# Annual Report 2008/2009

Securities and Exchange Surveillance Commission

JAPANESE GOVERNMENT

# Message from the Chairman

The Securities and Exchange Surveillance Commission (SESC) is carrying out its mission of ensuring fairness and transparency of the Japanese markets and protecting investors.

The progress of the globalization of financial and capital markets in recent years has been tightening the linkage among the financial and capital markets around the world, including those in Japan. This has accelerated problems associated with subprime loans issue that has turned into financial crises that affect the entire world.

Recognizing the need to respond quickly and flexibly to the instability caused by this increase of global financial unrest, the SESC has been working to enhance its surveillance of any market misconduct that takes advantage of the current market turmoil, and to strengthen its international alliances with other countries.

Regarding the aspect of legal systems, the implementation of the Act for the "Amendment of the Financial Instruments and Exchange Act (FIEA)" in December 2008 has expanded the scope of administrative monetary penalties investigation and disclosure documents inspection. As is evident, the expected roles of the SESC in market oversight have been increasing more and more. And furthermore, the SESC will continue to optimize the effects of the authority and functions given to it and will seek to develop a more,responsive and effective surveillance system so as to protect investors.

Since sound market operation requires shared recognition of problems and close information exchange with self-regulatory organizations and relevant authorities, the SESC will further strengthen its cooperative relationship with such organizations.

Responding to the changing environments in the markets and revision of the regulatory systems, the SESC will do its utmost to establish fair, highly transparent and healthy markets and maintain the trust of investors. We would like to "assert an intimidating presence against those reckless parties impairing the fairness of the markets, and become a dependable supporter for decent investors."

October 2009

Kenichi SADO
Chairman
Securities and Exchange Surveillance Commission

# Annual Report 2008/2009

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# 1. Market Surveillance

## 1) Outline

The Securities and Exchange Surveillance Commission (SESC) conducts market surveillance in which it extensively collects and analyzes various materials and information related to financial and capital markets on daily basis. Through market surveillance, the SESC investigates suspected cases of market misconduct and analyzes market trends.

Through the broad-based supervision of transactions in financial and capital markets, the SESC aims to ensure the fairness of trading in these markets.

A feature of business year (BY) 2008 was the launch of "Compliance WAN" in January 2009. Compliance WAN (Wide Area Network) is a system that connects nationwide securities companies, national securities exchanges, the Japan Securities Dealers Association (JSDA), the SESC and the local finance bureaus with a dedicated line, and which electronically transfers the transaction data. The use of "Compliance WAN" is in line with the efforts for the "enhanced cooperation with self-regulatory organizations," which is one of the priority measures of the SESC.

Another feature of BY 2008 is that the SESC has strived for "comprehensive and timely market oversight," which is another priority measure, as demonstrated by the market surveillance focused on both primary and secondary markets, and by the close watch on a broad range of transactions that would not necessarily be considered illegal. In recent years, market misconduct has been seen not only as conventional transactions in the secondary markets, but also as transactions closely linked to the primary markets. Consequently, the collection of information from a wide view, and an approach of analyzing a variety of events in the market from various angles and aspects are becoming more and more essential.

## 2) Receipt of Information from the General Public

### 1. Outline of the Receipt of Information

The SESC receives wide-ranging information from the general public as a part of its collection of materials and information.

Information received from the general public reflects candid opinions of investors in the markets. Such information is highly useful, because it often leads the SESC to launch market surveillance, inspections of financial instruments business operators, administrative monetary penalty investigations, inspections of disclosure documents, and investigations of criminal cases.

For this reason, the SESC uses a variety of means, including telephone, letter, visitation, and the internet, to receive information from as many people as possible.

The SESC has also made positive efforts to increase the number of contacts for information submission, such as calling for information from the general public through government bulletins and lecture meetings.

Information provided on problems between a financial instruments business operator and an investor is effectively utilized in inspections and others by the SESC. Furthermore, if an information provider seeks individual settlement of a conflict, the SESC deals with it such as by referring them to the Securities Mediation and Consultation Center, which is a system for handling complaints within the JSDA.

In addition, the SESC introduces appropriate consultation services to people who have

complaints about commodity futures trading or other products that do not fall under the jurisdiction of the SESC.

## 2. Receipt of Information

In BY 2008, the SESC received 6,412 pieces of information from the general public. This was an increase of approximately 10% compared to BY 2007 (5,841), and it was the third largest amount of information received since the inception of the SESC in 1992.

Looking at the breakdown of the means used in providing information, there were 3,847 contacts via the internet, 1,253 by telephone, 384 in writing, 67 visitations, and 861 referrals from the local finance bureaus, meaning that the internet accounted for approximately 60% of all receipts of information.

In terms of the substance of information, 4,789 cases were related to individual stocks, 1,038 cases were related to sales practices and other issues of financial instruments business operators, and 585 cases were opinions on other matters.

Among the cases related to individual stocks, suspicions of market manipulation ranked highest (1,975 cases), making up approximately 30% of all cases. This figure is indicative of widespread doubts among investors as to the formation of stock prices in the markets. The second-largest group was related to the suspicious spreading rumors, representing approximately 10% (814 cases) of all cases. Such information was, for the most part, related to unfounded rumors, investment decisions or other tips posted on internet bulletin boards and the like. Much information was also received on suspected insider trading and on annual securities reports, etc. containing suspected false statements.

Diverse information was also provided in connection with cases related to sales practices and other issues of financial instruments business operators, including unauthorized transactions and inappropriate solicitations in light of the customer's knowledge.

## 3. Review of Public Appeals for Information

As stated previously, information contributed from the general public is quite helpful, because it often leads the SESC to launch market surveillance, inspections of securities companies, administrative monetary penalty investigations, inspections of disclosure documents, and investigations of criminal cases. Given this, during BY 2008, in an effort to increase the number of contacts for information submission, the SESC continued to appeal to the public for information by utilizing lecture meetings, the internet and other means. In particular, during BY 2008 – given that the SESC was conducting market surveillance focused on both primary and secondary markets, and given that, with respect to the inspection of securities companies, the SESC was tending to enhance verifications focused on financial soundness and risk management systems while maintaining a basic approach of verifying legal compliance systems – in order for the SESC to collect information from a wide view and to analyze a variety of events in the market from various angles and aspects, the SESC reviewed its public appeals for information as follows.

(1) Review of Information Called for Submission

[Cases related to individual stocks]

In addition to information called for in the past, namely:

- Suspicions of market manipulation (Misegyoku (false orders), short selling, etc.);
- Suspicions of insider trading (selling off of stocks by a corporate insider prior to

publication of material facts, etc.);

- Suspicions of spreading rumors (false rumors through posts to online bulletin boards, blog entries or email magazines, etc.); and
- Suspicious disclosure (annual securities reports, large shareholding reports, timely disclosure, IR, etc.),

the SESC decided to explicitly call for information on the following:

- Suspicious financing (fictitious capital increases, suspicious allottees, etc.); and
- Overall problems for corporate activities, including internal control and corporate governance.

[Cases related to financial instruments business operators]

In addition to information called for in the past, namely:

- Suspicions of wrongful acts by financial instruments business operators (securities companies, management firms, FX firms, etc.) (unsolicited sales, inadequate explanation of risks, system-related problems, etc.),

the SESC decided to explicitly call for information on the following:

- Compliance-related problems of financial instruments business operators (internal control systems likely to permit the wrongful acts of officers and employees); and
- Problems related to the financial soundness, or risk management or other business management systems of financial instruments business operators (calculation of capital adequacy ratio, risk management, customer asset segregation, etc.).

[Other cases]

For the first time, the SESC also decided to explicitly call for information on the following:

- Suspicious financial instruments and funds (fraudulent fund-raising schemes);
- Unregistered business operators (investment advisory/agency business operators, FX firms, etc.);
- Unlisted shares (fraudulent investment shares); and
- Market participants who are likely to impair the fairness of markets (speculator groups, etc.).

(2) Review of the SESC Brochure

With regard to the SESC brochure, as well having the appeal for information from the general public highlighted on the back cover, in terms of actual guidance, in light of the review outlined in (1) above, the SESC decided to describe information called for submission more clearly as it is seeking.

(3) Review of the SESC (Japanese) Website

With respect to the guidance provided in the SESC Japanese website which calls for information on suspected market misconduct in light of the review outlined in (1) above, as well as describing more clearly the information sought by the SESC, improvements were also made to the way in which the notes and other precautions are stated. Revisions were also made to the data entry form.

Going forward, the SESC plans to overhaul its entire website and update its posters calling for the submission of information.

(4) Appeals to Various Associations

In October 2008, the SESC sent requests to the JSDA, the Investment Trusts Association, the Japan Securities Investment Advisers Association, and the Financial Futures Association of Japan (FFAJ), asking for links to the SESC Japanese website which calls for information on suspected market misconduct to be established on the websites of their respective members. In response to this request, each of the associations issued notices to their respective members, resulting in more than 170 additional companies establishing links on their websites.

The SESC is also making broad appeals for information such as by making use of materials when engaging in dialogue with, or disseminating information to, market participants or individual investors during lectures, meetings for the exchange of views and other such occasions.

## 3) Market Oversight

### 1. Outline of Market Oversight

In market oversight, the SESC first extracts the following kinds of stocks based on its routine oversight of market trends and on information obtained from various sources. The SESC then requests financial instruments business operators to provide detailed reports or submit materials in relation to the securities transactions.

(1) Stocks showing sharp rises or declines in price or other questionable movements
(2) Stocks for which "material facts" have been published which may have a significant influence on investors' investment decisions
(3) Stocks that are the topic of conversation in newspapers, magazines or on the internet bulletin boards
(4) Stocks mentioned in information obtained from the general public

Next, based on these reports and materials, the SESC investigates suspected transactions of market manipulation, insider trading and other transactions that impair the fairness of the markets. At the same time, the SESC examines whether the financial instruments business operators involved in these transactions have committed any questionable acts such as violating regulations prohibiting them from doing certain acts.

If these examinations reveal any suspicious transactions, they are reported to the SESC's relevant divisions for further investigation.

In addition to the above, the SESC also requests financial instruments business operators and other related persons to submit reports or materials relating to the following: new financial products designed to meet growing needs for new investment instruments; new products incorporating complicated financial derivatives; and new transaction methods. Based on these reports and materials, the SESC conducts detailed analyses if a more complete understanding of the true nature of the new products and methods is required.

### 2. Legal Basis

In market oversight, when the SESC finds it necessary and appropriate for ensuring fairness of financial instruments trading and protecting investors, it requests financial instruments business operators and other related persons to submit reports and materials on securities transactions. The authority delegated to the SESC is prescribed in the Financial Instruments

and Exchange Act (FIEA).

### 3. Market Surveillance Targeting Primary and Secondary Markets

With respect to capital increases through the allocation of shares to a third-party and other types of financing by listed companies, in recent times, there have been various problems, including frequent large-scale capital increases resulting in the dilution of the rights of existing shareholders, and concerns of the involvement of anti-social forces and the like underlying the capital increases. Statutory disclosure and the response of exchanges to such problems as the allocation of shares to a third-party were included in discussions on the corporate governance of listed companies which were held by the Financial Services Agency's (FSA) Study Group on the Internationalization of Japanese Financial and Capital Markets. The study group's report "Toward Stronger Corporate Governance of Publicly Listed Companies" was published in June 2009. The Tokyo Stock Exchange's (TSE) Advisory Group on Improvements to TSE Listing System also coordinated discussions on environmental developments aimed at improving the corporate governance of listed companies, including proposals related to capital increases through the allocation of shares to a third-party, and its report, "For Creating a Better Market Environment where Investors Feel Secure," was published in April 2009.

Related to this kind of financing, there are some cases which are now being suspected of market manipulation, insider trading and other market misconduct in secondary markets, and of suspected false disclosure and use of fraudulent means. In this way, recently, market misconduct has not been limited to merely conventional transactions in the secondary markets: market misconduct closely linked to the primary markets is now also being observed. In response, the SESC is collecting information from a wide range of angles, and is analyzing a variety of events in the market from various angles and aspects.

In its statement, "Towards Enhanced Market Integrity," announced in September 2007, the SESC highlights directing attention toward both the primary and secondary markets. As well as further strengthening cooperation with the listing management and listing review divisions of self-regulatory organizations, the SESC is making efforts to further enhance its market surveillance targeting primary and secondary markets, such as by sharing information and exchanging views with various FSA departments on problems originating in the primary markets.

### 4. Close Cooperation with Self-Regulatory Organizations

Day-to-day market surveillance activities are also conducted by self-regulatory organizations such as financial instruments exchanges and financial instruments firms associations. Their surveillance activities have a function of checking whether market participants are carrying out their business operations in an appropriate manner. As financial and capital markets are becoming more complex and sophisticated in recent years due to the emergence of new financial instruments and transaction methods, the market surveillance activities by self-regulatory organizations are becoming increasingly important. Therefore, the SESC cooperates closely with these self-regulatory organizations by communicating regularly or as needed, and also by making inquiries about the facts.

A recent example of cooperation with self-regulatory organizations in market oversight is the use of the "Compliance WAN" (since January 2009). Another is the revisions that were made by the JSDA in October 2008 to its "Regulations Concerning Establishing a Sale and Purchase Management System for the Prevention of Market Misconducts," requiring members of the

JSDA to report to the SESC and the JSDA if they become aware of a possibility of insider trading. As a consequence of these revised regulations, reports have been coming in to the SESC since April 2009, and the SESC has been making use of them in its market oversight over insider trading.

## 5. Results of Market Oversight

### (1) Results of Market Oversight

In BY 2008, the SESC conducted its market oversight activities, broadly classified into the following categories, in an efficient and flexible manner pursuant to the policy of promptly taking initial actions for speedy settlement.

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

The number of cases of oversight conducted by the SESC and the local finance bureaus are as follows.

| Number of oversight cases | | BY 2008 | BY 2007 |
|---|---|---|---|
| Total | | 1,031 | 1,098 |
| | SESC | 493 | 598 |
| | Local finance bureaus | 538 | 500 |
| (Breakdown of oversight items) | | | |
| Price formation | | 132 | 141 |
| Insider trading | | 889 | 951 |
| Other aspects | | 10 | 6 |

The SESC and the local finance bureaus conduct day-to-day surveillance of trading in the markets based on overall market movements, and as part of this, examine particular transactions as necessary.

In market oversight, in addition to collecting associated information, the SESC and local finance bureaus clarify the facts by analyzing actual individual transactions that are conducted in the markets. The amount of time and work required for examination varies depending on each particular case.

Although fluctuations in the number of oversight cases can be observed, the SESC continues to implement strict day-to-day market surveillance, and is committed to ensuring the fairness of trading in the markets.

### (2) Main Cases Examined

The main cases examined during BY 2008 were as follows.

(i) Examples of reasons for conducting oversight related to price formation:
  (a) The share price and traded volume of Company A rose sharply without any particular reason.
  (b) The share price and traded volume of Company B rose sharply without any

particular reason, and there was a rumor within the securities industry of intervention by a specific person.

(c) Information was provided on the suspicion of share price manipulation by a specific person in relation to the stock of Company C.

(d) A specific person was repeatedly placing and cancelling questionable orders. The SESC examined transactions relating to the stocks of Company D and other companies which had been bought and sold by this person.

(ii) Examples of reasons for conducting oversight related to insider trading of shares prior to an announcement:

(a) The share price of Company F soared after an announcement by Company E that it would make a tender offer for Company F shares. The SESC examined transactions of Company F shares prior to the announcement.

(b) The share price of Company G soared after it announced a business alliance involving a capital tie-up.

(c) The share price of Company H soared after it announced that it would acquire treasury stock.

(d) The share price of Company I plummeted after it announced that it had filed for commencement of civil rehabilitation proceedings.

(e) The share price of Company J soared (plummeted) after it announced an upward (downward) revision of its expected dividend.

(f) The share price of Company K soared (plummeted) after it announced an allocation of shares to a third-party.

(iii) Examples of reasons for conducting oversight related to other aspects:

(a) The share price of Company L fluctuated considerably after it made an announcement concerning a capital increase through the allocation of shares to a third-party. There were also misgivings about how the funds would be used. The SESC conducted oversight from the perspectives of the spreading rumors and the use of fraudulent means.

(b) The share price of Company M fluctuated considerably after it made an announcement concerning a business alliance for the purpose of expanding into a new business. Information was also provided by an ordinary investor expressing doubt as to the feasibility of the matters announced. The SESC conducted oversight from the perspectives of the spreading rumors and the use of fraudulent means.

**6. Use of "Compliance WAN"**

In the past, transferring transaction data with securities companies for market oversight meant the SESC and the local finance bureaus using fax machines or other means to send requests for the submission of necessary transaction data, and the securities companies submitting transaction data by email or by mailing floppy disks or written documents. A lot of feedback was received from securities companies on these methods of sending data, including the risk of personal information being leaked, and the increasing administrative burden related to the procedures for forwarding data. The work involved in receiving submitted transaction data and the work involved in returning floppy disks and so forth were also increasing for the

SESC and the local finance bureaus as well.

It was amid these circumstances that the summary of issues (June 2006), compiled by the Consultative Council on Market Intermediary Function of Securities Companies, which had been established by the FSA Supervisory Bureau earlier in March of that year, stated: "From the perspective of pushing ahead with such matters as reviewing the form of electronic data and constructing a WAN for exchanging information on market misconduct quickly and smoothly between market participants (including the authorities), detailed examinations need to be conducted, led by the JSDA and securities exchanges." In view of this, detailed examinations were advanced, led by the JSDA and securities exchanges, resulting in the form of submitting transaction data – which, to that point, had varied among securities exchanges – becoming standardized on April 1, 2008.

Furthermore, the new "Compliance WAN" system began its operation on January 26, 2009. The SESC and the local finance bureaus, as well as the TSE and its general trading participants started using the system on this date; and other securities exchanges, the JSDA and other securities companies on the TSE that are not general trading participants also began using the system from April 2009. Also, the individual messaging function in the Compliance WAN came online on June 1, 2009. As well as enabling data other than transaction details to be received from securities companies, individual messaging means that data can now also be exchanged between the SESC and the local finance bureaus, and securities exchanges and the JSDA.

The new "Compliance WAN" system uses a dedicated line connected to the network nationwide securities companies with national securities exchanges, the JSDA, the SESC and with the local finance bureaus, and electronically transfers the transaction data. Transaction data used to be submitted by floppy disks, email and various other means; but by unifying these means into a single method utilizing a highly secure dedicated network, the Compliance WAN has the following advantages:

(i) the risk of personal information being leaked and the risk of storage media being lost in the transfer of transaction data are reduced;
(ii) a reduction in the amount of time needed to request submissions and process receipts of transaction data leads to more efficient market oversight activities; and
(iii) for securities companies as well, leads to a reduction in costs involved in the submission of transaction data.

### 4) Market Trend Analysis

Based on the perspective of identifying any risks inherent in financial systems as quickly as possible, and effectively allocating administrative resources to dealing with priority issues, the SESC conducts timely analyses of any new movements across financial and capital markets, such as new financial products and new transaction methods (market trend analysis). It identifies the background events to individual transactions, and makes use of this in the SESC's market surveillance.

The results of these analyses are shared among the SESC and the local finance bureaus, and where necessary, information is now also being provided to relevant FSA departments.

[Main analysis cases]

The main cases analyzed by the SESC in BY 2008 were as follows.

(a) Analysis of the incidence of failed in delivery or settlement before and after the strengthening of short selling regulation

With respect to the regulation of short selling, from the perspective of ensuring the fairness of trading in the markets, naked short selling (short selling without borrowing shares at the time of selling) has been prohibited since October 30, 2008. Furthermore, in order to fulfill the requirement of verifying whether transactions are short selling, and to ensure the effectiveness of the prohibition of naked short selling, an obligation to verify settlement measures and other matters has been imposed on securities companies since December 16, 2008. Throughout the process of strengthening short selling regulation, the SESC conducted analyses on the types of changes that could be observed in the incidence of failed in delivery or settlement.

(b) Analysis of CFDs

A contract for difference (CFD) is a transaction which regards an individual listed stock and others as reference asset, where a customer deposits a margin with a dealer equal to a certain percentage of the contracted sale price, and where the customer receives the difference between the price of reference asset at a time of settlement optionally chosen by the customer and the price of reference asset previously agreed upon by the parties to the contract. The SESC identified the scale and actual state of CFD trading, and conducted an analysis both from the perspective of the effects of CFDs on the markets and the monitoring of market misconduct.

(c) Analysis of PIPEs

A private investment in public equity (PIPE) is a technique in which an investment fund makes an investment by negotiating with a listed company over conditions of a capital increase through the allocation of shares to a third-party and others. Unlike a management buyout (MBO) which is premised on the delisting of the company's shares, a PIPE enables the achievement of such purposes as capital build-up, sponsor discovery and other management improvements, successor policy, business succession and so forth while avoiding the delisting of the company. The SESC verified individual PIPE cases and conducted analysis from the perspective of market surveillance.

(d) Analysis of CDSs

A credit default swap (CDS) is a type of transaction in which credit risk is transferred. Its economic effects and transaction structure resemble a financial guarantee. Although the global balance of CDSs rose rapidly from approximately 8 trillion dollars at the end of 2004 to approximately 62 trillion dollars at the end of 2007 (Note), since CDSs are not traded at exchanges, their true state is obscure. CDSs, in particular the credit risk, counterparty risk and systemic risk of CDSs, have even been the subject of discussion at G20 meetings and other international occasions. The SESC is also interested in CDSs, primarily in terms of market misconduct such as insider trading and market manipulation. Since October 2008, the SESC has interviewed about 20 companies, including securities companies, banks, law firms, auditing firms and information vendors. As well as gaining an understanding of the current situation of CDS trading, the SESC analyzed and examined conceivable market misconduct and their possibility.

(Note) Source: International Swaps and Derivatives Association (ISDA).

