takehiko Mizushiro**

Mr. Mizushiro was appointed commissioner of the SESC in July 2004. Before being appointed to the commission, he served as a senior commentator of Japan Broadcasting Corporation.

Securities and Exchange Surveillance Commission

3-1-1 Kasumigaseki, Chiyoda-ku, Tokyo 100-8967, Japan

Tel : +81(3)3581-7868

Fax : +81(3)3581-9846

Website : http://www.fsa.go.jp/sesc/english/index.htm