### 5) Future Challenges

Market surveillance fulfills a point-of-contact function of the SESC, conducting day-to-day market surveillance, and collecting and analyzing information. Since the outcomes of market surveillance affect the success or otherwise of the ensuing inspections of securities companies, administrative monetary penalty investigations, criminal case investigations and so forth, not only will it be necessary to respond to market changes in a timely and flexible manner, but prompt and effective market surveillance will need to be conducted, aiming for a responsive approach that also provides against emerging risks. To this end, as well as working to collect and analyze information and to enhance and strengthen the system of market oversight, without limiting itself to collecting and analyzing market information related to market misconduct, the SESC must also identify market trends from a wide range of angles, and must continue to conduct market surveillance based on a forward-looking approach focused on future risks. Furthermore, the SESC will further strengthen its cooperation with self-regulatory organizations and the like, and will raise the effectiveness of its market surveillance as a whole.

The SESC will contribute to the rule-making and system-development processes of the FSA and other relevant authorities by utilizing policy proposals to reflect the challenges it identifies through its market surveillance activities such as market oversight and market trend analysis. Furthermore, in terms of strengthening market discipline, the SESC needs to actively appeal to individual market participants, such as through self-regulatory organizations, to encourage their self-discipline for market integrity. To achieve this, it is essential that dialogue with market participants and the provision of information to the markets be strengthened.

In terms of enhancing cooperation with overseas regulators, as trading becomes more and more computerized and as cross-border transactions become increasingly active, the SESC will also actively cooperate with overseas regulators and will step up its efforts to prevent loopholes in market surveillance. This includes communication utilizing the multilateral framework for facilitating exchanges of information between securities regulators (Multilateral MOU), and reinforcement of its surveillance of international electronic trading.

Looking at the primary markets for a moment, in recent years, capital increases through the allocation of shares to a third-party and other types of financing have been observed where the identity of the allottee is unclear and there are fears of the involvement of anti-social forces, or where the rights of existing shareholders end up becoming significantly diluted. Moreover, these kinds of questionable financing in the primary markets often lead to problems in terms of ensuring fairness and transparency in the secondary markets, such as inducing market manipulation, insider trading or other types of market misconduct. In light of the arguments put forward by the FSA's Study Group on the Internationalization of Japanese Financial and Capital Markets and by the TSE's Advisory Group on Improvements to TSE Listing System, the SESC will need to remain committed to ensuring the effectiveness of its market surveillance targeting primary and secondary markets.

The revised FIEA, which came into effect in December 2008, allows for the creation of exchanges which limit participants to professional investors. Consequently, in June 2009, as a joint venture with the London Stock Exchange, the TSE established "TOKYO AIM," a market for professional investors. As a place for professional investors to trade based on the principle of self-responsibility, the aim of this market is to raise the attractiveness of Japan's markets as places for financing and investment. One attraction is the flexible treatment of statutory

disclosure regulation. However, even though it is a market for professionals, in the administration of the market, there are strong demands for the guarantee of market transparency and fairness. With a mind toward ensuring market transparency and fairness based on the characteristics of this kind of market for professionals, the SESC will work to strengthen further cooperation with self-regulatory organizations, and will strive for effective market surveillance.

## 2. Inspections of Securities Companies and Other Entities

### 1) Outline

The Securities and Exchange Surveillance Commission (SESC) conducts on-site inspections of financial instruments business operators and others entities based on the authority delegated by the Prime Minister and the Commissioner of the Financial Services Agency (FSA) under the Financial Instruments and Exchange Act (FIEA) and other laws, to check their compliance with rules and regulations for ensuring fairness in financial instruments trading and their financial soundness.

Following its inception in 1992, the SESC has conducted inspections to ensure fairness in trading. Furthermore, since July 2005 when the revised Securities and Exchange Act (SEA) etc. came into force to reinforce market surveillance functions, the scope and objects of inspection have been significantly expanded. Specifically, the authority to inspect financial soundness of securities companies, financial futures dealers, and others and the authority to inspect investment trust companies and others, formerly conducted by the Inspection Bureau of the FSA are now delegated to the SESC. At the same time, under the revised Financial Futures Trading Act (FFTA), companies dealing with foreign exchange margin trading (FX) have also included to be inspected and regulated as a sort of financial futures dealers.

The coverage and scope of inspection has further expanded since the FIEA (reorganized and succeeded the SEA) came fully into force in September 2007. As a cross-sectional laws for investor protection, the new FIEA aims at keeping up with changes surrounding the financial and capital markets, ensuring investor protection and user convenience, enhancing market functions which encourage the flow of savings into investments, and adjusting to the globalization of financial and capital markets. To be more specific, the FIEA expanded regulatory coverage where the new definition of "securities" includes rights under partnership agreements etc, and a cross-sectional definition of "financial instruments business" covers investment advisory service, investment management service, and custody service as well as selling and soliciting securities and financial derivatives. Consequently, regulated entities are expanded to those engaged in the sale or solicitation of units in collective investment schemes (funds) and those engaged in the investment management of primarily securities or financial derivatives in these funds. Furthermore, the SESC is now authorized to inspect those who undertake services delegated from financial instruments firms, financial instruments firms associations, financial instruments exchanges. In this respect as well, the SESC's scope of inspection was further expanded.

During the inspections as written above, if necessary and appropriate, the SESC also conduct those inspections under the Act on Prevention of Transfer of Criminal Proceeds (APTCP) based on the authority delegated by the Prime Minister and the Commissioner of the FSA, which aim to prevent them from being used for money laundering or other crimes by encouraging them to develop customer management systems.

The SESC delegates a part of its authority to conduct inspections and collect reports and materials to the Director-Generals of Local Finance Bureaus of the Ministry of Finance. (Where necessary, the SESC may exercise such authority by itself.)

Based on the results of these inspections, the SESC may recommend to the Prime Minster and the Commissioner of the FSA that administrative actions should be taken for ensuring the fairness of transaction, protecting investors and securing other public interests. Responding to such recommendation, the Prime Minster, the Commissioner of the FSA, the Director-General of

the Local Finance Bureau or any other competent authorities may take administrative action against the inspected entity, such as order for rescission of registration or business suspension order or business improvement order, if appropriate upon formal hearing with the inspected entity. The duties related to the registration of sales representatives are delegated from the Prime Minister to Financial Instruments Firms Associations. Therefore, when the recommendation is made against such as a sales representative of either a financial instruments business operator, a registered financial institution, or a financial instruments intermediary service provider, the Financial Instruments Firms Association to which the concerned sales representative belongs, or from any other persons may take disciplinary action, either rescinding the registration of the sales representative or suspending his/her duties, if appropriate upon hearings from members of the association.

Furthermore, since the order to improve the methods of its business a financial instruments business operator, when deemed necessary and appropriate for the public interest or for the protection of investors, is stipulated upon the enactment of Article 51 of the FIEA, the SESC conducts inspections focusing on the internal control in addition to individual violations of law.

Business year 2008 was marked by the "Lehman Shock" – the collapse of major US securities company, Lehman Brothers. Dubbed a "once-in-a-century financial crisis," it had severe repercussions on Japan's financial and capital markets as well. Such recent global financial crisis has also put pressure on manners of inspection on financial capital markets or financial business operators for further enhancements. Furthermore, as a result of a series of regulatory reforms, including revision of the FIEA, the scope of businesses inspected by the SESC has been increasing significantly. In light of these factors, the SESC launched the Project for Reviewing the Inspection Process to review the inspection process and to improve them if necessary for more efficient and more effective securities inspections. The project team held 10 meetings as well as hearings with the Japan Securities Dealers Association (JSDA) and other industry organizations to exchange views. Having gone through this process, on December 25, 2008, the SESC published a progress report "Progress of the Project for Reviewing the Inspection Process," outlining the future direction of the securities inspections. The SESC revised "Basic Inspection Guidelines" upon the preliminary conclusions of the progress report as well as its subsequent discussion in June 2009.

Moreover, in order for the enhanced short selling regulation (prohibition of naked short selling, and the reporting requirement for holders of short positions of a certain amount to the exchanges through securities companies) to be effective, the Secretary-General of the Executive Bureau of SESC issued notification on October 30, 2008 to inspectors and Local Finance Bureaus, directing that verification on short selling and systems for managing failed trades should be prioritized to strengthen the relevant verification on short selling.

Furthermore, upon the amendment of the FIEA and other laws which require the establishment of systems for managing conflicts of interest under the easing of firewall regulations, the Inspection Manual of Financial Instruments Business Operators was revised to be effective on June 1, 2009.

## 2) Basic Inspection Policy and Basic Inspection Plan

Formerly, our business year (BY) started on July 1 and ended on June 30 of the following year. From this BY, the period of BY was changed to start on April 1 and ends on March 31 of the following year. In order to conduct securities inspections systematically, the SESC and the

Directors-General of the Local Finance Bureaus develop a Basic Inspection Policy and a Basic Inspection Plan every BY.

The Basic Inspection Policy stipulates the priority items and other fundamental direction of inspection for that BY. The Basic Inspection Plan specifies the scheduled number of each type of entities to be inspected for that BY.

### 3) Revision of Inspection Manual of Financial Instruments Business Operators

#### 1. Background

The Inspection Manual of Financial Instruments Business Operators (the "Inspection Manual") formally amended in July 2008, was further revised following the partial amendment of the FIEA and other laws (the mitigation of firewall regulations and the establishment of systems for managing conflicts of interest) as well as the partial revision and establishment of rules for self-regulatory organizations (the revision of the "Regulations Concerning Establishing a Sale and Purchase Management System for the Prevention of Unfair Trading", and the establishment of the "Regulations Concerning Distribution, etc. of Securitized Products"). Revised Inspection Manual was published on May 20, 2009 after the public comment period between March 31 and April 30, and applied to inspections starts after June 1, 2009.

#### 2. Key Points of the Revisions

(1) The following checkpoints on systems for managing conflicts of interest were added:

(i) Management's effort to develop systems for identifying and managing Transaction with Potential Conflicts of Interest (TPCI)
(ii) Identification of TPCI
(iii) Development of management systems for TPCI
(iv) Formulation and publication of policies for identification and management of TPCI
(v) Retention of records concerning the identification and management of TPCI
(vi) Regular or as-needed reviews of measures for identification and management of TPCI

(2) Checkpoints were revised with regard to the appropriateness of giving corporate customers the opportunity to opt out during the exchange of undisclosed information with a parent/subsidiary corporation, etc.

(3) Checkpoints were added on sales management and examination system regarding verifying incident reports on their responses over suspected case of insider trading, which filed to the SESC and other bodies, including the results of examining such transaction and any measures that were taken against the said customer.

(4) Checkpoints related to traceability were added as follows:

(i) Development of sales systems and assurance of traceability with regard to the sale of securitized products
(ii) Status of the development of adequate underwriting and examination systems if securitized products are being arranged or underwritten.

## 4) Project for Reviewing the Inspection Process

On September 17, 2008, the SESC launched the "Project for Reviewing the Inspection Process" aimed at improving the inspection process in terms of efficiency and effectiveness. 10 discussions and meetings with the JSDA, the Investment Trusts Association, the Japan Securities Investment Advisers Association, and the International Bankers Association were held in the project. Having gone through this process, on December 25, 2008, the SESC published progress report "Progress of the Project for Reviewing the Inspection Process" indicating the future direction for the securities inspections.

### 1. Background

The following ideas were behind the launch of the "Project for Reviewing the Inspection Process".

(1) The financial capital markets in Japan face a dynamically transforming landscape. This involves changes both in market environment, with the arrival of more complex, diversified and globalized financial instruments and transactions, and also in market infrastructure, including the legislative reform in the Financial Instruments and Exchange Act (FIEA). Such changes required the SESC to achieve further efficient and effective inspections based on the mission of the SESC.

(2) In order to improve the efficiency and effectiveness of securities inspection, while taking a basic approach of verifying conducts in violation of laws and regulations, and in consideration of protection of the public interests and investors, it is also important to verify appropriateness of the underlying internal control systems, taking into account the size and characteristics of those firms.

(3) Given the recent global financial crisis, inspection of global firms should be paid more attention to their overall risk management as well as financial soundness.

### 2. Announcement of the Direction of Discussions

Based on the above perspectives, the SESC announced preliminary conclusion to improve the efficiency and effectiveness of inspections, on December 25, 2008. The measures are as follows.

- Prior notice inspection

As the inspections are not only pointing out acts that are in violation of laws and regulations but also verifying of underlying management systems, the benefit of unannounced inspections may become limited. Therefore, the SESC introduced prior notice inspections on a tentative basis in certain situations for more efficient inspections.

- Better dialogue during inspection

The SESC enhanced interactive dialogue between the inspectors and the financial instruments business operators during on-site inspections, such as meetings with management held at the beginning and conclusion of the on-site inspection (exit meetings, etc.)

Furthermore, orally feedback of the findings of the inspection shall be made as soon as possible in order to enhance interactive dialogue and transparency of administration.

- Quality control of inspection

The SESC will strengthen the support systems for the on-site inspection provided by middle offices (Office of the Inspection Administrator, etc.) and training systems for inspectors, as well as reviewing the Inspection Manual in order to ensure the quality of inspections and to unify the perspective of inspectors with respect to verifying the appropriateness of internal control systems based on the size and characteristics of the entity.

Inspection monitoring will also be enhanced to monitor the efficiency of inspection process as well as the effectiveness of inspection by checking whether dialogue has been conducted appropriately in verification of internal control systems. The SESC also enhanced off-site inspection monitoring by providing opportunity for the inspected firms to submit their opinion by means of filling out questionnaires after the conclusion of on-site inspections.

- Results of inspections

Notification of inspection results will include such description as not only an analysis of individual acts that are in violation of laws and regulations but also its analysis of the appropriateness of the underlying internal control systems and risk management systems of the inspected firms.

Furthermore, when deciding whether to make recommendations for disciplinary action, the SESC will take into account the seriousness and maliciousness of the acts or situations in violation of the laws and regulations as well as comprehensively verification of the appropriateness of the underlying management systems, while taking into account the size and characteristics of the inspected firms.

### 3. Revision of the Basic Inspection Guidelines

In light of conclusions drawn from subsequent discussion, and based on the perspective of conducting highly transparent, efficient and effective inspections, the SESC revised the "Basic Inspection Guidelines," which specify basic inspection items and procedures for implementing inspection to be applied for future inspections.

Highlights in the revised Guidelines

- The chapter on "Mission of Inspections" was revised to stipulate that the inspection shall also conducted for the verification of internal control and risk management systems in addition to that of compliance with laws and regulations. The list of practical checkpoints is also added.
- Trial introduction of prior notice inspections
- Enhancement of inspection support function through the Inspection Administrator's Office (responding to inquiries from the inspection team during on-site inspections, on-site monitoring and supports for the inspection team, instructions for amendment to the duration of on-site inspections, etc.)
- Enhancement of interactive dialogue with the senior management of the inspected entities (exit meeting etc.)
- Enhancement of the inspection monitoring system by providing opportunity for the inspected firms to submit their opinion by means of filling out questionnaires format
- Preparation of a "List of Materials to be Submitted" for each type of business operator as a standard example of materials to be submitted at the beginning of inspections

## 5) Results of Inspections

In BY 2008, the SESC commenced inspections of 117 Type I financial instruments business operators, 25 registered financial institutions, 1 Type II financial instruments business operator, 15 investment management business operators, 58 investment advisory and agency business operators, 7 investment corporations, and 5 self-regulatory organizations.

## 6) Thematic Inspection

The Electronic Share Certificate System was implemented on January 5, 2009. The shift to electronic share certificates is an institutional reform for securities settlement, whereby the management of shareholders' rights – which had previously been premised on the existence of actual share certificates – is recorded electronically in the accounts of securities companies and so forth. This system brings improvements in safety, efficiency and convenience to shareholders and other market participants.

Aimed at a smooth transition, the SESC has verified the status of development of systems of the securities companies that were headed to be the record-keeping organizations through its normal inspections during BY 2008. Specifically, the SESC verified management's initiatives for risk management, risk management systems relating to the transition, and their contingency plans.

That was the first effort for the SESC to conduct verifications related to so-called "system development projects" designed for this type of transition to electronic share certificates, since the SESC had conducted verifications of the IT risk management systems of securities companies.

From the end of August through to October 2008, the SESC and the surveillance divisions at Local Finance Bureaus commenced inspections for a total of 43 securities companies. Through these inspections, the SESC encouraged swift improvements of the problems identified while cooperating with the FSA and self-regulatory organizations in order to a smooth transition on January 5, 2009.

## 7) Summary of Inspection Results

### 1. Inspections of Type I Financial Instruments Business Operators

In BY 2008, inspections were completed for 145 Type I financial instruments business operators and other entities (meaning type I financial instruments business operators (former domestic securities companies, former foreign securities companies, former financial futures dealers) and registered financial institutions; the same shall apply hereinafter in this chapter), and problems were found in 70 of them. Of these, 13 business operators had problems related to market misconduct, 17 had problems related to investor protection, 27 had problems related to financial soundness or accounting, and 38 had problems related to other business operations.

The main problems identified are to be explained later.

(Of these problems, those for which the SESC issued recommendations are detailed in "1. Recommendations Based on the Results of Inspections of Type I Financial Instruments Business Operators" in part 8 of this chapter. Regarding the other problems, although no

recommendations were issued, the SESC notified the relevant financial instruments business operators of the detected problems.)

**2. Inspections of Type II Financial Instruments Business Operators**

In BY 2008, inspections were completed for three Type II financial instruments business operators, and problems were found in one entity related to investor protection.

(The SESC issued recommendations for this problem, and details can be found in "2. Recommendations Based on the Results of Inspections of Type II Financial Instruments Business Operators" in part 8 of this chapter.)

**3. Inspections of Investment Management Business Operators and Investment Advisory and Agency Business Operators**

In BY 2008, inspections were completed for 70 investment management business operators and investment advisory and agency business operators, and problems were found in 39 of them. Two business operators had problems related to market misconduct, 25 had problems related to investor protection, one had problems related to financial soundness or accounting, and 20 had problems related to other business operations.

The main problems detected are as below.

(These problems for which the SESC issued recommendations are detailed in "3. Recommendations Based on the Results of Inspections of Investment Management Business Operators and Investment Advisory and Agency Business Operators" in part 8 of this chapter.)

**4. Inspections of Financial Instruments Brokers**

In BY 2008, inspections were completed for one financial instruments broker, and problems related to business operations were found.

(The SESC issued recommendations for this problem, and it is detailed in "4. Recommendations Based on the Results of Inspections of Financial Instruments Brokers" in part 8 of this chapter.)

**5. Inspections of Self-Regulatory Organizations**

In BY 2008, inspections were completed for one self-regulatory organization, and problems related to market misconduct and other business operations were found.

(Although no recommendations were issued regarding the problems, the SESC did notify the self-regulatory organization.)

## 8) Recommendations Based on the Results of Inspections

**1. Recommendations Based on the Results of Inspections of Type I Financial Instruments Business Operators**

**(1) Registration of a financial instruments business under the false statement, and deficient capital adequacy ratio (under 120%), etc.** [Application of Article 52(1)(iii), (v) and (vi), and application of Article 198-6(x) of the FIEA; violation of Article 43-3(1) and Article 46-6(1) and (2) of the FIEA]

(i) Registration under the false statement

In November 2007, **Asset Company Inc.** applied for registration as a type I financial instruments business operator pursuant to Article 31(4) of the FIEA. However, the company has not meet the requirement of net assets and capital adequacy ratio at the end of September 2007, while Article 29-4(1)(v)(b) and Article 29-4(1)(vi)(a) of the FIEA requires net assets (50 million yen) and capital adequacy ratio (120%) for registration.

Thereupon, the company manipulated its balance sheets and profit and loss statements (Article 10(1)(i) of the Cabinet Office Ordinance regarding Financial Instruments Business, etc. (FIB Cabinet Office Ordinance)) for the end of September and the end of October 2007. The company also stated false matters in the document calculating net assets (Article 10(1)(ii)(a)) and in the document calculating the capital adequacy ratio (Article 10(1)(iii)(b)). The company then applied for registration as a person for which the conditions for refusal of registration are not applicable. The company obtained registration as a type I financial instruments business operator on November 28, 2007.

(ii) Deficient capital adequacy ratio (less than 120%)

(a) The company's capital adequacy ratio was below 120% throughout the period from the date of the application for registration (November 2, 2007) until the inspection (May 30, 2008). The company's net assets were also less than 50 million yen throughout the same period.

(b) However, no report which is required in case the ratio under 140% was submitted by the company despite that the ratio based on Article 46-6(1) of the FIEA had been below 140% during the period from the date of the application for registration until inspection. Moreover, false reports which were required every month were submitted stating that its capital adequacy- ratio was satisfying the 120% requirement.

(c) In response to the order based on Article 56-2(1) of the FIEA, the company has been submitted monthly report regarding capital adequacy ratio and support documents such as (a) trial balances for every month, and (b) customer deposit balances.

However, both of these documents contained false statements; (a) during the period from November 2007 to April 2008 and (b) during the period from February to April, 2008.

(iii) False on separate management between own property and customer belongings.

The company claimed that it was separately managing its customer property, such as customer deposit and equivalent amount of realized/unrealized gains and losses related to foreign exchange margin trading, by depositing specified bank account and by depositing with the counterpart of cover transaction (hereinafter referred to as the "amount of separate management" in this section (1)). However, deficit amount of separate management has been deposited from December 14, 2007 until May 30, 2008 (the base date of inspection).

- Date of recommendation: August 1, 2008
- Target of recommendation: The company
- Details of the administrative actions
  - (i) Rescission of registration
  - (ii) Dismissal of the representative director
  - (iii) Business improvement orders ((a) To close customer transactions quickly, refund customers property, and to sustain company asset, (b) To take all possible measures for the customers protection and fairness among customers, (c) To thoroughly inform customers of the rescission of registration, such as displaying at company's office and posting on its website, and to take care of the customer appropriately)

**(2) Insufficient management of electronic data processing systems** [Application of Article 123(xiv) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

○ **Tokiwa Investments Inc.** conducts internet-based foreign exchange margin trading (FX trading). Then the maintenance, management and other tasks regarding its electronic data processing systems related to FX trading (hereinafter referred to as the "systems" in this section (2)) were entirely entrusted to another entity. Therefore the company was unable to identify or manage its system failures.

The SESC verified the system failures at the company and found that no less than 30 system failures had occurred during the 16 months from the start of the operations until the inspection. Several failures had a critical impact on customer transactions, such as preventing customer's orders of FX trading from being executed. Nevertheless, the company not once verified the damage to the customers caused by these system failures, and did not provide necessary customer service, such as compensation for losses incurred.

As described above, the IT risk management systems at the company were found to be extremely substandard.

- Date of recommendation: August 8, 2008
- Target of recommendation: The company
- Details of the administrative action

  Business improvement orders ((a) To clarify the responsibility for these violation of laws and regulations, (b) To develop effective IT risk management systems by means of such measures: fully reviewing its systems and the system failures, implementation of external system audits and the establishment of rapid reporting of system failures (c) To formulate and disseminate appropriate measures to prevent violations of laws and regulations)

**(3) Compensating customers for losses caused by transactions, etc.** [Application of Article 39(1)(iii) of the FIEA and Article 25(iii) of the Ordinance for Enforcement of the Financial Futures Trading Act based on Article 76(ix) of the FFTA; violation of Article 83 of the FFTA]

(i) Compensating by engaging in fictitious transactions

The member of the FX Division at **Panta Rhei Securities Co., Ltd.** accommodated a request from the customer to compensate for losses caused by loss-cut related to foreign exchange margin trading in August 2007. He provided financial benefits amounting to 12.58 million yen by six fictitious transactions on three days (September 5, September 10 and October 9, 2007). The methods he used were to produce settlement profits by entering fictitious new orders and settlement orders at a management terminal, and to lessen the settlement losses by adjusting the unit price of the contract data.

(ii) Failing to report to the authority while compensating customers' losses due to system failures, etc.

(a) Between July 13 and September 4, 2007, the company provided compensation amounting to 7.888 million yen to ten customers who had incurred losses during eight system failures related to foreign exchange margin trading which occurred between July 13 and August 9, 2007. The company did not submit notification of these cases to the Director-General of the Kinki Local Finance Bureau. (b) On August 6 and September 4, 2007, the company compensated for 47,000 yen in excess of the losses to three customers caused by two system failures that occurred on July 20 and August 9, 2007.

・Date of recommendation: September 17, 2008
・Targets of recommendation: The company and one sales representative
・Details of the administrative actions
(i) Business suspension order
Three days suspension of all over-the-counter derivatives trading
(ii) Business improvement orders ((a) To clarify the responsibility for these violation of laws and regulations, (b) To improve business management systems for compliance, (c) To enhance internal control systems and to take appropriate measures in order to prevent violation of laws and regulations, (d) To fully review of the system failures, to develop effective IT risk management systems by means of the implementation of audits and the establishment of rapid reporting of system failures)
・Details of the disciplinary action against the sales representative
Member of the FX Division: Suspension of duties for six weeks
(Note) The above administrative actions are not only for this violation of the law. They also include administrative actions for case (4) "**Insufficient management of electronic data processing systems**" which was also the subject of this recommendation.

**(4) Insufficient management of electronic data processing systems** [Application of Article 123(xiv) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

○ During the period from June to September 2007, **Panta Rhei Securities Co., Ltd.** caused no less than 18 system failures related to foreign exchange margin trading. A large number of these failures caused losses to customer transactions. Nevertheless, the company had no procedure for responding to system failures, and it did not even identify that customers had incurred losses. There was no systematic response, only a manager dealing with the situation on an ad hoc basis.

Given that the company's IT risk management is left entirely up to certain employees and that no systematic IT risk management are in place, the company has failed to notice that in response to a request from a customer, a member of the FX Division had single-handedly provided financial benefit by entering fictitious transactions using a management terminal, as described in (3) (i) above.

Thus the company's IT risk management systems were found to be in an extremely inadequate.

・Target of recommendation: The company

(Note) For details of the recommendation and administrative actions, refer to case (3) "**Compensating customers for losses caused by transactions, etc.**."

**(5) Inappropriately providing necessary information to customers with designated accounts** [Application of Article 123(viii) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

○ In 2003, **Marusan Securities Co., Ltd.** has developed the system to apply with the designated account system. When it came to a rights offering, the system figures out the mean price on the assumption that any customers that held such shares in designated accounts applied for the rights offering.

The mean price of the share which does not applied for the offering would need to be revised under such system, however, the company failed to revise it for four rights offerings

during the period from October 2005 to April 2008. As a result, the company communicated inappropriate information of share price based on incorrect mean prices to 152 customers (153 customers gross) who sold stocks related to the said capital increases.

- Date of recommendation: October 15, 2008
- Target of recommendation: The company
- Details of the administrative action

Business improvement orders ((a) To provide appropriate explanations and care to customers who have been affected by this problem, (b) To investigate this misconduct and to enhance internal control systems from the following perspectives ((i) To verify its internal control systems and clarify responsibilities, (ii) To conduct necessary staff training for compliance to ensure fair and appropriate operations, (iii) Based on the above, to implement preventing measures against a recurrence))

**(6) Setting price without quoting both bid and asked prices for over-the-counter financial futures transactions** [Application of Article 123(xx) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

(i) In the over-the-counter foreign exchange margin trading business conducted by **Succet Co., Ltd.,** while bid and ask prices were not offered to customers which is against the pre-contract documents for the customers, bid and asked prices were solely set by the price-setting manager at his own discretion.

Amid this situation, from May 2007 until about June 2007, a employee A, the acting chief of the Administration Department, who is in charge of price-setting, thought that offsetting transactions against the long position of New Zealand dollar/yen currency transactions held by customers (hereinafter referred to as "NZ dollar/yen transactions" in this section (6)) would be profitable, since the Japanese yen was weakening at that time.

(ii) Taking advantage of the situation as above (i) as well as the fact that the order from customers were usually be conducted at market order, the acting chief planned to generate for the company the margins arising between the transactions with the customers and the transactions with the covering company, i.e.

- conducting transactions with customers at exchange rate much lower than offered rate indicated by the covering company (that is, a rate to which the company would offer in its normal pricing process), while, at the same time,
- entering into agreements with the covering company at the offered rate.

(iii) Based on the plan described in (ii) above, on June 12 -15, 2007, the employee A issued instructions to each of the sales persons at the company to confirm whether customers would be interested in over-the-counter sales of buy contracts of NZ dollar/yen transactions. The sales persons who had received these instructions then solicited customers for trade. As a result, despite both selling and buying prices being available, and without presenting these prices to customers at the same time, the company accepted over-the-counter sale orders (at market price) from 46 customers, and made contracts at prices about two to four yen per unit currency lower than the prices offered by the covering company.

Meanwhile, following the said contracts, the employee A then conducted the over-the-counter sales at the covering company at the asking rate, which resulted in the company obtaining a trading profit of 48,526,300 yen from the margin generated by the transactions with the customers and the transactions with the covering company (except for the spreads and commissions explained by the company to the customers).

- Date of recommendation: November 4, 2008
- Targets of recommendation: The company and one sales representative (the acting chief)
- Details of the administrative actions:

  Business improvement orders ((a) To establish well managed legal compliance systems and internal control systems, and to review business operations in order to conduct fair and appropriate operations, (b) To implement effective recurrence prevention measures, and to clarify the responsibilities)
- Details of the disciplinary action against the sales representative

  The acting chief of the Administration Department: Suspension of duties for three weeks

**(7) Insufficient management of electronic data processing systems** [Application of Article 123(xiv) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

○ On June 7, 2006, **Monex, Inc.** received a business improvement order from the Commissioner of the FSA on the inadequate management of electronic data processing systems for securities business. Pursuant to this order, on July 7, the company presented to the Commissioner of the FSA the "Report Based on the Business Improvement Order under Article 56(1) of the SEA," including requisition for improvement to outsourcee, ongoing monitoring the improvement progress, and implementation of improvement measures at the company.

However, the company failed to execute the improvement measures, and the management system remained inadequate. Some reasons contributed to such problem, as the company's senior management had only received reports on the improvement from the Technology Division (in charge of the improvement) and (i) there was no department responsible for the overall management of the improvements made by each division, (ii) there was no specific objectives of the improvement activities, and (iii) there was no standards for appraising the improvement activities.

- Date of recommendation: March 13, 2009
- Target of recommendation: The company
- Details of the administrative actions

  (i) Business suspension order

  Suspension of any new business expansion involving the development of systems for three months

  (ii) Business improvement orders ((a) To identify the causes of such inappropriate improvement, to review business management systems and internal control systems, and to clarify where responsibilities lie, including responsibilities of senior management, (b) To conduct necessary reviews of the improvement measures reported before, and to implement them appropriately, (c) As part of the improvement measures in (b) above, to verify the effectiveness of systems management by having an external systems audit on all systems, and to improve responding to the findings of that audit, (d) To establish monitoring function on the progress of improvements described in (b), (e) To make necessary system improvements and conduct training, etc., in order for employees to reconfirm the importance of systems management and to ensure an appropriate structure for business operations)

**(8) Insufficient management of electronic data processing systems** [Application of Article 123(xiv) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

○ (i) On November 11, 2008, **Rakuten Securities, Inc.** caused a large-scale system failure

that triggered suspension of receipt of orders from all customers for approximately seven hours, including the morning session. (ii) On January 13, 2009, the company also caused a system failure that had the effect of delaying orders placed for 3,024 customers for a period of just under five hours, including the morning session. It was found that the company did not have in place sufficient arrangements for recovering from system failures, either to prevent damage attributable to system failures from spreading or to minimize such damage. Further, appropriate measures for averting confusion for customers in the event of system failures were not implemented.

- Date of recommendation: March 13, 2009
- Target of recommendation: The company
- Details of the administrative actions

(i) Business suspension order

Suspension of any new business expansion involving the development of systems for one month

(ii) Business improvement orders ((a) To classify any possible problems in the arrangements for recovering from system failures by means of verifying past cases of system failure, and to implement effective countermeasures, (b) Given that it is the third business improvement order on the same sort of problem, to clarify where responsibilities lie, including responsibilities of management, (c) To implement improvement plans covering each of the planning, development, operation, maintenance of the systems, aimed at stable operation of systems, (d) When implementing the improvement plan described in (c), to verify the effectiveness of systems management by having an external systems audit conducted on all systems, and to implement system improvements based on the findings of that audit, (e) To make necessary system improvements and conduct training, etc., in order for employees to reconfirm the importance of systems management and to ensure an appropriate business operations)

**(9) Inadequate measures by a financial instruments broker for preventing violation of laws and regulations, and insufficient internal control system for trading based on orders with specified consent** [Application of Article 123(xiii) and Article 123(xv) of the FIB Cabinet Office Ordinance based on Article 40(ii) of the FIEA]

(i) Inadequate measures by a financial instruments broker for preventing violation of laws and regulations

On December 24, 2007, **Avalon Shonan Securities Co., Ltd.** ("Avalon Shonan Securities") outsourced their intermediary services of financial instruments with Yu Capital Management Co., Ltd. ("Yu Capital").

However, Avalon Shonan Securities had no measures on Yu Capital to ensure compliance among its financial instruments brokers, such as training and audits for preventing violation of laws and regulations. Moreover, Avalon Shonan Securities had not implemented adequate measures for preventing violation of laws and regulations by financial instruments brokers – for instance, Avalon Shonan Securities insisted that Yu Capital should manage its transactions entrusted from customers for themselves, and had not conducted any verifications or investigations into the business operations nor investment solicitation of Yu Capital.

(ii) Insufficient internal control system for trading based on orders with specified consent

On December 25, 2007, through the intermediation of Yu Capital, Avalon Shonan Securities

entered into agreements with four customers for Nikkei index options trading. Under the agreement, Avalon Shonan Securities was entrusted from customers on whether to buy or sell, security selection, and the quantity of shares, and was delegated to determine the price within a range of specified consent (consent having some latitude, setting upper and lower limit in consideration of the market price at the time of such consent; the same shall apply hereinafter in this section (9)).

However, Avalon Shonan Securities executed the transactions pursuant to the orders under such specified consent without confirming the relevant laws and regulations. Moreover, Avalon Shonan Securities made no effort to ascertain or manage on the violation of laws and regulations by Yu Capital, such as executing the delegated transactions at its own discretion, insisting these transactions should be managed by Yu Capital. Such situation indicated that Avalon Shonan Securities has insufficient internal control systems to ensure thorough legal compliance, to execute customer order with integrity, and to monitor such transactions.

- Date of recommendation: March 27, 2009
- Target of recommendation: The company
- Details of the administrative action

  Business improvement orders (To investigate the fundamental causes and the problem areas, to enhance internal control systems from the following perspectives ((a) To review its internal control systems, and to clarify where responsibilities lie, (b) To provide necessary training in order to boost awareness of legal compliance and to ensure fair and appropriate business operations, (c) To implement recurrence prevention measures))

**(10) Inadequate segregation of customer asset for refund on cancellation of foreign securities investment trust** [Violation of Article 43-2(2) of the FIEA]

○ In the previous inspection, a business improvement order had been issued over **Nippon Investors Securities Co., Ltd** for a shortage in cash segregated as deposits for customers. However, this current inspection also revealed that, at the discretion of the then director and vice-president of the company (currently the company president), business at Nippon Investors Securities Co., Ltd. was continuing without monies pertaining to the calculation of cancellations, etc. of foreign investment trust beneficiary certificates (hereinafter referred to as "cancellation returns, etc." in this section (10)) being separately managed.

As a result, on the base date of recalculating the amount of cash required to be segregated as deposits for customers, which occurred 57 times during the period from October 22, 2007 to the inspection (November 18, 2008), the company had failed to record figures for cancellation returns, etc. to the amount of cash required to be segregated as deposits for customers on 25 occasions, and had caused a deficit in the amount of cash held separately in trust as deposits for customers five times (maximum amount: approximately 139 million yen).

- Date of recommendation: May 29, 2009
- Targets of recommendation: The company and one sales representative
- Details of the administrative actions

  Business improvement orders ((a) To improve procedures related to segregation management, and to build a system where cash segregated as deposits for customers is held in trusts appropriately, (b) To investigate the fundamental causes, and to clarify where responsibilities lie, taking into account that indications were

raised again regarding the company's failure to hold cash segregated as deposits for customers in trust, (c) In addition, to enhance business management systems and internal control systems, (d) To provide necessary training to boost awareness of legal compliance among officers and employees)

- Details of the disciplinary action against the sales representative

  President: Suspension of duties for one year

**(11) Improper receiving dividends not belonging to the company** [Application of Article 51 of the FIEA]

○ It was found that, during the period from April 1998 at the latest to the date of inspection (August 27, 2008), **Naruse Securities Co., Ltd.**, used improper means to receive dividends that did not belong to the company, but belonged to the customers and former employees of the company for the purpose of increasing its profits.

(a) Act of improperly receiving dividends on shares for customers.

With regard to the safe custody of share for 1,042,973 shares on 201 companies owned by a total of 76 customers who had not given their consent for the transfer of share, the company improperly received dividends that should have been returned to the customers for the purpose of increasing its profits. (The total amount received by the company was at least approximately 5,897,000 yen.) By utilizing the fact that the share certificates would be returned from the security depository center prior to the right allotment, and without any authority, the company transferred the title of the said share certificates to the company and reported with the company as the beneficial owner, and entering the company's name and affixing the company's seal to the receipts of disbursement attached to the notices of dividend payment titled to the company, which had been sent to the company for the said share certificates.

(b) Act of improperly receiving dividends on shares for former employees.

Furthermore, with regard to the share certificates for 1,131 shares on 7 companies titled to the six former employees of the company, the company improperly received dividends on such shares that should have been returned to them for the purpose of increasing its profits. (The total amount received by the company was at least approximately 53,000 yen.) The company abused the fact that notices of dividend payment on such share certificates would be mailed to the company, and without any authority whatsoever, the company signed the names of the former employees and affixed the seal of the company's representative director on the receipts of disbursement attached to the said notices.

Such acts of the company amount to receiving monies not belonging to the company (dividends that should have been returned to customers, former employees, etc.) by using improper means which cause a serious damage on confidence in securities companies, for which fairness and transparency are required as market intermediaries. These acts at the company had been conducted continuously over a long period of time and under the leadership of top cadres. Moreover, management and the audit division had overlooked them. Thus, the company's internal control systems had serious deficiencies, and improvements through administrative actions should be sought.

- Date of recommendation: June 5, 2009
- Target of recommendation: The company
- Details of the administrative action

Business improvement orders ((a) To take measures so that dividends improperly received are returned to customers, etc., (b) To investigate the fundamental causes, to strengthen internal control systems, and to clarify where responsibilities lie, (c) To provide training and to publicize the necessary points to officers and employees so that they conduct business operations fairly and appropriately, (d) To ensure the effectiveness of audit functions, (e) Based on the above, to implement recurrence prevention measures)

**(12) Deficient capital adequacy ratio (under 120%)** [Violation of Article 46-6(2) of the FIEA]

○ The capital adequacy ratio of **TONK Corporation** was below 120% as of March 17, 2009.

・Date of recommendation: June 26, 2009

・Target of recommendation: The company

・Details of the administrative actions

(i) Business suspension order

Suspension of all over-the-counter derivatives trading for three months

(ii) Business improvement orders ((a) To formulate improvement plans for the adequate capital ratio and net assets, and to implement these plans quickly, (b) To continue to enforce the preservation and segregated management of money and securities deposited by customers, (c) To inform customers on this administrative action, and, if so requested by customers, to return and to swiftly cancel contracts for security deposits held for those customers, (d) To sustain company asset, (e) In light of the fact that this is the second administrative action based on the same grounds, to ensure internal control systems needed to protect investors)

(Note) The above administrative actions are not only for this violation of the law. They also include administrative actions for case (13) "**Net asset under the minimum requirement of a financial instruments business operator**" which was also the subject of a recommendation.

**(13) Net asset under the minimum requirement of a financial instruments business operator** [Application of Article 52(1)(iii) of the FIEA]

○ The net assets of **TONK Corporation** had fallen below 50 million yen as of March 17, 2009.

・Target of recommendation: The company

(Note) For details of the date of recommendation and administrative actions, refer to case (12) "**Deficient capital adequacy ratio (under 120%)**."

## 2. Recommendations Based on the Results of Inspections of Type II Financial Instruments Business Operators

**(1) Serious violation of laws and regulations which damaged public interest and investor protection in the solicitation for units in collective investment schemes** [Violation of Article 36-3 and Article 37(2) of the FIEA; application of Article 117(1)(ii) of the FIB Cabinet Office Ordinance based on Article 38(vi) of the FIEA]

○ **Gains Asset Management Ltd.** (hereinafter referred to as "Gains Asset Management" in this section (1)) obtained registration as a type II financial instruments business operator in May 2008, stating its principle business as soliciting investment for anonymous partnership

agreements. The partnership funded to 2 projects ("the financed projects") including leasing high-concentration oxygen generators (hereinafter, the company managing the said project is referred to as "Company A" in this section (1)).

From May 2008, Gains Asset Management solicited for seven types of units in the collective investment scheme related to the said oxygen generator lease project (hereinafter referred to as the "O2 Fund" in this section (1)). However, as described in (ii) and (iii) below, serious violation of laws and regulations in terms of public interest and investor protection were found in the said solicitation.

(i) Administration of the O2 Fund

(a) Dividends unsupported by the assets of the anonymous partnership or by the actual performance of the financed project

With respect to the financed project related to the O2 Fund, from November 2008, Gains Asset Management did not receive any performance reports on the said project from Company A. Furthermore, with the utilization rate on oxygen generators deteriorating considerably, the financed project had almost no earnings from December 2008, which meant that Gains Asset Management was in a position where either the receipt of earnings from Company A was delayed or there were no receipts.

Amid this situation, without ascertaining the condition of the assets of the anonymous partnership, or confirming the actual performance of the financed project, and indeed not having any performance, Gains Asset Management paid dividends equivalent to an annual rate of return of about 10%, which was premised on a utilization rate of 70%.

(b) Charging of large, unexplained costs borne by investors (promotional costs)

With regard to the fees, commissions and other costs, etc. borne by investors which are charged by Gains Asset Management (hereinafter referred to as the "costs borne by investors" in this section (1)), the promotional and sales materials and the pre-contract documents only go as far as stating "subscription fees" equivalent to 5% of the contribution (or 25,000 yen per contribution unit of 500,000 yen).

However, in addition to the "subscription fees", Gains Asset Management also charged 200,000 yen for promotional costs from each contribution unit of 500,000 yen (equivalent to 40% of each unit of 500,000 yen) by means of receiving from Company A, thereby imposing this cost on investors.

(ii) Misleading advertisements or other representations to investors

It was found that all of the facts mentioned in (i) above could have a significant influence on the investment decision on the O2 Fund, and that Gains Asset Management should have recognized these facts from March 2009 at the latest, or should have investigated.

However:

(a) Although Gains Asset Management was charging 200,000 yen in promotional costs to each contribution unit (500,000 yen), at the time of soliciting for the investment, in terms of the costs borne by investors which would be collected by Gains Asset Management from the investment contributions, the promotional and sales materials, etc. only showed "subscription fees" (25,000 yen). Despite these promotional costs should be expressed and explained to investors, Gains Asset Management neither expressed nor explained that such costs would be charged.

(b) With regard to the dividends paid by Gains Asset Management, despite the fact that

there was absolutely no ground of actual performance of the financed project, the Gains Asset Management website expressed remarkably misleading representation such information as an annual rate of return of "10.8%" and as the financed project "had a utilization rate of about 70%, and was supported by a suitable track record."

(c) When soliciting investment for the O2 Fund, subscriptions for which began in March 2009, despite the facts that, at that time, the actual performance of the financed project could not be confirmed, that the actual utilization rate had deteriorated considerably, and that no earning for that period had been received from Company A, in addition to listing a table of expected yield focused on a utilization rate (50-90%) which could best be described as virtually unfeasible given the current conditions, the "Subscription Guidelines," namely the promotional and sales materials, also included such statements that the company would work to maintaining that utilization rate. Furthermore, the investment policy contained in the anonymous partnership agreement stated that the expected utilization rate would be set at above 60%. It was found that, on the whole, these kinds of representations caused customer's misunderstanding by which investors could believe that "a utilization rate of oxygen generators of 50-90% is feasible, and moreover, Gains Asset Management pays dividends having ascertained and confirmed actual utilization rates."

(iii) Solicitation by lending the company's name to an unregistered business operator

From about December 2008, an employee at Company B solicited for investment related to the anonymous partnership agreements, as part of the company's business, using the name of Gains Asset Management and claiming to be a sales agent. Gains Asset Management lent its name to Company B, which had not obtained registration as a financial instruments business operator, and to the employee, and allowed the said solicitation to be conducted.

- Date of recommendation: June 26, 2009
- Target of recommendation: The company
- Details of the administrative actions

(i) Business suspension order

Suspension of all financial instruments business for six months

(ii) Business improvement orders ((a) To quickly ascertain the circumstances of customers and how the investment assets have been used and managed, and to plan refund policies of the assets to customers and specific measures for it, (b) To explain to customers how the investment assets have been used and managed, and to take necessary procedures based on the wishes of customers, (c) To take all possible measures for the protection of customers, with due consideration to equality among customers, (d) To put in place the necessary staff assignment in order to explain and to return invested monies to customers, (e) To sustain company asset)

## 3. Recommendations Based on the Results of Inspections of Investment Management Business Operators and Investment Advisory and Agency Business Operators

**(1) False advertisements that contain considerable variance with the facts** [Violation of Article 37(2) of the FIEA]

○ During the period from August 1, 2006 to September 30, 2007, **Golden Pyramid Inc.**

produced leaflets designed to find potential customers on three occasions (17,080 leaflets in total), and offered them for distribution in taxis.

The leaflets were produced by the head of the financial instruments business division, who concurrently serves as the head of the legal compliance division. They describe "date joined," "invested funds" and "performance" etc. for a total of 12 customers (four customers for each of the three leaflets) and posted their excellent performance as their actual result. However:

(i) No one of the twelve "customers" exists among the company's customer base; and

(ii) "Performance" has not been calculated based on the actual results of any specific customers, and "invested funds" and "performance" has been fabricated based on the favorable image.

By creating false performance of its advisory service, and including them in leaflets to the public, the company made indications that are at considerable variance with the facts.

- Date of recommendation: July 11, 2008
- Target of recommendation: The company
- Details of the administrative actions

(i) Business suspension order

Suspension of all services for investment advisory business for one month

(ii) Business improvement orders ((a) To clarify where the responsibility lies for these violations of laws and regulations, (b) To enhance and strengthen internal control systems, to formulate recurrence prevention measures designed to eradicate violations of laws and regulations, and to boost awareness of employees with them, (c) To improve business management systems for compliance, (d) To implement measures for the enhancement of the internal inspection system)

**(2) Avoidance of inspection, and violation of an order for filing report** [Application of Article 52(1)(vi) and Article 198-6(xi) of the FIEA]

(i) Avoidance of inspection

On May 28, 2008, at approximately 9 o'clock in the morning, an inspector from the Kanto Local Finance Bureau (hereinafter referred to as the "Bureau" in this section (2)), visited the offices of **Theresa Portfolio Management Corporation** in order to conduct an inspection of the company. The company president refused the on-site inspection that day, citing such reasons as that he was unable to come into the office that day, and that he would not be able to agree to the unannounced inspection.

The following day, May 29, the Bureau inspector visited the company once again. Although, the president acceded to the inspection under a time restriction, during the subsequent on-site inspection, he refused physical inspections on actual articles and denied interviews with other employees.

Furthermore, despite the Bureau inspector requesting presentation of materials needed for the inspection, only a small portion of materials were presented. For the other materials, the president just responded repeatedly such as, "It's somewhere, but I'm not sure where." Therefore, it was impossible to verify or ascertain the actual business conditions of the company from such materials.

The president also refused copies to be taken of the presented materials, citing the risk of personal information being leaked.

(ii) Violation of an order for production of report

As described in (i) above, given that it was not possible to verify or ascertain any actual business conditions of the company during the inspection, the Bureau issued the company with an "order for production of report" to present books, documents and other materials pertaining to the company's business affairs, so that the actual business conditions of the company could be verified and ascertained.

On the date of the deadline for production of report based on the said order, the president brought some of the materials subject to the order for production. However, these materials did not enable to verify or ascertain the actual business conditions of the company. Furthermore, with respect to the other outstanding materials, the president stated that some of them he would not be submitting, and the remainder would be submitted at a later date, although no further submissions have been received.

- Date of recommendation: October 29, 2008
- Target of recommendation: The company
- Details of the administrative actions

(i) Business suspension order

Suspension of all financial instruments business for six months

(ii) Business improvement orders ((a) To develop business management systems (responsibilities of directors and auditors, etc.) and business operation systems (execution framework) in order to conduct financial instruments business (investment advisory and agency business) appropriately, (b) To develop appropriate management of documentation such as investment advisory contracts, advisory records, pre-contract documents, contract documents, and for statutory books pertaining to financial accounting, etc., (c) To develop systems for responding appropriately to administrative actions (inspections, orders for reports, etc.), (d) To broadly publicize these administrative actions to all customers, and to respond to customers with integrity, (e) To submit copies, etc. of books and documents pertaining to the business)

**(3) False entries, etc. in the minutes pertaining to the resolutions, etc. on allocation of shares to a third-party** [Application of Article 51 of the FIEA]

○ **CBRE Residential Management K.K.** performs the asset management of the New City Residence Investment Corporation. The company held investment committee on the advisory service for issuance of new investment securities through private placement ("allocation of new shares to a third party") by the investment cooperation. As regards the deliberations, approvals and resolutions, etc. at the above investment committee (hereinafter referred to as the "investment committee" in this section (3)), and at the board of directors' meeting which was convened following the investment committee ("meeting of the board of directors"), the company adopted an incorrect resolution pertaining to the proposal for the allocation of shares to a third-party. Additionally the company took an inappropriate response immediately after becoming aware of the said incorrect resolution, made a request to outside director for cooperation in making false entries in the minutes of both the investment committee and the board of directors (these books of minutes are hereinafter collectively referred to as the "books of minutes" in this section (3)), and made false entries in the books of minutes.

(i) Incorrect resolution pertaining to the proposal for the allocation of shares to a third-party

at the meeting of the investment committee

Under the company's internal rules, "approval of all outside directors entitled to vote" is a requirement for resolution. However, at the investment committee (held April 22, 2008), no members and observers of the investment committee was aware of the said requirement for resolution, and despite the fact that the company's outside director (hereinafter referred to as the "outside director" in this section (3)) had expressed opposition against the proposal for the allocation of shares to a third-party, the resolution for the proposal was carried by a majority vote, supported by the members apart from the outside director.

(ii) Inappropriate response immediately after becoming aware of the incorrect resolution at the investment committee

When the meeting of the board of directors, which had been convened on the same day and following the investment committee, the chief compliance officer of the company (hereinafter referred to as the "CCO" in this section (3)), who had been in attendance at the investment committee – despite being aware of the fact that the opposition expressed by the outside director meant that the proposal did not satisfy the said requirement for resolution, and that it was inappropriate to present such proposal to a meeting of the board of directors – allowed the proceedings of the meeting of the board of directors to continue without taking appropriate action. Subsequently, the investment corporation resolved to support the proposal for the allocation of shares to a third-party. The investment corporation and the company issued press releases based on the results of the resolution, and the investment corporation submitted a securities registration statement to the Kanto Local Finance Bureau.

(iii) Request to outside director for cooperation in making false entries in the books of minutes

On April 23, 2008, after discussing how to deal with the resolution by the investment committee over the allocation of shares to a third-party together with the company president and two other persons, the CCO decided to make a request to the outside director regarding the said resolution at the investment committee, stating that they wished to record in the minutes that (a) the outside director had abstained from voting on the resolution, and (b) as a result, the resolution had been passed by unanimous approval. The representative director, the CCO and one other person drew up the request, and sent it to the outside director, dated April 28.

(iv) False entries in the books of minutes

(a) On May 20, 2008, in the draft minutes of the board of directors (the section on the proposal for the said capital increase), the CCO included false statements, stating that the outside director had abstained from the resolution and had waived their voting rights, and that the proposal had been approved and passed unanimously.

Furthermore, the draft minutes of the investment committee also contained statements that differ from the facts, since they are prepared based on the draft minutes of the board of directors.

(b) On May 22, 2008, the company made a request to the outside director to approve and affix the seal to the draft books of minutes which contained the statements that differed from the facts. The outside director refused and responded that he had not abstained from voting and had cast a vote against the said proposal at the investment committee as well as the meeting of the board of directors.

Furthermore, the outside director made a request to the president of the company's group member companies (hereinafter referred to as the "president of the Japanese corporation" in this section (3)), asking that the representative director of CBRE Residential Management K.K. should check the corrections in the minutes.

In response, the representative director made corrections to the statements in the draft minutes of the meeting of the board of directors, but only with regard to the resolution items pertaining to the said proposal. Once more, the representative director requested the approval of the outside director, and gained approval from the president of the Japanese corporation only presenting the corrected section.

(c) However, the authentic copy of the minutes of the board of directors remained containing a statement that differs from the facts, in that the proposal for the capital increase had been presented to the meeting of the board of directors having been deliberated and passed at the meeting of the investment committee. Despite being aware of the said untrue statement, the representative director and the CCO used these minutes as the authenticated copy without correcting the said statement.

Moreover, the company also made no corrections whatsoever to the minutes of the investment committee, and did not even send these to the outside director for confirmation.

As described above, with respect to the resolution at the meeting of the investment committee on the proposal for the allocation of shares to a third-party: (a) the CCO, namely the person responsible for compliance, failed to take appropriate action despite being aware of the fact that the requirement for resolution had not been satisfied, (b) the representative director and the CCO made a request to the outside director, who had opposed the proposal for the allocation of shares to a third-party, wanting to contend that he had abstained from voting on the said proposal, (c) the CCO prepared false draft minutes of the board of directors on the premise that the outside director agreed to the said request, and failed to correct the books of minutes, and (d) the representative director permitted these actions of the CCO.

- Date of recommendation: November 7, 2008
- Target of recommendation: The company
- Details of the administrative actions

  Business improvement order (contained in the business improvement order (October 9, 2008) already issued to the company)

**(4) Violation of duty of due care pertaining to the property acquiring from a stakeholder**

[Violation of Article 34-2(2) of the Investment Trust Act]

○ **Creed REIT Advisors, Inc.** managed the entrusted assets owned by the Creed Office Investment Corporation based on an entrustment agreement. In March 2006, when acquiring properties from a stakeholder such as the company's parent company, Creed REIT Advisors, Inc., with respect to one property, failed to take action for meeting the criteria set out in the investment policy pertaining to the acquisition of properties in which asbestos has been used, and caused the investment corporation to incur unnecessary expenses. Furthermore, the company made the investment corporation acquire another property without taking into account the no rental earning period during extension and rebuilding work.

- Date of recommendation: November 14, 2008
- Target of recommendation: The company

・Details of the administrative action

Business improvement orders ((a) To clarify the management stance on legal compliance, to establish legal compliance systems and internal control systems in which management is responsible, and to review business operations to steadily activate these systems, in an attempt to realize fair and appropriate business operations as an investment management business operator, (b) To make any arrangements so that, when acquiring and managing the operating property of the investment corporation, verification of appropriateness of materials provided to real estate appraisers and the reflection of the materials in the appraisal, so that properties are acquired based on an appropriate appraised value, (c) To formulate and implement effective recurrence prevention measures, and to clarify where responsibilities lie)

**(5) Ineffective internal control systems on managing undisclosed corporate information, and the advice exploiting undisclosed corporate information** [Application of Article 51 of the FIEA]

○ **Japan Advisory Ltd.** has in place internal rules requiring the compliance officer to be notified if undisclosed corporate information is acquired. However, the internal rules do not clearly define "undisclosed corporate information," and in the past, nothing has been reported for undisclosed corporate information. This situation indicates that internal control systems on managing undisclosed corporate information are not working.

On August 22, 2007, a senior analyst at the company obtained undisclosed corporate information from a listed company that the said company would purchase treasury stock. The senior analyst communicated the said undisclosed corporate information to a senior partner at the company. However, as the company was in such situation described above, and as no one had reported the said undisclosed corporate information to the compliance officer, prior to the publication of the information on August 27, 2007, the company provided advice to clients that they should purchase the shares of the said listed company by using the said undisclosed corporate information.

・Date of recommendation: December 5, 2008

・Target of recommendation: The company

・Details of the administrative action

Business improvement orders ((a) To develop internal control systems on managing undisclosed corporate information, (b) To boost awareness of compliance with laws and regulations among employees, including representatives)

## 4. Recommendations Based on the Results of Inspections of Financial Instruments Brokers

**(1) Financial instruments transactions, etc. that exceed the restrictions of financial instruments brokers** [Violation of Article 66-12 of the FIEA and Article 66-11 of the SEA]

○ **Yu Capital Management Co., Ltd.** (hereinafter referred to as "Yu Capital" in this section (1)) is registered for financial instruments intermediary services, and is a financial instruments broker, having been entrusted with the financial instruments intermediary activities of Avalon Shonan Securities Co., Ltd. ("Avalon Shonan Securities"). Yu Capital is also a financial instruments business operator, having obtained registration of an investment advisory business. However, it was found, as described below, that Yu Capital conducted financial

instruments transactions, etc. which exceeded the restrictions of financial instruments brokers.

(i) Determining prices at one's own discretion with respect to entrusted intermediary activities upon trading based on orders with specified consent,

On December 24, 2007, Yu Capital entered into an outsourcing contract for financial instruments intermediary services with Avalon Shonan Securities. On December 25, 2007, Avalon Shonan Securities entered into agreements with four customers for Nikkei index options trading. Under the agreement, Avalon Shonan Securities obtained customer approval on whether to buy or sell, security selection, and the quantity of shares, and was delegated to determine the price within a range of specified consent (consent having some latitude, setting upper and lower limit in consideration of the market price at the time of such consent; the same shall apply hereinafter in this section (1)).

As for the trading based on the said orders with specified consent, while the company should have been soliciting and mediating as its intermediary acts, instead, during the period from January 15 to June 2, 2008, a commissioned sales representative, who is a senior derivative consultant with the company, and his staff went beyond the scope of intermediation with respect to the orders with specified consent entrusted from the said four customers, and at its own discretion, they determined prices within the range of the said specified consent, and placed orders directly with the securities company that is the agent for Avalon Shonan Securities.

(ii) Dealing of private placements without consignment from an affiliated financial instruments business operator, etc.

With regard to their operations, during the period from May 10 to June 29, 2007, despite not being commissioned by the company's affiliated securities company (affiliated financial instruments business operator), and despite not having obtained registration as a securities business, the representative director and senior managing director of the company engaged in private placements related to corporate bonds of other company for a total of 26 customers (including two customers of the affiliated securities company).

- Date of recommendation: March 27, 2009
- Targets of recommendation: The company and three sales representatives
- Details of the administrative actions
  - (i) Business suspension order
    Suspension of all financial instruments intermediary services and all investment advisory business for six months
  - (ii) Business improvement orders ((a) To thoroughly inform customers, etc. of the business suspension, (b) To verify the business management systems and internal control systems, and to clarify where responsibilities lie, (c) To provide necessary training, etc. in order to boost awareness of compliance among officers and employees and to conduct its business fairly and appropriately, (d) Based on the above, to formulate and implement recurrence prevention measures)
- Details of the disciplinary action against the sales representatives
  - Representative director: Suspension of duties for two years
  - Senior managing director: Suspension of duties for two years
  - Senior derivative consultant: Suspension of duties for 13 weeks

### 9) Future Challenges

The mission of the SESC is to conduct market surveillance in order to ensure the fairness and transparency of the Japanese markets and to protect investors. Inspection of securities companies is an important tool granted to the SESC to fulfill this mission, and needless to say, the *ex-post* monitoring style of administration, focused on ensuring fair trade, will continue to be fundamental to this mission.

However, in view of the recent expansion in the range of businesses being inspected and other factors, it is now necessary more than ever before to conduct more meticulous inspections. As a result of a series of regulatory reforms, including revision of the FIEA, the scope of business operators inspected by the SESC has grown from a few hundred securities companies to more than 9,000 financial instruments business operators encompassing a wide variety of different business sectors. The impacts on the market considered to be different between the activities of large, globally active businesses and the activities of other types of businesses. It is equally conceivable that there will be gaps in the development of compliance systems between businesses which have newly regulated and those that have not. Accordingly, it is important to take a "risk-based, flexible approach," which takes into account the size and risk profiles of each business type and of each operator, rather than uniformly applying the same inspection method across all firms.

In addition, given such factors as the recent significant increase in the number of business operators subject to inspection, while being mindful of ensuring public interest and protecting investors, there needs to be greater enhancement of inspections that are also focused on internal control systems. It is required extending the sustainability of inspection result, which can continually prevent violations of laws and regulations into the future. However, inspections are not just about merely pointing out acts that are in violation of laws and regulations. In order to ensure the effective investor protection and so forth, another important element of the supervision by the *ex-post* monitoring style is reviewing whether financial instruments business operators have built internal control systems designed to prevent violations of the laws and regulations from being committed or being allowed to be committed, while taking into account the size and characteristics of those entities.

The inspections are conducted based on the strong expectation that financial instruments business operators, which serve as market intermediaries, play a public role of gatekeepers. Together with these gatekeepers, it is expected that the SESC will expand the depth and breadth of its market surveillance. This is consistent with the concept of better regulation, which emphasizes the importance of dialogue.

Moreover, in addition to responding to market changes in a timely and flexible manner, the inspections need to be pursued for a proactive approach toward the emerging risks. Since the revision of the regulatory system in fiscal 2005, the authority given to the SESC has gone beyond just ensuring fair trade; but the recent global financial crisis is putting new pressure for further enhancements on both monitoring to the capital market and inspection to financial instruments business operators. Even supposing that customer asset segregation was ensured, the collapse of globally active financial instruments business operators could cause global systemic risk. Furthermore, recent operation of capital markets depends heavily on IT systems. It appears, therefore, that inspections will also be expected to play a role of carefully watching the overall quality of the risk management systems of financial instruments business operators, including their financial soundness.

The SESC aims to enhance inspections, which take into account the recent significant increase

in the number of the firms to be inspected, and which are also focused on a risk-based, flexible approach, internal control systems and risk management systems. In order to achieve such inspection, specifically it will be necessary to strengthen the cooperation with supervisory departments. In addition to regularly ascertaining the circumstances and selecting the entities to be inspected by sharing their operational and financial information, it is also important to concentrate on the perspectives and problem areas related to internal control systems and risk management systems.

Furthermore, since July 2005, the SESC has been delegated the authority for the inspection of financial soundness, risk management systems and other such systems of securities companies. This authority had previously been exercised by the FSA Inspection Bureau. Since being delegated this authority, the SESC has strived to properly maintain investor confidence in the markets through its inspections of securities companies; moreover, with respect to globally active financial instruments business operators in particular, the SESC needs to verify risk management systems of entire groups. To that end, in order to carry out more in-depth verifications of risk management, the SESC needs to conduct human resources development, including through training activities.

(Note 1) "'Ex-post surveillance' means removing as much as possible the *ex-ante* regulation on such items as the scope of business, products and services. It is not about doing away with the act of preventively examining the appropriateness of the operations of securities companies for ensuring the effectiveness of investor protection and so forth. It is an important role of this authority to routinely check on the improvement of internal control systems, such as business management systems, legal compliance systems and internal audits of the firms." (Refer to *Consultative Council on Market Intermediary Function of Securities Companies: Summary of Issues*, FSA (June 30, 2006))

(Note 2) "Internal control systems" refers to the management systems related to legal compliance. "Risk management systems" refers to the management systems related to credit risk, liquidity risk, market risk, IT risk and so forth.

## 3. Investigations of Market misconduct and Disclosure

### 1) Outline

"Market misconduct," such as market manipulation, insider trading, spreading of rumors on stock markets or fraudulent means, is an act of impairing the fairness and transparency of markets and deceiving investors.

In order to realize fair markets where market mechanisms work properly, it is essential to ensure proper disclosure of information. A disclosure system is the most fundamental system sustaining financial and capital markets.

The Securities and Exchange Surveillance Commission (SESC) conducts prompt and efficient investigations using the features of the administrative monetary penalty system in order to respond to environmental changes such as more complex, diversified and globalized financial instruments and transactions, and to realize highly flexible and strategic market surveillance. The SESC also carries out criminal case investigations and files formal complaints for malicious cases. In this way, the SESC maintains the confidence of investors and other market participants in the financial and capital markets, and strives to ensure fairness for financial instruments and transactions.

The administrative monetary penalty system was introduced in April 2005, and is a system in which, after going through procedures similar to a trial, administrative monetary penalties are imposed as administrative action against acts in violation of laws and regulations. This system requires the verification of less evidence than criminal trials.

With respect to administrative monetary penalty investigations, the SESC put effort into conducting prompt and efficient investigations using the features of the administrative monetary penalty system, and promoted further utilization of the system. As a result, in business year (BY) 2008, the SESC made 20 recommendations for the issuance of orders (BY 2007: 21 cases) for payment of administrative monetary penalties for market misconduct against 18 cases of insider trading and 2 cases of market manipulation. The SESC also made 12(BY 2007: 10 cases) recommendations for the issuance of orders to pay administrative monetary penalties for false statements in disclosure documents. The recommendation made in December 2008 for the case of market manipulation relating to Trinity Industrial Co., Ltd. shares was the first recommendation for the issuance of an order to pay an administrative monetary penalty relating to market manipulation.

With respect to the investigation of criminal cases, as a result of having engaged in comprehensive and timely market oversight focused on both primary and secondary markets, and having focused on its responses to globalization, during BY 2008, the SESC filed formal complaints for a total of 13 cases, comprised of two cases of assault or intimidation for the purpose of causing fluctuations in market prices, seven cases of insider trading, including one cross-border case, and four cases of submission of a false annual securities report (BY 2007: 10 cases).

As for the Act for the Amendment of the Financial Instruments and Exchange Act, which was passed on June 6, 2008, and came into force on December 12, 2008, a review of the administrative monetary penalty system was also carried out. The review included making new administrative monetary penalties to cover no submission of continuous disclosure documents or those for issuance of securities, no submission or false statements of advertisement for commencement of TOB, no submission of etc., false statement of "specified securities

information" pertaining to "securities for specified investors," and of the acts prohibited by Article 159 of the Financial Instruments and Exchange Act (FIEA) as acts of market manipulation, fictitious buying and selling of stocks, exchange of stocks based on collusive arrangements and illegal stabilization operation trade. The review also included raising the amount of administrative monetary penalties, and the introduction of systems for increased and reduced penalties. In addition to continuing to conduct prompt and efficient investigations using the features of the administrative monetary penalty system, the SESC is committed to responding properly to the review of the administrative monetary penalty system.

Investigation into administrative monetary penalties falls under the authority of the Civil Penalties Investigation and Disclosure Documents Inspection Division, and investigation of criminal cases falls under the authority of the Investigation Division. By strategically utilizing the functions performed by all the divisions of the SESC Executive Bureau, including the Market Surveillance Division, whose duties include day-to-day market surveillance and the collection and analysis of information, and the Inspection Division, which conducts inspections of financial instruments business operators and other related persons, the SESC is committed to conducting swift and efficient market surveillance.

## 2) Administrative Monetary Penalties Investigation

### 1. Purpose of the Administrative Monetary Penalty System

In the past, criminal penalties were the main measures used to ensure the effectiveness of regulations on insider trading and other violations of the FIEA. In addition to criminal penalties, however, the administrative monetary penalty system was introduced in April 2005 as a result of the revision of the Securities and Exchange Act (SEA) in 2004.

The administrative monetary penalty system is an administrative measure of imposing pecuniary penalties on persons who have violated certain provisions of the FIEA, in order to achieve the administrative objectives of curbing violations and ensuring the effectiveness of regulation. The level of pecuniary penalties is determined by the law, based on the amount of economic benefit gained by violator from his/her violation.

On April 1, 2005 when the administrative monetary penalty system was introduced, the SESC established the office for investigating Civil Penalties Investigation and Disclosure Documents with the aim of clamping down on violations that are subject to administrative monetary penalties. Then, in July 2006, in an effort to strengthen the system, the office was reorganized and became the "Civil Penalties Investigation and Disclosure Documents Inspection Division."

The SESC conducts necessary investigations into administrative monetary penalties, and if any violations are found, the SESC makes a recommendation to the Prime Minister and the Commissioner of the Financial Services Agency (FSA) for the issuance of an order to pay an administrative monetary penalty (Article 20 of the Act for Establishment of the FSA).

In the event a recommendation is made seeking the issuance of an order to pay an administrative monetary penalty, the Commissioner of the FSA (delegated by the Prime Minister)determines the commencement of trial procedures. Then, trial examiners conduct the trial procedures and prepare a draft decision on the case. Based on this draft decision, the Commissioner of the FSA (delegated by the Prime Minister) makes a decision on the issuance of the order to pay the administrative monetary penalty (see page 71 of this report).

## 2. Acts Subject to Administrative Monetary Penalties, and Amounts of Administrative Monetary Penalties

The Act for the Amendment of the Financial Instruments and Exchange Act, which was passed in June 2008, resulted in additional acts becoming subject to administrative monetary penalties, and increases in the amounts of administrative monetary penalties for violations that were already subject to them. The current acts subject to administrative monetary penalties and the amounts of those penalties are as follows.

(1) Act of having securities acquired or selling securities, through a public offering or secondary distribution, etc., without submitting a securities registration statements, etc. (offering disclosure for public offering or secondary distribution, etc.) (Article 172 of the FIEA) * New
Penalty: 2.25% of the total offering amount (4.5% in the case of shares)

(2) Act of having securities acquired or selling securities, through a public offering or secondary distribution, etc. using a securities registration statement, etc. (offering disclosure for public offering or secondary distribution, etc.) containing false statements (Article 172-2 of the FIEA, Article 172 of the former FIEA)
Penalty: 2.25% of the total offering amount (4.5% in the case of shares)

(3) Act of not submitting an annual securities report, etc. (which should be submitted for each business year) (Article 172-3 of the FIEA) * New
Penalty: Amount equivalent to the audit fee for the previous business year (or 4 million yen in the case that an audit was not conducted for the previous business year) (half of these amounts in the case of a quarterly or semiannual securities report)

(4) Act of submitting an annual securities report, etc. (which should be submitted for each business year) containing false statements (Article 172-4 of the FIEA, 172-2 of the former FIEA)
Penalty: 6 million yen or 6/100,000 of the total market value of the issuer, whichever is greater (half of these amounts in the case of a quarterly securities report, semiannual securities report or extraordinary report, etc.)

(5) Act of purchasing or accepting share certificates, etc. without issuing a public notice for commencing tender offer (Article 172-5 of the FIEA) * New
Penalty: 25% of the total purchase amount

(6) Act of issuing a public notice for commencing tender offer containing false statements, or submitting a tender offer notification, etc. containing false statements (Article 172-6 of the FIEA) * New
Penalty: 25% of the total market value of purchased share certificates, etc.

(7) Act of not submitting a large shareholding report or change report (Article 172-7 of the FIEA) * New
Penalty: 1/100,000 of the total market value of the issuer of the share certificates, etc.

(8) Act of submitting a large shareholding report or change report, etc. containing false

statements (Article 172-8 of the FIEA) * New
Penalty: 1/100,000 of the total market value of the issuer of the share certificates, etc.

(9) Act of conducting specified solicitation,etc.without provision or publication of specified information on securities(Article 172-9 of the FIEA) (see Note) * New
Penalty: 2.25% of the total offering amount (4.5% in the case of shares)

(10) Act of providing or publicizing specified information on securities,etc.containing false information(Article 172-10 of the FIEA) (see Note) * New
Penalty: (a) In cases where the information on specified securities, etc. has been announced:
2.25% of the total offering amount (4.5% in the case of shares)

(b) In cases where the information on specified securities, etc. has not been announced:
The amount calculated by multiplying the amount in (a) by:
(The number of persons provided with the information on specified securities, etc.) / (The number of persons to whom the specified solicitation, etc. was made)

(11) Act of providing or announcing issuer's information, etc. containing false statements (Article 172-11 of the FIEA) (see Note) * New
Penalty: (a) In cases where the information on the issuer, etc. has been announced:
6 million yen or 6/100,000 of the total market value of the issuer, whichever is greater

(b) In cases where the information on the issuer, etc. has not been announced:
The amount calculated by multiplying the amount in (a) by:
(The number of persons provided with the information on the issuer, etc.) / (The number of persons to whom the information on the issuer, etc. should have been provided)

(12) Spreading of rumors and fraudulent means(Article 173 of the FIEA)
Penalty: Difference between the value of sales, etc. (purchases, etc.) until the end of the violation (spreading of rumors or fraudulent scheme) and the value appraised using the lowest (highest) price during the one month after the violation

(13) Fictitous buying and selling of stocks and exchange of stocks based on collusire arrangments (Article 174 of the FIEA) (see Note) * New
Penalty: Difference between the value of sales, etc. (purchases, etc.) until the end of the violation (wash sales) and the value appraised using the lowest (highest) price during the one month after the violation

(14) Market manipulation (Article 174-2 of the FIEA, Article 174 of the former FIEA)
Penalty: Aggregate of the profit or loss during the period of the violation (market manipulation through actual transactions), and the difference between the value of sales, etc. (purchases, etc.) until the end of the violation and the value appraised using

the lowest (highest) price during the one month after the violation

(15) Illegal stabilizing transactions (Article 174-3 of the FIEA) (see Note) * New
Penalty: Aggregate of the profit or loss related to the violation (illegal stabilizing transactions), and the volume of sales, etc. (purchases, etc.) at the start of the violation multiplied by the difference between the average price during the one month after the violation and the average price during the period of the violation

(16) Insider trading (Article 175 of the FIEA)
Penalty: Difference between the value of sales, etc. (purchases, etc.) related to the violation (limited to those transacted during the six months prior to the publication of material facts), and the product of the lowest (highest) price during the two weeks after the publication of material facts and the volume of the said sales, etc. (purchases, etc.)

Note: Applied to offenses commenced on or after December 12, 2008.

**3. Authority of Administrative Monetary Penalty Investigations**

The authority to conduct administrative monetary penalty investigations in relation to the non-submission and inclusion of false statements in securities registration statements, annual securities reports and other disclosure documents is prescribed as disclosure documents inspection (see below) in Article 26 of the FIEA. Under this law, the SESC is authorized to:

(1) Order a person who has filed a securities registration statement, a person who has filed a shelf registration statement, a person who has filed an annual securities report, a person who has filed a quarterly securities report, a person who has filed a semiannual securities report, a person who has filed an extraordinary report, a person who is found to have had an obligation to file any of these documents, or any other related party or person to submit reports or materials that are informative for investigation; and

(2) Inspect books and, documents of the persons investigated and other items.

The authority to conduct administrative monetary penalty investigations in relation to the failure to give public notice for commencing tender offers and in relation to the non-submission and inclusion of false statements in tender offer notifications, etc. is prescribed in Article 27-22(1) of the FIEA (including cases where it is applied mutatis mutandis pursuant to Article 27-22-2(2)). Under this law, the SESC is authorized to:

(1) Order a tender offeror, a person who is found to have had an obligation to have made a purchase or other type of acceptance of share certificates, etc. by tender offer, a person who is in a special relationship with either of these persons, or any other related party or person to submit reports or materials that are informative for investigation; and

(2) Inspect books and, documents of the persons investigated and other items.

The authority to conduct administrative monetary penalty investigations in relation to the non-submission and inclusion of false statements in large shareholding reports and change reports is prescribed in Article 27-30(1) of the FIEA. Under this law, the SESC is authorized to:

(1) Order a person who has filed a large shareholding report, a person who is found to have had an obligation to file a large shareholding report, a joint holder of the large shareholding, or any other related party or person to submit reports or materials that are

informative for investigation; and

(2) Inspect books, and documents of the persons investigated and other items.

The authority to conduct administrative monetary penalty investigations in relation to the non-provision of specified information on securities, etc. and the inclusion of false statements in specified information on securities and issuer information, etc. is prescribed in Article 27-35 of the FIEA. Under this law, the SESC is authorized to:

(1) Order an issuer who has provided or announced specified information (specified information on securities, etc., or the issuer's information, etc.), an issuer who should have provided or publicized specific information, an underwriter of securities related to the specific information, or any other related party or person to submit reports or materials that are informative for investigation; and

(2) Inspect books and, documents of the persons investigated and other items.

The authority to conduct administrative monetary penalty investigations in relation to market misconduct, namely the spreading of rumors, fraudulent schemes, market manipulation and insider trading, is prescribed in Article 177 of the FIEA. Under this law, the SESC is authorized to:

(1) Question a persons concerned with a case or witnesses, or to have these any of these persons submit their opinions or reports; and

(2) Enter any business office of the persons concerned with a case and other necessary sites to inspect their books and, documents of the persons investigated and other items.

**4. Disclosure Documents Inspection**

With the aim of securing public interests and protecting investors by ensuring the appropriateness of disclosure, the FIEA prescribes that, when the Prime Minister finds it necessary and appropriate, he/she may order a person who has filed a securities registration statement, a person who has filed a shelf registration statement, a tender offeror, or a person who has filed a large shareholding report, etc. to submit reports or materials, and may inspect their books, documents and other articles (hereinafter referred to as the "disclosure documents inspection").

From about the middle of October 2004, a string of inappropriate cases pertaining to disclosure under the SEA were identified. In view of this, in July 2005, the Prime Minister and the Commissioner of the FSA delegated the authority to conduct disclosure documents inspection to the SESC as part of the measures for strengthening the system of inspecting annual securities reports, etc. aimed at ensuring the reliability of the disclosure system.

More specifically, the authority for disclosure documents inspection is as follows.

(1) The authority to require reporting from a person who has filed a securities registration statement, a person who has filed a shelf registration statement, a person who has filed an annual securities report, a person who has filed an internal control report, a person who has filed a quarterly securities report, a person who has filed a semiannual securities report, a person who has filed an extraordinary report, a person who has filed a share buyback report, a person who has filed a status report of parent company etc., a person who is found to have had an obligation to file any of these documents, an underwriter of securities, or any other related party or person to inspect these

indivisuals(Article 26 (including cases where it is applied mutatis mutandis pursuant to Article 27 of the FIEA))

(2) The authority to require reporting from a tender offeror, a person who is found to have had an obligation to have made a purchase or other type of acceptance of share certificates, etc. by tender offer, a person specially interested in either of these persons, or any other related party or person ,and to inspect these individuals(Article 27-22(1) of the FIEA (including cases where it is applied mutatis mutandis pursuant to Article 27-22-2(2) of the FIEA))

(3) The authority to require reporting from a person who has filed a subject company's position statement, a person who is found to have had an obligation to file a subject company's position statement, or any related party or person ,and to inspect these indivisuals (Article 27-22(2) of the FIEA)

(4) The authority to require reporting from a person who has filed a large shareholding report, a person who is found to have had an obligation to file a large shareholding report, a joint holder of either of these large shareholdings, or any other related party or person to inspect these indivisuals (Article 27-30(1) of the FIEA)

(5) The authority to require reporting from the company that is an issuer of the shares, etc. related to a large shareholding report, or a related party to inspect these individuals (Article 27-30(2) of the FIEA)

(6) The authority to require reporting from an issuer who provided or publicized specified information, an issuer who is found to have had an obligation to provide or publicize specified information, an underwriter of securities related to specified information, or any other related party or person or witness, and to inspect these indivisuals (Article 27-35 of the FIEA)

(7) The authority to require reporting from a certified public accountant or auditing firm that conducted an audit certification (Article 193-2(6) of the FIEA)

(Note 1) The SESC has not been delegated authority for the following:

- The authority to require reporting from a person who has filed a securities registration statement, etc. and the authority to inspect this indivisual before the effective date of the statement, etc. (Article 38-2(1)(i) and (ii) of the FIEA Enforcement Order)
- The authority to require reporting from a tender offeror, etc. or a person who has filed a subject company's position statement, etc. to submit a report and to inspect these individuals during the tender offer period (Article 38-2(1)(iii) of the FIEA Enforcement Order)

(Note 2) The abovementioned authority to order the submission of a report and authority to inspect in cases where it is found urgently needed for the sake of ensuring public interest or protecting investors do not preclude the Commissioner of the FSA from exercising the authority himself/herself (provisory clause in Article 38-2(1) of the FIEA Enforcement Order); and this authority and the authority described in Note 1 are delegated by the Commissioner of the FSA to the directors-general of the local finance bureaus, etc.

Under the FIEA, if disclosure documents are found to contain false statements, etc. pertaining to important matters, the Prime Minister must order the person who has submitted the disclosure documents, etc. to pay an administrative monetary penalty (see items (1) through to (11) of "2. Acts Subject to Administrative Monetary Penalties, and Amounts of Administrative Monetary Penalties" in section 2 of this chapter), and may order the person to

submit amendment reports, etc. (Article 10(1) of the FIEA, etc.).

In Japan's financial and capital markets, annual securities reports and other disclosure documents are submitted from approximately 4,500 companies with disclosure requirements, including approximately 3,900 listed companies.

## 3) Investigations of Criminal Cases

### 1. Purpose of Criminal Case Investigations

For the purpose of maintaining financial and capital markets in which investors and other market participants are able to participate with a sense of security, it is important to ensuring the fairness and transparency of these markets, and to nurture feelings of trust among all market participants. One way of doing this is by strictly punishing any offenders of market rules. With an aim of clarifying the truth behind any malicious acts that impair the fairness of these financial instruments and transactions, the authority for investigating criminal cases was vested in the SESC in conjunction with its inception in 1992.

The investigation of criminal cases is prescribed in the FIEA as an authority inherent to the SESC officials. The targeted scope of this authority is not limited to just financial instruments business operators. The SESC can also exercise this authority over investors and all other persons involved in financial instruments transactions and so forth. Furthermore, the SESC has also been given the authority to investigate criminal cases under the Act on Prevention of Transfer of Criminal Proceeds (APTCP), in which the FIEA is applied *mutatis mutandis* in this regard.

Financial instruments and transactions are becoming more and more complex, diversified and globalized. Therefore, in order to investigate criminal cases comprehensively and flexibly, the SESC conducts investigations of criminal cases focused on both primary and secondary markets.

### 2. Authority and Scope of Criminal Case Investigations

More specifically, the SESC has two types of authority related to the investigation of criminal cases. The SESC is authorized to conduct noncompulsory investigations, including questioning a suspect in, or witness to, a violation of the law or regulations (hereinafter referred to as a "suspected offender, etc."), inspecting articles possessed or left behind by a suspected offender, etc., and provisionally holding articles provided voluntarily or left behind by a suspected offender, etc. (Article 210 of the FIEA). The SESC is also authorized to carry out compulsory investigations, namely official inspections, searches and seizures conducted based on a warrant issued by a judge of the court (Article 211 of the FIEA, etc.).

The scope of criminal cases is specified by a government ordinance as a category of acts impairing fair securities trading (Article 45 of the FIEA Enforcement Order). Most typical criminal cases include the submission of a false annual securities report by an issuing company, insider trading by a corporate insider, and the spreading of rumors, fraudulent schemes and market manipulation by any persons.

Under the APTCP, in cases where a financial instruments business operator confirms the identity of individuals, an act by a customer to conceal his or her name or address is also subject to investigation as a criminal case.

At the conclusion of a criminal case investigation, the SESC official reports the results of the investigation to the SESC (Article 223 of the FIEA, Article 28 of the APTCP). In the event the investigation leads the SESC to believe that the case constitutes a violation, it files a formal complaint, and if there are any items that have been retained or seized, it sends this together with a list of retained/seized articles to a public prosecutor (Article 226 of the FIEA, Article 28 of the APTCP).

## 4) Filing of Formal Complaints and recommendation for Market misconduct

### 1. Recommendations for the issuance of Orders to Pay Administrative Monetary Penalties

#### (1) Issuance of Recommendations

In BY 2008, the SESC made 20 recommendations on market misconduct for the issuance of orders to pay administrative monetary penalties worth a total of 75.25 million yen in total. Of the 20 recommendations, 18 were cases relating to insider trading, and two were cases relating to market manipulation. This brings the total number of recommendations made since the introduction of the administrative monetary penalty system in April 2005 to 59 (55 against individuals and 4 against corporations), worth amounting to a total of 169.18 million yen. In conjunction with the system of filing formal complaints, the administrative monetary penalty system has enabled the careful surveillance, swift and effective responses to, and the prevention of violations.

A feature of the recommendations issued during BY 2008 was that the case of market manipulation relating to shares of Trinity Industrial Co., Ltd. in December 2008 was the first recommendation for the issuance of an order to pay an administrative monetary penalty relating to market manipulation since the introduction of the administrative monetary penalty system entered implementation in April 2005.

As far as insider trading is concerned, a number of cases were seen, perpetrated by people in professions or positions requiring a high degree of professional ethics. These include an active employee of a securities company conducting transactions using an account in someone else's name, an auditor conducting transactions using an account in someone else's name, and a certified public accountant conducting transactions having received information on a material fact from an employee of a securities company. In terms of material facts, these included facts relating to the issuance of shares, the exchange of shares, mergers, revisions to earnings forecasts, dissolution of a business alliance, and a tender offer. In addition, with respect to the case of insider trading by an employee of a client of Kurimoto, Ltd. (see (xii) below), the material fact was not one of the items listed individually in the law. Instead, the so-called "basket clause" was applied for the first time, prescribing "material fact pertaining to business or other matters" to include any material facts concerning the operation, etc. of a listed company, etc. that may have a significant influence on investors' investment decisions.

The amounts of the administrative monetary penalties ranged from 50,000 yen to 20.79 million yen.

#### (2) Outline of Recommendations Issued

Following is an outline of the cases in BY 2008 in which recommendations were made for the issuance of orders to pay administrative monetary penalties on market misconduct.

##### (i) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of Sanei-International Co., Ltd.

The person who was ordered to pay an administrative monetary penalty was an officer of Sanei-International Co., Ltd. In the course of his duties, he became aware of the fact that the company had decided to carry out a new share issue. On April 20, 2006, prior to this fact being publicized on July 14, 2006, the person sold a total of 4,800 shares for a total of 29,071,000 yen.

[Date of recommendation] July 24, 2008

[Amount of administrative monetary penalty] 12,460,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: July 24, 2008
Date of order to pay penalty: August 22, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(ii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of Valic Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty was an officer of Valic Co., Ltd.:

(1) In the course of his duties, he became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of Valic Co., Ltd. had decided to carry out a share exchange with Aoki Holdings Inc. On November 15, 2007, prior to this fact being publicized at 3:30PM on the same date, the person purchased a total of eight Valic Co., Ltd. shares for a total of 934,000 yen;

(2) As an officer of Valic Co., Ltd., which had concluded a non-disclosure agreement with Ravis Inc., the person had performed the said agreement, and in the course of performing the agreement, the person became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of Ravis Inc. had decided to carry out a share exchange with Aoki Holdings Inc. On November 14 and November 15, 2007, prior to this fact being publicized at 3:30PM on the latter date, the person purchased a total of 12 Ravis Inc. shares for a total of 972,000 yen.

[Date of recommendation] October 17, 2008

[Amount of administrative monetary penalty] 340,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: October 17, 2008
Date of order to pay penalty: November 7, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(iii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by a former employee of Valic Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty was an employee of Valic Co., Ltd. In the course of his duties, he became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of the company had decided to carry out a share exchange with Aoki Holdings Inc. After resigning from Valic Co., Ltd., on November 2 and November 7, 2007, prior to this fact being publicized on

November 15, 2007, the person purchased a total of two Valic Co., Ltd. shares for a total of 225,000 yen.

[Date of recommendation] October 17, 2008

[Amount of administrative monetary penalty] 50,000 yen

[Process following recommendation]
Date of on the commencement of trial procedures: October 17, 2008
Date of order to pay penalty: November 7, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(iv) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by a former employee of Mediceo Paltac Holdings Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty was an employee of Mediceo Paltac Holdings Co., Ltd. In the course of his duties, he became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of QOL Co., Ltd. had decided to take over Eber Co., Ltd. – a fact which had become known to another employee at the company in the course of executing a duty of confidentiality concluded between the company and QOL Co., Ltd. After resigning from Mediceo Paltac Holdings Co., Ltd., during the period from May 14 to May 23, 2007, prior to this fact being publicized on May 25, 2007, the person purchased a total of 102 QOL Co., Ltd. shares for a purchase price of 20,851,000 yen.

[Date of recommendation] October 24, 2008

[Amount of administrative monetary penalty] 1,180,000 yen

[Process following recommendation]
Date of on the commencement of trial procedures: October 24, 2008
Date of order to pay penalty: November 18, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(v) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of e-Seikatsu Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty was an employee of e-Seikatsu Co., Ltd.:

(1) In the course of his duties, the person became aware of the fact that the company would downgrade its earnings forecast for the fiscal year ending March 31, 2007. During the period from January 11 to January 30, 2007, prior to this fact being publicized on January 31, 2007, the person sold a total of 317 e-Seikatsu Co., Ltd. shares for a total of 64,576,000 yen;

(2) In the course of his duties, the person became aware of the fact that the company would downgrade its earnings forecast for the fiscal year ending March 31, 2008. During the period from October 12 to October 29, 2007, prior to this fact being publicized on October 29, 2007, the person sold a total of 403 e-Seikatsu Co., Ltd. shares for a total of 37,606,500 yen.

[Date of recommendation] November 4, 2008

[Amount of administrative monetary penalty] 20,790,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: November 4, 2008
Date of order to pay penalty: November 18, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(vi) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of Goldman Sachs Japan Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty (an employee of a securities company, primary recipient of information) received information on the fact that AP8 Co., Ltd. (currently Rex Holdings Co., Ltd.) had decided to make a tender offer on the shares of Rex Holdings Co., Ltd. (dissolution by merger on September 1, 2007). The information had been received from a person who had negotiated the conclusion of an agreement for a tender offer application with AP8 Co., Ltd., and who had come to know this fact in the course of negotiating the conclusion of that agreement. On November 8, 2006, prior to this fact being publicized on November 11, 2006, the person purchased 17 shares for a total of 3,638,000 yen.

[Date of recommendation] December 12, 2008

[Amount of administrative monetary penalty] 230,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: December 12, 2008
Date of order to pay penalty: January 20, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(vii) Recommendation for the issuance of an order to pay an administrative monetary penalty for market manipulation related to shares of Trinity Industrial Co., Ltd.**

In an attempt to raise the price of Trinity Industrial Co., Ltd. shares and to induce active trading in the shares, through employing such methods as raising the share price by matching buy orders and sell orders at around the same time at prices higher than the price contracted immediately prior, during the period from January 5 to January 6, 2006, the

person who was ordered to pay an administrative monetary penalty (individual investor) purchased a total of 170,000 Trinity Industrial Co., Ltd. shares on his own account while selling a total of 174,000 shares. As a result, the share price surged from 1,680 yen to 1,790 yen. In this way, the person conducted a series of transactions, causing the price of Trinity Industrial Co., Ltd. shares to fluctuate.

[Date of recommendation] December 19, 2008

[Amount of administrative monetary penalty] 7,450,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: December 19, 2008
Date of order to pay penalty: January 20, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(viii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of a subsidiary of Altech Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty was an employee working at a subsidiary of Altech Co., Ltd. In the course of his duties, he became aware of the fact that Altech Co., Ltd. would upgrade its consolidated earnings forecast for the period ending November 30, 2007. During the period from January 9 to January 21, 2008, prior to this fact being publicized at 11:04AM on January 21, 2008, the person purchased a total of 14,900 Altech Co., Ltd. shares for a total of 3,681,400 yen.

[Date of recommendation] February 10, 2009

[Amount of administrative monetary penalty] 550,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: February 10, 2009
Date of order to pay penalty: March 10, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(ix) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an auditor of Pioneer Corporation**

The person who was ordered to pay an administrative monetary penalty was an auditor of Pioneer Corporation. In the course of his duties, he became aware of the fact that Pioneer Corporation would make a tender offer for the shares of Tohoku Pioneer Corporation. During the period from April 27 to May 14, prior to this fact being publicized on May 15, 2007, the person purchased a total of 3,200 shares for a total of 5,598,000 yen.

[Date of recommendation] March 12, 2009

[Amount of administrative monetary penalty] 1,440,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: March 12, 2009
Date of order to pay penalty: March 31, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(x) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by a person receiving information from an officer of Cabin Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty (a primary recipient of information):

(1) Received information on the fact that the organ which is responsible for making decisions on the execution of the operations of Cabin Co., Ltd. had decided to dissolve the business alliance with Daiwa Securities SMBC Principal Investments Co. Ltd. The information had been received from an officer of Cabin Co., Ltd., who had come to know this fact in the course of his duties. During the period from March 29 to April 19, 2006, prior to this fact being publicized at 3:01PM on April 19, 2006, the person purchased a total of 40,000 Cabin Co., Ltd. shares for a total of 19,003,000 yen;

(2) Received information on the fact that the organ which is responsible for making decisions on the execution of the operations of Fast Retailing Co., Ltd. had decided to make a tender offer on the shares of Cabin Co., Ltd. The information had been received from an officer of Cabin Co., Ltd. who had concluded the business alliance agreement with Fast Retailing Co., Ltd., and who had come to know this fact in the course of exercising the agreement. During the period from June 11 to July 19, 2007, prior to this fact being publicized on July 23, 2007, the person purchased a total of 72,000 Cabin Co., Ltd. shares for a total of 38,283,000 yen.

[Date of recommendation] March 26, 2009

[Amount of administrative monetary penalty] 18,600,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: March 26, 2009
Date of order to pay penalty: April 21, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xi) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of GF Ltd.**

The person who was ordered to pay an administrative monetary penalty was an officer of GF Ltd. (currently Japan Asia Group Limited). In the course of his duties, he became aware

of the fact that the company had decided to carry out a new share issue. During the period from September 19 and October 3, 2007, prior to this fact being publicized on December 21, 2007, the person purchased a total of 100 GF Ltd. shares for a total of 3,127,150 yen.

[Date of recommendation] April 17, 2009

[Amount of administrative monetary penalty] 1,700,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: April 17, 2009
Date of order to pay penalty: May 14, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of a client of Kurimoto, Ltd.**

The person who was ordered to pay an administrative monetary penalty was an employee of a client of Kurimoto, Ltd. In the course of his duties, he became aware of the fact that it had been confirmed that, in a strength test for hollow slab pipes used in expressways, which are manufactured and distributed by Kurimoto, Ltd., test figures and sheet thickness had been altered, and that this confirmation was a material fact concerning the operation, business or property of the company and may have a significant influence on investors' investment decisions. This was a fact which had become known to another employee at the same company in the course of executing a sales contract which had been concluded between Kurimoto, Ltd. On November 21, 2007, prior to this fact being publicized at 1:30PM on the same date, the person sold a total of 11,000 Kurimoto, Ltd. shares for a total of 3,454,000 yen.

The material fact in this case – that confirmation had been made of test figures and sheet thickness having been altered in a strength test of hollow slab pipes used in expressways – was an application of the so-called "basket clause" of Article 166(2)(iv) of the FIEA.

[Date of recommendation] April 22, 2009

[Amount of administrative monetary penalty] 1,210,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: April 22, 2009
Date of order to pay penalty: May 21, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xiii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading related to the shares of Argo21 Corporation and four other companies**

The person who was ordered to pay an administrative monetary penalty (a certified public accountant, a primary recipient of information) received information on the fact that Canon Marketing Japan Inc. and four other companies had each decided to make tender offers for the shares of Argo21 Corporation and four other companies. The information had been received from an employee of a securities company, which was party to such agreements with Canon Marketing Japan Inc. and the four other companies to act as agent for the tender offers and to provide advice on the tender offers. The employee had come to know of the fact in the course of either performing those agreements or negotiating for their conclusion. During the period from April 25 to November 12, 2007, prior to these facts being publicized, the person purchased a total of 7,800 shares in Argo21 Corporation and the four other companies for a total of 6,833,900 yen.

[Date of recommendation] May 22, 2009

[Amount of administrative monetary penalty] 2,580,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: May 22, 2009
Date of order to pay penalty: June 23, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xiv) Recommendation for the issuance of orders to pay an administrative monetary penalty for insider trading by an employee of kabu.com Securities Co., Ltd. and oneother person**

1. One of the persons who was ordered to pay an administrative monetary penalty (Person A) was an employee of kabu.com Securities Co., Ltd., which had concluded agreements for a business alliance and capital tie-up with The Bank of Tokyo-Mitsubishi UFJ, Ltd.:
   (1) In the course of his duties, Person A became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of The Bank of Tokyo-Mitsubishi UFJ, Ltd. had decided to make a tender offer for the shares of kabu.com Securities Co., Ltd. – a fact which had become known to another officer at the company in the course of performing the said agreement. On March 5, 2007, prior to this fact being publicized on March 6, 2007, Person A purchased a total of 26 kabu.com Securities Co., Ltd. shares on his own account for a total of 5,101,000 yen;
   (2) In the course of his duties, Person A became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of The Bank of Tokyo-Mitsubishi UFJ, Ltd. had decided to make a tender offer for the shares of kabu.com Securities Co., Ltd. – a fact which had become known to another officer at the company in the course of performing the said agreement. On November 14, 2007, prior to this fact being publicized on November 15, 2007, Person A purchased 7.5 kabu.com Securities Co., Ltd. shares on his own account for a total of 1,147,500 yen.

2. The other person who was ordered to pay an administrative monetary penalty (Person B) received information on the fact described in (1) above from Person A. On March 5,

2007, prior to this fact being publicized on March 6, 2007, Person B purchased a total of 26 kabu.com Securities Co., Ltd. shares on his own account for a total of 5,101,000 yen.

[Date of recommendation] June 5, 2009

[Amount of administrative monetary penalty]
Person A ordered to pay an administrative monetary penalty of 440,000 yen
Person B ordered to pay an administrative monetary penalty of 380,000 yen

[Process following recommendation]
(same date for both persons A and B)
Date of decision on the commencement of trial procedures: June 5, 2009
Date of order to pay penalty: June 26, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xv) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of Ajinomoto Co., Inc.**

The person who was ordered to pay an administrative monetary penalty was an employee of Ajinomoto Co., Inc., which had negotiated the conclusion of a share exchange agreement with Calpis Co., Ltd. In the course of his duties, he became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of Calpis Co., Ltd. had decided to carry out a share exchange with Ajinomoto Co., Inc. – a fact which had become known to another employee at the same company in the course of negotiating the conclusion of the said agreement. On June 11, 2007, prior to this fact being publicized at 3:00PM on the same date, the person purchased a total of 2,000 Calpis Co., Ltd. shares for a total of 2,213,000 yen.

[Date of recommendation] June 19, 2009

[Amount of administrative monetary penalty] 390,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: June 19, 2009

**(xvi) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by a person receiving information from an employee of Calpis Co., Ltd.**

The person who was ordered to pay an administrative monetary penalty received information on the fact that the organ which is responsible for making decisions on the execution of the operations of Calpis Co., Ltd. had decided to carry out a share exchange with Ajinomoto Co., Inc. The information had been received from an employee of Calpis Co., Ltd. who had come to know this fact in the course of his duties. On June 8, 2007, prior to this fact being publicized on June 11, 2007, the person purchased a total of 2,000 Calpis Co., Ltd. shares for a total of 2,220,000 yen.

[Date of recommendation] June 19, 2009

[Amount of administrative monetary penalty] 390,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: June 19, 2009
Date of order to pay penalty: July 7, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xvii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by an employee of Itochu Corporation**

The person who was ordered to pay an administrative monetary penalty was an employee of the Itochu Corporation. In the course of his duties, he became aware of facts concerning actions being taken corresponding to a tender offer, to the effect that Itochu Corporation had decided to buy up Adways Co., Ltd. shares with at least 5% of the total shareholder voting rights. On June 14, 2007, prior to this fact being publicized on June 15, 2007, the person purchased a total of 50 Adways Co., Ltd. shares for a total of 4,940,000 yen.

[Date of recommendation] June 25, 2009

[Amount of administrative monetary penalty] 1,410,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: June 25, 2009
Date of order to pay penalty: July 24, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xviii) Recommendation for the issuance of an order to pay an administrative monetary penalty for insider trading by a person receiving information from an officer of GF Ltd.**

The person who was ordered to pay an administrative monetary penalty received information on the fact that GF Ltd. (currently Japan Asia Group Limited) had decided to carry out a new share issue. The information had been received from an officer of the company, who had come to know this fact in the course of his duties. During the period from October 9 to November 6, 2007, prior to this fact being publicized on December 21, 2007, the person purchased a total of 30 GF Ltd. shares for a total of 1,047,650 yen.

[Date of recommendation] June 25, 2009

[Amount of administrative monetary penalty] 400,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: June 25, 2009
Date of order to pay penalty: July 24, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xix) Recommendation for the issuance of an order to pay an administrative monetary penalty for market manipulation related to shares of GaiaX Co. Ltd.**

In an attempt to raise the price and influence the closing price of GaiaX Co. Ltd. shares and to induce active trading in the shares, through employing such methods as (i) establishing an *itayose* price bid by placing buy orders to display the special bid quote, then once this had been updated, placing sell orders, and (ii) raising the share price by matching buy orders and sell orders at around the same time at prices higher than the price contracted immediately prior, during the period from June 13 to June 23, 2008, the person who was ordered to pay an administrative monetary penalty purchased a total of 173 of the company's shares on his own account while selling a total of 86 shares. As a result, the share price surged from 68,000 yen to 95,000 yen. In this way, the person conducted a series of transactions, causing the price of GaiaX Co. Ltd. shares to fluctuate.

[Date of recommendation] June 30, 2009

[Amount of administrative monetary penalty] 3,260,000 yen

[Process following recommendation]
Date of decision on the commencement of trial procedures: June 30, 2009

## 2. Investigations of Criminal Cases and Filing of Formal Complaints

### (1) Investigations of Criminal Cases

With respect to the formal complaints filed during BY 2008, the SESC conducted the compulsory investigations of the residences and relevant offices of suspected offenders, etc., as well as noncompulsory investigations.

### (2) Filing of Formal Complaints

Based on the results of criminal case investigations, the SESC filed formal complaints with the following district public prosecutors offices for a total of nine cases (ten individuals), which consisted of two cases (two individuals) of suspected assault or intimidation for the purpose of causing fluctuations in market prices, and seven cases (eight individuals) of suspected insider trading.

| Name of case | Office at which formal complaints filed |
|---|---|
| Insider trading in connection with an Asclepius Ltd. fraud case (1) (2) | Tokyo District Public Prosecutors Office |
| Insider trading in J.Bridge Corp. shares by a managing executive officer | |

| Name of case | Office at which formal complaints filed |
|---|---|
| Cross-border insider trading in J.Bridge Corp. shares by a former chairman of the board of directors using overseas dummy accounts | |
| Insider trading by IR professional in shares targeted for IR | Osaka District Public Prosecutors Office |
| Insider trading prior to announcement of the SESC compulsory investigations into Produce Co., Ltd. | Saitama District Public Prosecutors Office |
| Assault or intimidation for the purpose of causing fluctuations in market prices by means of setting fire in Don Quijote Co., Ltd. stores (1) (2) | Yokohama District Public Prosecutors Office |
| Insider trading by the president of a company listed on the First Section of the Tokyo Stock Exchange (Image Co., Ltd.) | Takamatsu District Public Prosecutors Office |

As cases become more geographically widespread as shown above, the SESC has conducted effective and efficient investigations in close cooperation with the investigative agencies and local finance bureaus of each region.

In a policy statement, *Towards Enhanced Market Integrity*, it is shown that the SESC works on preventing any gaps from opening up in its market surveillance by actively cooperating with overseas regulators. The SESC has since strengthened its surveillance of cross-border transactions by utilizing MOU frameworks, and in BY 2008, in cooperation with the Monetary Authority of Singapore (MAS), the SESC filed its first ever formal complaint for cross-border market misconduct.

Furthermore, for the first time since the enactment of the SEA, the SESC filed a formal complaint based on assault or intimidation for the purpose of causing fluctuations in market prices, Article 158 of the FIEA.

In this way, the SESC is responding flexibly and quickly to changes in the environment, such as more complex, diversified, globalized and localized financial instruments and transactions, and is handling a diverse and wide range of cases, including difficult and complex composite cases. Having conducted investigations in an effective, efficient and flexible manner, while cooperating with various relevant organizations, the SESC has filed formal complaints one after the other, and has strived to conduct strict market surveillance.

### (3) Outline of Formal Complaints

#### (i) Insider trading in connection with an Asclepius Ltd. fraud case (1)

The suspected offender, in his capacity as Vice Chairman of the Board at LTT Bio-Pharma Co., Ltd., on about January 25, 2008, became aware of a material fact concerning the operations of the company, that is, an organ which is responsible for making decisions on the execution of the operations of LTT Bio-Pharma Co., Ltd. had decided to dissolve a capital tie-up with its subsidiary, Asclepius Ltd., and make a transfer of shares involving restructuring of subsidiaries; and on about March 3, 2008, he became aware of a material fact concerning the operation, business or property of the company which may have a significant influence on investors' investment decisions, that is, it had been revealed that the hospital restructuring projects, for which Asclepius Ltd. had been soliciting investments as its core business, were

fabricated, and that it was no longer certain that redemption monies maturing subsequent to that time would be repaid. Despite there being no statutory grounds for exclusion, during the period from March 4 to March 19, 2008, prior to each of these facts being announced, the suspected offender sold a total of 11,500 LTT Bio-Pharma Co., Ltd. shares for a total price of 412,232,000 yen.

**(ii) Assault or intimidation for the purpose of causing fluctuations in market prices by means of setting fire in Don Quijote Co., Ltd. stores (1)**

For the purpose of selling Don Quijote Co., Ltd. shares in advance on credit, then causing the share price to fall, such as by inciting apprehension for the security of the company's stores, before making a profit by repurchasing the same shares at a lower price:

1. On July 2, 2008, in the apparel section on the second floor of the Don Quijote Tomei Yokohama Inter store, which was open for business, the suspected offender sprayed gasoline, which he had prepared earlier in a plastic bottle, on the floor near a rack of clothes which had been installed in the same area. Using a lighter, he ignited and set fire to the gasoline, causing the floor, display rack and other articles in that area to catch alight. In this way, he committed an assault in an attempt to cause fluctuations to the prices of securities, etc.;
2. At about 7:23PM on the same date, the suspected offender used a facsimile machine installed in a convenience store located in Naka-ku, Yokohama City, to send a letter addressed to the Reader Information Center at the Kanagawa Shimbun newspaper. The letter included a statement: "*The sanctions against Don Quijote will still continue. It's up to you whether you choose to run an article on the information I send, but I would like this to be seen as a protest against Don Quijote. The second sanctions will be applied within the prefecture on July 5 (Saturday). Decisive action will be taken at sundown.*" The content of the letter was communicated to the head office of Don Quijote by police officers from the Kanagawa Prefectural Police who had received a report from the said newspaper, and the company was notified of the serious danger to which its assets, reputation and so forth would be exposed. In this way, the suspected offender intimidated the company in an attempt to cause fluctuations to the prices of securities, etc.

**(iii) Insider trading in connection with an Asclepius Ltd. fraud case (2)**

On about February 22, 2008, the suspected offender received information from the Vice Chairman of the Board at LTT Bio-Pharma Co., Ltd. on a material fact in connection with the operations and so forth of LTT Bio-Pharma Co., Ltd., which had become known to the said Vice Chairman *ex officio*. The information purported that an organ which is responsible for making decisions on the execution of the operations of LTT Bio-Pharma Co., Ltd. had decided to conduct a share transfer involving restructuring of subsidiaries, thereby dissolving a capital tie-up they had with a subsidiary, Asclepius Ltd., by selling their Asclepius shares. Furthermore, on about March 10, 2008, the suspected offender received information from a director of Asclepius Ltd. on a material fact concerning the operation, business or property of Asclepius Ltd. which may have a significant influence on investors' investment decisions – a material fact which had become known to the said director in the course of his duties. The information purported that it would soon become known to investors that all of the hospital restructuring projects, for which Asclepius Ltd. had successively been soliciting investments

as its core business, were fabricated, and that each time a maturity date arrived, it had repeatedly funded repayments using money it had procured by deceiving other investors; and that continuation of the said projects had become, in effect, difficult. Despite there being no statutory grounds for exclusion, during the period from March 4 to March 17, 2008, prior to each of these facts being announced, the suspected offender sold a total of 486 LTT Bio-Pharma shares for a total price of 19,240,030 yen.

**(iv) Assault or intimidation for the purpose of causing fluctuations in market prices by means of setting fire in Don Quijote Co., Ltd. stores (2)**

For the purpose of selling Don Quijote Co., Ltd. shares in advance on credit, then causing the share price to fall, such as by inciting apprehension for the security of the company's stores, before making a profit by repurchasing the same shares at a lower price:

1. On May 26, 2008, in the apparel section on the first floor of the Don Quijote Minato Yamashita store, which was open for business, the suspected offender attached a plastic bag containing tissues, which had been soaked in lighter fluid, to clothing which was being displayed in the same area. Using an oil lighter, he ignited and set fire to the clothing. Furthermore, in the bedding section on the first floor of the same store, the suspected offender attached a similar plastic bag to a cardboard box containing bedding, which had been displayed in the same area. He then placed a lit oil lighter directly underneath the plastic bag, causing garments in the apparel section to catch alight. In this way, he committed an assault in an attempt to cause fluctuations to the prices of securities, etc.;
2. On May 29, 2008, in attempt to give warning of a crime to set fire to Don Quijote stores, the suspected offender mailed letters addressed to four newspapers and to the head office of Don Quijote from Naka-ku, Yokohama City. The letters included a statement: "*Warning: On several occasions, I have made proposals for improvements to late-night noise and to the decline in public security. However, it is extremely displeasing and regrettable that no proposed action or measures have been forthcoming. We will therefore resort to forceful means. We will inflict damage of magnitude similar to the earlier fire at the Kanpachi Setagaya store to several stores in Kanagawa Prefecture. The incident at the Shinyamashita store the other day is evidence that this is not a joke.*" On May 31 and June 1, 2008, the executives of Don Quijote were made aware of the content of each of the letters by police officers from the Kanagawa Prefectural Police who had received reports from each of the aforementioned newspapers, and by reading the letter addressed to the Don Quijote head office. On June 2, 2008, the same people communicated this information to the representative of Don Quijote, and notified the company of the serious danger to which its assets, reputation and so forth would be exposed. In this way, the suspected offender intimidated the company in an attempt to cause fluctuations to the prices of securities.

**(v) Insider trading by IR professional in shares targeted for IR**

1. The suspected offender had concluded an IR consulting advisory agreement with Works Applications Co., Ltd. On about April 14, 2006, in the course of performing that agreement, he became aware of a material fact concerning the operations of the company, that is, a difference had arisen between new forecasts calculated by the company and the latest forecasts already open to the public, and this difference fell

under the criteria provided by a cabinet order as a difference that may have a material influence on investors' investment decisions. Whereas the forecast for the company's consolidated ordinary income for the accounting period ending June 30, 2006 had been published on March 16, 2006 as the figures between 2,360 million and 2,580 million yen, the company calculated the latest forecast as 1,800 million yen. Despite there being no statutory grounds for exclusion, during the period from April 17 and April 21, 2006, prior to publication of the said material fact, the suspected offender sold a total of 693 Works Applications Co., Ltd. shares for a total price of 72,551,000 yen;

2. As a director of the Eneserve Corporation, the suspected offender had been engaged in IR services and so forth. On about April 29, 2006, in the course of his duties, he became aware of a material fact concerning the operations of the company, that is, a difference had arisen between the forecasts for the current business year calculated by the company and the actual figures for the previous business year, which had already been open to the public, and this difference fell under the criteria provided by a cabinet order as a difference that may have a material influence on investors' investment decisions. Whereas the actual figure for the dividend of surplus for the interim period of the previous business year had been published as 25 yen, the company newly calculated the forecast for the dividend of surplus for the current interim period ending September 30, 2006 as zero yen. Despite there being no statutory grounds for exclusion, during the period from May 8 and May 17, 2006, prior to publication of the said material fact, the suspected offender sold a total of 28,000 Eneserve Corporation shares for a total price of 48,374,200 yen.

**(vi) Insider trading by the president of a company listed on the First Section of the Tokyo Stock Exchange (Image Co., Ltd.)**

The suspected corporation was a limited liability company whose objectives included securities investment and holding. The suspected offender was the president of Image Co., Ltd. (currently Image Holdings Co., Ltd.), and he did actually control all business affairs of the company. On January 31, 2006, in the course of performing a business alliance agreement that had been concluded between Cabin Co., Ltd. and Daiwa Securities SMBC Principal Investments Co. Ltd., the suspected offender received information on a material fact from an officer of Daiwa Securities SMBC Principal Investments Co. Ltd., who had earlier come to know of the same material fact concerning the operations of Cabin Co., Ltd., namely, an organ which was responsible for making decisions on the operations of Cabin Co., Ltd. had decided to dissolve the business alliance with Daiwa Securities SMBC Principal Investments Co. Ltd. Despite there being no statutory grounds for exclusion, during the period from April 6 to April 11, 2006, prior to publication of the said material fact, the suspected offender, in relation to the business and property of the suspected corporation, purchased a total of 500,000 Cabin Co., Ltd. shares in the name of the suspected corporation for a total price of 248,638,000 yen.

**(vii) Insider trading prior to announcement of the SESC compulsory investigations into Produce Co., Ltd.**

On September 19, 2008, the suspected offender received information on a material fact concerning the operation, business or property of Produce Co., Ltd. which may have a significant influence on investors' investment decisions, that is, on September 18, the

company had been subject to a compulsory investigation by the SESC on suspicion of window-dressing of accounts, hence a violation of the FIEA, and that it was only a matter of time before the fact that the company had window-dressed its accounts would become public. The information was received from an employee of Produce Co., Ltd. who had come to know of this fact in the course of his duties. Despite there being no statutory grounds for exclusion, on September 19, 2008, prior to publication of the said material fact, the suspected offender sold a total of 236 Produce Co., Ltd. shares for a total price of 78,884,000 yen.

**(viii) Insider trading in J.Bridge Corp. shares by a managing executive officer**

The suspected offender was the managing executive officer and manager of corporate planning at J.Bridge Corp. On about April 20, 2006, in the course of his duties, he became aware of a material fact concerning the operations of the company, that is, a difference had arisen between new forecasts calculated by the company and the latest forecasts which had already been open to the public, and this difference fell under the criteria provided by a cabinet order as a difference that may have a material influence on investors' investment decisions. Whereas the forecasts for the company's turnover and ordinary income for the accounting period ending March 31, 2006 had been published on November 24, 2005 as 10,800 million yen and 8,000 million yen respectively, the latest forecasts calculated by the company were 8,107,893,000 yen and 3,435,493,000 yen respectively. Despite there being no statutory grounds for exclusion, on April 24 and May 12, 2006, prior to publication of the said material fact, the suspected offender sold a total of 10,000 J.Bridge Corp. shares for a total price of 9,154,000 yen.

**(ix) Cross-border insider trading in J.Bridge Corp. shares by a former chairman of the board of directors using overseas dummy accounts**

The suspected offender was the chairman of the board of directors at J.Bridge Corp. On about April 20, 2006, in the course of his duties, he became aware of a material fact concerning the operations of the company, that is, a difference had arisen between new forecasts calculated by the company and the latest forecasts which had already been open to the public, and this difference fell under the criteria provided by a cabinet order as a difference that may have a material influence on investors' investment decisions. Whereas the forecasts for the company's turnover and ordinary income for the period ending March 31, 2006 had been published on November 24, 2005 as 10,800 million yen and 8,000 million yen respectively, the latest forecasts calculated by the company were 8,107,893,000 yen and 3,435,493,000 yen respectively. Moreover, on about May 2, 2006, the suspected offender became aware of another material fact concerning the operations of the company, that is, damage had arisen in the course of the company's operations, and it would record in its settlement of accounts for the period ending March 31, 2006, an extraordinary loss totaling about 1,500 million yen as a reserve for bad debts against its consolidated subsidiaries. Despite there being no statutory grounds for exclusion, during the period from May 8 to May 11, 2006, prior to publication of each of the aforementioned material facts, the suspected offender had sold a total of 70,000 J.Bridge Corp. shares for a total price of 65,640,400 yen. For this insider trading, he employed securities accounts in a financial institution in the Republic of Singapore, whose business was to provide private banking services, and these accounts had been opened under the names of corporations set up in

the British Virgin Islands.

## 5) Recommendations and Filing of Formal Complaints Pertaining to Disclosure

### 1. Recommendations relating to Orders for the Payment of Administrative Monetary Penalties

#### (1) Issuance of Recommendations

In BY 2008, in relation to false statements in disclosure documents, the SESC made 12 recommendations for the issuance of orders for payment of administrative monetary penalties, worth a total of 713,759,997 yen.

The recommendations made in BY 2008 include recommendations in relation to false statements in offering disclosure documents (Article 172 of the former FIEA) and recommendations in relation to false statements in ongoing disclosure documents (Article 172-2 of the former FIEA). These included the first ever such recommendation for the issuance of an order to pay an administrative monetary penalty made against an officer (individual) of a company (see (xii) below). The recommendation asserted that an officer of BicCamera Inc. who had used a prospectus containing false statements, had been involved in the production of the said prospectus while knowing that it contained false statements, and through a secondary distribution related to the said prospectus, he had sold shares that he held. The administrative monetary penalty amounted to 120,730,000 yen, which is the highest ever penalty against an individual.

#### (2) Outline of Recommendations Issued

Following is an outline of the cases in BY 2008 in which recommendations were made for the issuance of orders to pay administrative monetary penalties in relation to disclosure documents.

**(i) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Magara Construction Co., Ltd.**

(1) In relation to annual securities reports, etc., Magara Construction Co., Ltd. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:

(i) On December 22, 2005, the company submitted its semiannual securities report for the six months ended September 30, 2005. Although it should have recorded an interim net loss of 405 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for interim net income/loss and net income/loss), by overstating net sales and understating the cost of sales, the report included an interim profit and loss statement in which the interim net loss was stated at 165 million yen;

(ii) On June 30, 2006, the company submitted its annual securities report for the fiscal year ended March 31, 2006. Although it should have recorded a net income of 199 million yen, by overstating net sales and understating the cost of sales, the report included a profit and loss statement in which net income was stated at 911 million yen;

(iii) On December 21, 2006, the company submitted its semiannual securities report for the six months ended September 30, 2006. Although it should have recorded an interim net loss of 913 million yen, by overstating net sales, understating the cost of

sales and by other means, the report included an interim profit and loss statement in which interim net income was stated at 34 million yen;

(iv) On June 29, 2007, the company submitted its annual securities report for the fiscal year ended March 31, 2007. Although it should have recorded a net loss of 1,624 million yen, by overstating net sales, understating the cost of sales and by other means, the report included a profit and loss statement in which net income was stated at 1,003 million yen.

(2) In relation to securities registration statements, on December 22, 2006, Magara Construction Co., Ltd. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau, in which it incorporated its annual securities report for the fiscal year ended March 31, 2006 and its semiannual securities report for the six months ended September 30, 2006. On January 11, 2007, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 1,000,000,000 yen.

[Date of recommendation] July 3, 2008

[Amount of administrative monetary penalty] 24,999,999 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: July 3, 2008
Date of order to pay penalty: August 1, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(ii) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Heiwa Okuda Construction Co., Ltd.**

(1) In relation to annual securities reports, etc., Heiwa Okuda Construction Co., Ltd. submitted each of the following to the Director-General of the Kinki Local Finance Bureau:

(i) On December 21, 2005, the company submitted its annual securities report for the fiscal year ended September 30, 2005. Although it should have recorded a consolidated ordinary loss of 943 million yen, and a consolidated net loss of 2,026 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated ordinary income/loss, consolidated net income/loss, consolidated interim net loss, and consolidated net assets), by overstating net sales, not recording an impairment loss and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary loss was stated at 581 million yen, and consolidated net loss was stated at 350 million yen;

(ii) On June 23, 2006, the company submitted its semiannual securities report for the six months ended March 31, 2006. Although it should have recorded a consolidated ordinary loss of 1,126 million yen, and a consolidated interim net loss of 1,581 million yen, by understating the cost of sales and by other means, the report included an interim consolidated profit and loss statement in which consolidated ordinary income

was stated at 226 million yen, and consolidated interim net loss was stated at 307 million yen;

(iii) On December 20, 2006, the company submitted its annual securities report for the fiscal year ended September 30, 2006. Although it should have recorded a consolidated ordinary loss of 1,825 million yen, and a consolidated net loss of 2,263 million yen, by overstating net sales, understating the provision of allowance for doubtful accounts and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 528 million yen, and consolidated net income was stated at 7 million yen;

(iv) On June 27, 2007, the company submitted its semiannual securities report for the six months ended March 31, 2007. Although it should have recorded a deficit in consolidated net assets of 485 million yen, by overstating accounts receivable (trade) and inventory assets, and by other means, the report included an interim consolidated balance sheet in which a figure of 1,804 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

(2) In relation to securities registration statements, on December 12, 2006, Heiwa Okuda Construction Co., Ltd. submitted a securities registration statement to the Director-General of the Kinki Local Finance Bureau, in which it incorporated its annual securities report for the fiscal year ended September 30, 2005 and its semiannual securities report for the six months ended March 31, 2006. On December 20, 2006, the company also submitted an amendment and a securities registration statement in which it incorporated its annual securities report for the fiscal year ended September 30, 2006. On December 28, 2006, the public offering based on the said securities registration statements and said amendment resulted in 770,000 shares being acquired for 308,000,000 yen.

[Date of recommendation] September 12, 2008

[Amount of administrative monetary penalty] 12,660,000 yen

[Developments following recommendation]
Date of on the commencement of trial procedure: September 12, 2008
Date of order to pay penalty: October 1, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(iii) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports containing false statements concerning Cyber Firm Inc.**

On March 31, 2006, Cyber Firm Inc. submitted its annual securities report for the fiscal year ended December 31, 2005 to the Director General of the Okinawa General Bureau. Although it should have recorded a consolidated ordinary income not in excess of 862 million yen, and a consolidated net income not in excess of 139 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated ordinary income and consolidated net income), by recording sales in advance, the report included a consolidated

profit and loss statement in which consolidated ordinary income was stated at 1,245 million yen, and consolidated net income was stated at 522 million yen.

[Date of recommendation] October 31, 2008

[Amount of administrative monetary penalty] 3,000,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: October 31, 2008
Date of order to pay penalty: November 21, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(iv) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Nakamichi Machinery Co., Ltd.**

Nakamichi Machinery Co., Ltd. submitted each of the following to the Director-General of the Hokkaido Local Finance Bureau:

(1) On April 20, 2006, the company submitted its annual securities report for the fiscal year ended January 31, 2006. Although it should have recorded a net loss of 32 million yen, and net assets of 1,618 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for net income and net assets), by understating the cost of sales and overstating inventory assets, the report included a profit and loss statement in which net income was stated at 30 million yen, and it included a balance sheet in which a figure of 2,138 million yen was stated in the equity section, which corresponds to consolidated net assets;

(2) On October 20, 2006, the company submitted its semiannual securities report for the six months ended July 31, 2006. Although it should have recorded net assets of 1,337 million yen, by overstating inventory assets, the report included an interim balance sheet in which a figure of 1,772 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(3) On April 18, 2007, the company submitted its annual securities report for the fiscal year ended January 31, 2007. Although it should have recorded net assets of 1,433 million yen, by overstating inventory assets, the report included a balance sheet in which a figure of 1,894 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(4) On October 18, 2007, the company submitted its semiannual securities report for the six months ended July 31, 2007. Although it should have recorded net assets of 1,251 million yen, by overstating inventory assets, the report included an interim balance sheet in which a figure of 1,733 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

[Date of recommendation] November 11, 2008

[Amount of administrative monetary penalty] 7,500,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: November 11, 2008
Date of order to pay penalty: December 3, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(v) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Trustex Holdings, Inc.**

(1) In relation to annual securities reports, etc.:

(i) On December 27, 2005, Trustex Holdings, Inc. submitted its semiannual securities report for the six months ended September 30, 2005 to the Director-General of the Kinki Local Finance Bureau. Although it should have recorded a consolidated ordinary loss of 994 million yen, a consolidated interim net loss of 1,170 million yen, and a deficit in consolidated net assets of 2,623 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated ordinary income/loss, consolidated net income/loss, consolidated interim net income/loss and consolidated net assets), by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable and bankruptcy/reorganization claims, etc. (hereinafter referred to as "long-term accounts receivable, etc."), by overstating subordinated trust beneficial interest, and by other means, the report included an interim consolidated profit and loss statement in which consolidated ordinary income was stated at 1,083 million yen, and consolidated interim net income was stated at 578 million yen, and it included an interim consolidated balance sheet in which a figure of 7,697 million yen was stated in the equity section, which corresponds to consolidated net assets;

(ii) On June 30, 2006, Trustex Holdings, Inc. submitted its annual securities report for the fiscal year ended March 31, 2006, to the Director-General of the Kinki Local Finance Bureau. Although it should have recorded a consolidated ordinary loss of 528 million yen, a consolidated net loss of 955 million yen, and a deficit in consolidated net assets of 1,796 million yen, by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable, etc. and subordinated trust beneficial interest, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 1,885 million yen, and consolidated net income was stated at 1,314 million yen, and it included a consolidated balance sheet in which a figure of 9,052 million yen was stated in the equity section, which corresponds to consolidated net assets;

(iii) On January 16, 2007, Trustex Holdings, Inc. submitted its semiannual securities report for the six months ended September 30, 2006 to the Director-General of the Kanto Local Finance Bureau. Although it should have recorded a consolidated ordinary loss of 313 million yen, and a deficit in consolidated net assets of 605 million yen, by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable, etc. and subordinated trust beneficial interest, and by other means, the report included an interim consolidated profit and loss statement in which

consolidated ordinary income was stated at 319 million yen, and it included an interim consolidated balance sheet in which a figure of 1,586 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(iv) On June 29, 2007, Trustex Holdings, Inc. submitted its annual securities report for the fiscal year ended March 31, 2007, to the Director-General of the Kinki Local Finance Bureau. Although it should have recorded a deficit in consolidated net assets of 1,643 million yen, by overstating long-term accounts receivable, etc. and by other means, the report included a consolidated balance sheet in which a deficit of 918 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(v) On December 28, 2007, Trustex Holdings, Inc. submitted its semiannual securities report for the six months ended September 30, 2007 to the Director-General of the Kinki Local Finance Bureau. Although it should have recorded consolidated net assets of 134 million yen, by overstating long-term accounts receivable, etc. and by other means, the report included an interim consolidated balance sheet in which a figure of 849 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(vi) On June 30, 2008, Trustex Holdings, Inc. submitted its annual securities report for the fiscal year ended March 31, 2008, to the Director-General of the Kinki Local Finance Bureau. Although it should have recorded a consolidated ordinary loss of 411 million yen and consolidated net assets of 298 million yen, by understating bad debts expenses, overstating long-term accounts receivable, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary loss was stated at 248 million yen, and it included a consolidated balance sheet in which a figure of 786 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

(2) In relation to securities registration statements:

(i) On November 25, 2005, Trustex Holdings, Inc. submitted a securities registration statement to the Director-General of the Kinki Local Finance Bureau to which it attached as reference its annual securities report for the fiscal year ended March 31, 2005. Although the report should have recorded a consolidated ordinary loss of 207 million yen, and a deficit in consolidated net assets of 1,366 million yen, by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable, etc. and subordinated trust beneficial interest, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 656 million yen, and it included a consolidated balance sheet in which a figure of 7,247 million yen was stated in the equity section, which corresponds to consolidated net assets. On December 12, 2005, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 5,000,000,000 yen;

(ii) On January 16, 2007, Trustex Holdings, Inc. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau in which it included several financial statements. Although the consolidated profit and loss statement for the fiscal year ended March 31, 2006, should have recorded a consolidated ordinary loss of 528 million yen and a consolidated net loss of 955 million yen, and although the consolidated balance sheet for the fiscal year ended

March 31, 2006 should have recorded a deficit in consolidated net assets of 1,796 million yen, by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable, etc. and subordinated trust beneficial interest, and by other means, consolidated ordinary income was stated at 1,885 million yen, consolidated net income was stated at 1,314 million yen, and a figure of 9,052 million yen was stated in the equity section, which corresponds to consolidated net assets. Moreover, although the interim consolidated profit and loss statement for the six months ending September 30, 2006, should have recorded a consolidated ordinary loss of 313 million yen, and although the interim consolidated balance sheet for the six months ending September 30, 2006, should have recorded a deficit in consolidated net assets of 605 million yen, by overstating net sales, understating bad debts expenses, overstating long-term accounts receivable, etc. and subordinated trust beneficial interest, and by other means, consolidated ordinary income was stated at 319 million yen, and a figure of 1,586 million yen was stated in the total net assets section, which corresponds to consolidated net assets. On February 5, 2007, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 300,000,000 yen;

(iii) On February 22, 2007, Trustex Holdings, Inc. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau in which it included a consolidated profit and loss statement and a consolidated balance sheet for the fiscal year ended March 31, 2006, as well as an interim consolidated profit and loss statement and an interim consolidated balance sheet for the six months ending September 30, 2006, each of which contained similar information as described in (2)(ii) above. On March 12, 2007, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 260,000,000 yen;

(iv) On March 2, 2007, Trustex Holdings, Inc. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau in which it included a consolidated profit and loss statement and a consolidated balance sheet for the fiscal year ended March 31, 2006, as well as an interim consolidated profit and loss statement and an interim consolidated balance sheet for the six months ending September 30, 2006, each of which contained similar information as described in (2)(ii) above. On March 19, 2007, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 100,000,000 yen;

(v) On April 27, 2007, Trustex Holdings, Inc. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau in which it included a consolidated profit and loss statement and a consolidated balance sheet for the fiscal year ended March 31, 2006, as well as an interim consolidated profit and loss statement and an interim consolidated balance sheet for the six months ending September 30, 2006, each of which contained similar information as described in (2)(ii) above. On May 17, 2007, the public offering based on this securities registration statement resulted in 60,023,540 shares being acquired for 5,120,000,900 yen.

[Date of recommendation] November 21, 2008

[Amount of administrative monetary penalty] 224,240,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: November 21, 2008
Date of order to pay penalty: December 19, 2008

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(vi) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Placo Co., Ltd.**

By means of recording sales in advance, overstating accounts receivable (trade) and understating advances received, Placo Co., Ltd., submitted each of the following to the Director-General of the Kanto Local Finance Bureau:

(1) On December 21, 2007, the company submitted its semiannual securities report for the six months ended September 30, 2007. Although it should have recorded an ordinary loss of 68 million yen, an interim net loss of 95 million yen, and net assets of 475 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for ordinary income/loss, interim net income/loss, net assets and net income/loss), the report included an interim profit and loss statement in which ordinary income was stated at 2 million yen, and interim net income was stated at 7 million yen, and it included an interim balance sheet in which a figure of 638 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(2) On June 30, 2008, the company submitted its annual securities report for the fiscal year ended March 31, 2008. Although it should have recorded an ordinary loss of 64 million yen, a net loss of 97 million yen, and net assets of 451 million yen, the report included a profit and loss statement in which ordinary income was stated at 17 million yen, and net income was also stated at 17 million yen, and it included a balance sheet in which a figure of 625 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

[Date of recommendation] January 21, 2009

[Amount of administrative monetary penalty] 3,000,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: January 21, 2009
Date of order to pay penalty: February 17, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(vii) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning IBE Holdings, Inc.**

(1) In relation to annual securities reports, etc., by means of overstating intangible fixed assets and understating accounts payable (other), IBE Holdings, Inc. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:
  (i) On June 30, 2006, the company submitted its annual securities report for the fiscal year ended March 31, 2006. Although it should have recorded a deficit in consolidated net assets of 894 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated net assets and net assets), the report included a consolidated balance sheet in which a figure of 40 million yen was stated in the equity section, which corresponds to consolidated net assets;
  (ii) On December 26, 2006, the company submitted its semiannual securities report for the six months ended September 30, 2006. Although it should have recorded a deficit in consolidated net assets of 1,005 million yen, the report included an interim consolidated balance sheet in which a deficit of 254 million yen was stated in the total net assets section, which corresponds to consolidated net assets;
  (iii) On June 28, 2007, the company submitted its annual securities report for the fiscal year ended March 31, 2007. Although it should have recorded a deficit in net assets of 40 million yen, the report included a balance sheet in which a figure of 95 million yen was stated in the total net assets section, which corresponds to consolidated net assets;
  (iv) On December 21, 2007, the company submitted its semiannual securities report for the six months ended September 30, 2007. Although it should have recorded a deficit in net assets of 83 million yen, the report included an interim balance sheet in which a figure of 22 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

(2) In relation to securities registration statements, IBE Holdings, Inc. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:
  (i) On February 21, 2007, the company submitted a securities registration statement, in which it incorporated its annual securities report for the fiscal year ended March 31, 2006 and its semiannual securities report for the six months ended September 30, 2006. On March 8, 2007, the public offering based on this securities registration statement resulted in 19,610 shares being acquired for 921,670,000 yen;
  (ii) On July 25, 2007, the company submitted a securities registration statement, in which it incorporated its annual securities report for the fiscal year ended March 31, 2007. On August 9, 2007, the public offering based on this securities registration statement resulted in bonds with share options being acquired for 400,000,000 yen.

[Date of recommendation] March 24, 2009

[Amount of administrative monetary penalty] 33,930,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: March 24, 2009
Date of order to pay penalty: April 10, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(viii) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Zentek Technology Japan, Inc.**

Zentek Technology Japan, Inc. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:

(1) On June 25, 2008, the company submitted its annual securities report for the fiscal year ended March 31, 2008. Although it should have recorded a consolidated ordinary loss of 761 million yen, a consolidated net loss of 3,421 million yen, and consolidated net assets of 6,396 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated ordinary income, consolidated net income/loss and consolidated net assets), by overstating net sales, understating bad debts expenses, overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 1,228 million yen, and consolidated net income was stated at 645 million yen, and it included a consolidated balance sheet in which a figure of 10,435 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(2) On August 14, 2008, the company submitted its quarterly securities report for the first quarter ended June 30, 2008. Although it should have recorded consolidated net assets of 6,514 million yen, by overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated quarterly balance sheet in which a figure of 10,041 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(3) On November 14, 2008, the company submitted its quarterly securities report for the second quarter ended September 30, 2008. Although it should have recorded consolidated net assets of 3,569 million yen, by overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated quarterly balance sheet in which a figure of 6,137 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

[Date of recommendation] April 21, 2009

[Amount of administrative monetary penalty] 6 million yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: April 21, 2009
Date of order to pay penalty: May 21, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(ix) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Japan Digital Contents Trust Inc.**

Japan Digital Contents Trust Inc. submitted each of the following to the Director-General

of the Kanto Local Finance Bureau:

(1) On June 30, 2006, the company submitted its annual securities report for the fiscal year ended March 31, 2006. Although it should have recorded a consolidated net loss of 1,020 million yen and consolidated net assets of 2,475 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated net loss and consolidated net assets), by recording fictitious sales, overstating accounts receivable (trade) and intangible fixed assets, and by other means, the report included a consolidated profit and loss statement in which consolidated net loss was stated at 677 million yen, and it included a consolidated balance sheet in which a figure of 3,317 million yen was stated in the equity section, which corresponds to consolidated net assets;

(2) On December 22, 2006, the company submitted its semiannual securities report for the six months ended September 30, 2006. Although it should have recorded consolidated net assets of 1,978 million yen, by overstating accounts receivable (trade) and loans, and by other means, the report included an interim consolidated balance sheet in which a figure of 2,729 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(3) On May 25, 2007, the company submitted an amendment report relating to its semiannual securities report for the six months ended September 30, 2006. Although it should have recorded consolidated net assets of 1,978 million yen, by overstating accounts receivable (trade) and loans, and by other means, the amendment report included an interim consolidated balance sheet in which a figure of 2,511 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

[Date of recommendation] June 16, 2009

[Violation subject to recommendation]

[Amount of administrative monetary penalty] 6 million yen
[Developments following recommendation]
Date of decision on the commencement of trial procedure: June 16, 2009
Date of order to pay penalty: July 14, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(x) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning Futaba Industrial Co., Ltd.**

Futaba Industrial Co., Ltd. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:

(1) On June 29, 2006, the company submitted its annual securities report for the fiscal year ended March 31, 2006. Although it should have recorded a consolidated ordinary income of 2,571 million yen and a consolidated net loss of 13,096 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated

ordinary income, consolidated net income/loss, consolidated interim net income/loss, consolidated net assets and consolidated quarterly net income), by understating the cost of sales and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 19,429 million yen, and consolidated net income was stated at 11,499 million yen;

(2) On December 28, 2006, the company submitted its semiannual securities report for the six months ended September 30, 2006. Although it should have recorded consolidated ordinary income of 1,721 million yen, a consolidated interim net loss of 24,949 million yen, and consolidated net assets of 114,770 million yen, by understating the cost of sales, not recording an impairment loss, overstating inventory assets and tangible fixed assets, and by other means, the report included an interim consolidated profit and loss statement in which consolidated ordinary income was stated at 9,721 million yen, consolidated interim net income was stated at 5,256 million yen, and it include an interim consolidated balance sheet in which a figure of 177,696 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(3) On June 28, 2007, the company submitted its annual securities report for the fiscal year ended March 31, 2007. Although it should have recorded consolidated ordinary income of 291 million yen, a consolidated net loss of 33,827 million yen, and consolidated net assets of 109,701 million yen, by understating the cost of sales, not recording an impairment loss, overstating inventory assets and tangible fixed assets, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 23,457 million yen, and consolidated net income was stated at 12,770 million yen, and it included a consolidated balance sheet in which a figure of 189,122 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(4) On December 26, 2007, the company submitted its semiannual securities report for the six months ended September 30, 2007. Although it should have recorded consolidated ordinary income of 1,565 million yen, a consolidated interim net loss of 5,205 million yen, and consolidated net assets of 104,918 million yen, by understating the cost of sales, overstating inventory assets and tangible fixed assets, and by other means, the report included an interim consolidated profit and loss statement in which consolidated ordinary income was stated at 12,014 million yen, and consolidated interim net income was stated at 5,322 million yen, and it included an interim consolidated balance sheet in which a figure of 194,462 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(5) On June 30, 2008, the company submitted its annual securities report for the fiscal year ended March 31, 2008. Although it should have recorded consolidated ordinary income of 1,745 million yen, a consolidated net loss of 13,061 million yen, and consolidated net assets of 94,219 million yen, by understating the cost of sales, overstating inventory assets and tangible fixed assets, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 24,847 million yen, and consolidated net income was stated at 11,046 million yen, and it included a consolidated balance sheet in which a figure of 198,030 million yen was stated in the total net assets section, which corresponds to consolidated net assets;

(6) On August 13, 2008, the company submitted its quarterly securities report for the first

quarter ended June 30, 2008. Although it should have recorded consolidated ordinary income of 1,403 million yen, consolidated quarterly net income of 163 million yen, and consolidated net assets of 91,339 million yen, by understating the cost of sales, overstating inventory assets and tangible fixed assets, and by other means, the report included a quarterly consolidated profit and loss statement in which consolidated ordinary income was stated at 3,486 million yen, and consolidated quarterly net income was stated at 1,406 million yen, and it included a quarterly consolidated balance sheet in which a figure of 196,374 million yen was stated in the total net assets section, which corresponds to consolidated net assets.

[Date of recommendation] June 23, 2009

[Amount of administrative monetary penalty] 18,169,998 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: June 23, 2009
Date of order to pay penalty: July 28, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xi) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to annual securities reports, etc. containing false statements concerning BicCamera Inc.**

(1) BicCamera Inc. had operated a real estate securitization scheme utilizing a special purpose company. The special purpose company had set up an anonymous partnership in which another company, Toshima Co., Ltd., had contributed funds along with BicCamera. The investment/financing circumstances were tantamount to Toshima Co., Ltd. being a subsidiary of BicCamera, and hence BicCamera's share of risk in the scheme amounted to approximately 31%. At the conclusion of the scheme, although by virtue of the above, on October 26, 2007, BicCamera could not accrue 4,920 million yen (rounded down to the nearest million yen) from the anonymous partnership as a dividend on liquidation of anonymous partnership, and although BicCamera could not record this amount as an extraordinary gain, by disguising the investors of Toshima Co., Ltd. as third parties unrelated to BicCamera, BicCamera asserted to come under the situation where a dividend on liquidation of anonymous partnership could be accrued, and where this could be recorded as an extraordinary gain.

Based on this assertion, in relation to annual securities reports, etc., BicCamera submitted each of the following to the Director-General of the Kanto Local Finance Bureau:

(i) On November 20, 2007, BicCamera submitted an extraordinary report, stating that an event had occurred which would have a significant effect on the financial position and business performance of BicCamera and BicCamera's consolidated companies: "As a consequence of the conclusion of the scheme, a dividend on liquidation of anonymous partnership will be accrued…" and, "We expect to record

a dividend on liquidation of anonymous partnership of 4,920 million yen as an extraordinary gain in the nonconsolidated settlement of accounts and consolidated settlement of accounts for the fiscal year ending August 31, 2008";

(ii) On November 29, 2007, BicCamera submitted its annual securities report for the fiscal year ended August 31, 2007. In the explanatory notes for "material subsequent events" contained in the consolidated financial statements for the fiscal year ended August 31, 2007, it stated, "As a consequence of the conclusion of the scheme, a dividend on liquidation of anonymous partnership of 4,920 million yen has been accrued, dated October 26, 2007";

(iii) On May 2, 2008, BicCamera submitted its semiannual securities report for the six months ended February 29, 2008. Although it should have recorded consolidated interim net income of 1,398 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated interim net income and consolidated net income/loss), by recording a dividend on liquidation of anonymous partnership and by other means, the report included an interim consolidated profit and loss statement in which consolidated interim net income was stated at 7,145 million yen;

(iv) On November 27, 2008, BicCamera submitted its annual securities report for the fiscal year ended August 31, 2008. Although it should have recorded a consolidated net loss of 1,662 million yen, by recording a dividend on liquidation of anonymous partnership and by other means, the report included a consolidated profit and loss statement in which consolidated net income was stated at 4,112 million yen.

(2) Moreover, in relation to securities registration statements, on May 16, 2008, BicCamera Inc. submitted a securities registration statement to the Director-General of the Kanto Local Finance Bureau, to which it attached as reference, its annual securities report for the fiscal year ended August 31, 2007, and its semiannual securities report for the six months ended February 29, 2008. On June 9, 2008, the public offering based on this securities registration statement resulted in 163,500 shares being acquired for 12,337,710,000 yen.

[Date of recommendation] June 26, 2009

[Amount of administrative monetary penalty] 253,530,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: June 26, 2009
Date of order to pay penalty: July 30, 2009

Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted.

**(xii) Recommendation for the issuance of an order to pay an administrative monetary penalty in relation to false statements contained in a prospectus relating to the secondary distribution of shares in BicCamera Inc. held by an officer of BicCamera Inc.**

BicCamera Inc. had operated a real estate securitization scheme utilizing a special purpose company. The special purpose company had set up an anonymous partnership in which another company, Toshima Co., Ltd., had contributed funds along with BicCamera. The investment/financing circumstances were tantamount to Toshima Co., Ltd. being a subsidiary of BicCamera, and hence BicCamera's share of risk in the scheme amounted to approximately 31%. At the conclusion of the scheme, although by virtue of the above, on October 26, 2007, BicCamera could not accrue 4,920 million yen (rounded down to the nearest million yen) from the anonymous partnership as a dividend on liquidation of anonymous partnership, and although BicCamera could not record this amount as an extraordinary gain, by disguising the investors of Toshima Co., Ltd. as third parties unrelated to BicCamera, BicCamera asserted to come under the situation where a dividend on liquidation of anonymous partnership could be accrued, and where this could be recorded as an extraordinary gain.

The person who was ordered to pay an administrative monetary penalty (an officer of BicCamera) had used a prospectus to which had been attached as reference:

(i) The annual securities report for the fiscal year ended August 31, 2007, which contained explanatory notes for "material subsequent events" in the consolidated financial statements for the fiscal year ended August 31, 2007, that remarked, "As a consequence of the conclusion of the scheme, a dividend on liquidation of anonymous partnership of 4,920 million yen has been accrued, dated October 26, 2007"; and

(ii) The semiannual securities report for the six months ended February 29, 2008, which contained an interim consolidated profit and loss statement which recorded the consolidated interim net income at 7,145 million yen (rounded down to the nearest million yen) although it should have been 1,398 million yen; this was partly the result of having recorded the dividend on liquidation of anonymous partnership.

Although aware of the fact that the said prospectus contained false statements, the person had been involved in its production, and on June 10, 2008, he had used a secondary distribution connected with the said prospectus to sell 80,000 BicCamera shares that he held for a price of 6,036,800,000 yen.

[Date of recommendation] June 26, 2009

[Amount of administrative monetary penalty] 120,730,000 yen

[Developments following recommendation]
Date of decision on the commencement of trial procedure: June 26, 2009

## 2. Investigations of Criminal Cases and Filing of Formal Complaints

### (1) Investigations of Criminal Cases

With respect to the formal complaints filed during BY 2008, the SESC conducted compulsory investigations of the residences and relevant offices of suspected offenders, etc. and noncompulsory investigations in connection with the OHT Inc. case related to the submission of a false annual securities report, and the Produce Co., Ltd. cases (1) (2) (3) relating to the submission of false securities registration statements, etc., including those for initial public

offering, in collusion with a certified public accountant.

In market surveillance, whilst constantly collecting and analyzing information from the markets and detecting problem cases is important, amongst the formal complaints filed during BY 2008, there was indeed a window-dressing case where a suspected corporation had been wining the high esteem of the market until the SESC raided them. In order to assure the reliability of disclosed information that forms the foundation for the investment decisions of ordinary investors, the SESC continues its vigorous efforts in monitoring disclosure-related fraud.

**(2) Filing of Formal Complaints**

Based on the results of criminal case investigations, the SESC filed formal complaints with the offices of district public prosecutors as outlined below for four cases (11 individuals) of submission of false annual securities reports, etc. and accused them of violating the former SEA and FIEA.

| Name of case | Office at which formal complaints filed |
|---|---|
| Produce Co., Ltd. cases (1) (2) (3) relating to the submission of false securities registration statements, etc., including one for initial public offering, in collusion with a certified public accountant | Saitama District Public Prosecutors Office |
| OHT Inc. case related to the submission of false annual securities reports | Hiroshima District Public Prosecutors Office |

In the policy statement, *Towards Enhanced Market Integrity*, it is shown that the SESC works on market surveillance targeting both primary and secondary markets. In addition to insider trading and other types of fraud in the secondary markets, the SESC is also vigorously engaged in keeping watch for fraud in the primary markets and corporate financing. Amongst the window-dressing cases for which formal complaints were filed during BY 2008, there are four cases where false securities registration statements related to initial public offering and other corporate financing transactions were submitted. In addition to exposing fraudulent schemes relating to unfair financing and so forth, the SESC also keeps monitoring disclosure-related fraud, and is committed to ensuring the integrity of the primary markets.

**(3) Outline of Formal Complaints**

**(i) OHT Inc. case related to the submission of false annual securities reports**

The suspected corporation, OHT Inc., is a company whose objectives include the manufacture and sale of commercial and household electronic instruments and the production machinery thereof. Its head office is located in Fukuyama City in Hiroshima Prefecture. The company list their shares on Mothers, a market established by the Tokyo Stock Exchange (TSE). Suspect A, as President of the suspected corporation, did control and manage all business affairs of the whole company; Suspect B, as Director and Manager of the Administration Department of the suspected corporation, did control and manage all business affairs of the company's administrative divisions; and Suspect C, as Director and Manager of the General Planning Department of the suspected corporation, was in charge of the company's investor relations and capital policy planning.

1. Suspect A and Suspect B conspired to submit annual securities reports containing false

statements pertaining to important matters in relation to the business of the suspected corporation:

(i) On July 28, 2005, the suspects submitted to the Director-General of the Chugoku Local Finance Bureau, an annual securities report of the suspected corporation for the consolidated fiscal year ended April 30, 2005. Although it should have recorded a net loss before taxes and other adjustments of 101,753,000 yen, by employing such methods as recording fictitious sales, the report included a consolidated profit and loss statement in which net income before taxes and other adjustments was falsely stated as 100,721,000 yen;

(ii) On July 31, 2006, the suspects submitted to the Director-General of the Chugoku Local Finance Bureau, an annual securities report of the suspected corporation for the consolidated fiscal year ended April 30, 2006. Although it should have recorded a net loss before taxes and other adjustments of 136,973,000 yen, by employing such methods as recording fictitious sales, the report included a consolidated profit and loss statement in which net income before taxes and other adjustments was falsely stated as 267,643,000 yen.

2. When offering bonds with share options, on September 15, 2006, the three suspects conspired to submit to the Director-General of the Chugoku Local Finance Bureau, a securities registration statement incorporating the consolidated profit and loss statement containing the false statement described in 1(ii) above. In this way, they submitted a securities registration statement containing false statements pertaining to important matters.

**(ii) Produce Co., Ltd. case (1) relating to the submission of false securities registration statements, etc., including one for initial public offering, in collusion with a certified public accountant**

The suspected corporation, Produce Co., Ltd., is a company whose objectives include the development, design and manufacture of equipment used in manufacturing electronics components. The company had approval to list their shares on the Jasdaq Securities Exchange, Inc. Suspect A, as CEO of the suspected corporation, controlled all business affairs of the company; and Suspect B, as Senior Managing Director of the suspected corporation, controlled the administrative divisions of the company. On November 10, 2005, when making initial public offering and secondary distribution of shares following new listing on the Jasdaq Securities Exchange, Inc., the two suspects conspired to submit to the Director-General of the Kanto Local Finance Bureau, a false securities registration statement. Although, for the business year of the suspected corporation ended June 30, 2005, it should have recorded turnover of 1,476,689,000 yen and a net loss before taxes of 68,384,000 yen, by employing such methods as recording fictitious sales, the statement included a profit and loss statement in which turnover was stated as 3,109,763,000 yen, and a net income before taxes was stated as 191,119,000 yen. In this way, they submitted a securities registration statement containing false statements pertaining to important matters in relation to the business of the suspected corporation.

**(iii) Produce Co., Ltd. case (2) relating to the submission of false securities registration statements, etc., including one for initial public offering, in collusion with a certified public accountant**

The suspected corporation, Produce Co., Ltd., is a company whose objectives include the development, design and manufacture of equipment used in manufacturing electronics components. The company listed their shares on the Jasdaq Securities Exchange, Inc. Suspect A, as CEO of the suspected corporation, controlled all business affairs of the company; and Suspect B, as Senior Managing Director of the suspected corporation, controlled the administrative divisions of the company. The two suspects, in collusion with a certified public accountant – who was a senior partner at the audit firm then commissioned by the suspected corporation to conduct audit for the purpose of making audit certification for statements on finance and accounting information contained in annual securities reports, etc., pursuant to Article 193-2 of the SEA – submitted annual securities reports and a securities registration statement containing false statements pertaining to important matters in relation to the business of the suspected corporation:

1. On September 29, 2006, the two suspects submitted to the Director-General of the Kanto Local Finance Bureau, a false annual securities report for the suspected corporation for the business year ended June 30, 2006. Although it should have recorded turnover of 2,450,716,000 yen and a net loss before taxes of 230,973,000 yen, by employing such methods as recording fictitious sales, the report included a profit and loss statement in which turnover was stated as 5,885,618,000 yen, and a net income before taxes was stated as 694,202,000 yen;
2. On September 27, 2007, the two suspects submitted to the Director-General of the Kanto Local Finance Bureau, a false annual securities report for the suspected corporation for the business year ended June 30, 2007. Although it should have recorded turnover of 3,118,488,000 yen and a net loss before taxes of 729,658,000 yen, by employing such methods as recording fictitious sales, the report included a profit and loss statement in which turnover was stated as 9,704,000,000 yen, and a net income before taxes was stated as 1,223,761,000 yen;
3. On November 16, 2007, when the suspected corporation was making public offering of shares, the two suspects submitted to the Director-General of the Kanto Local Finance Bureau, a securities registration statement which made reference to the annual securities report described in paragraph 2 above.

**(iv) Produce Co., Ltd. case (3) relating to the submission of false securities registration statements, etc., including one for initial public offering, in collusion with a certified public accountant**

The suspected offender was a senior partner at an audit firm commissioned by Produce Co., Ltd. to conduct audit for the purpose of making audit certification for statements on finance and accounting information contained in annual securities reports, etc., pursuant to Article 193-2 of the SEA. The suspected offender, in collusion with CEO and others at the company, submitted annual securities reports and securities registration statements containing false statements pertaining to important matters in relation to the business of the company:

1. On November 10, 2005, when the company was making initial public offering and secondary distribution of shares following new listing on the Jasdaq Securities Exchange, the suspected offender submitted to the Director-General of the Kanto Local Finance Bureau, a false securities registration statement. Although, for the business year of the company ended June 30, 2005, it should have recorded turnover of 1,476,689,000 yen and a net loss before taxes of 68,384,000 yen, by employing such

methods as recording fictitious sales, the statement included a profit and loss statement in which turnover was stated as 3,109,763,000 yen, and a net income before taxes was stated as 191,119,000 yen;

2. On September 29, 2006, the suspected offender submitted to the Director-General of the Kanto Local Finance Bureau, a false annual securities report of the company for the business year ended June 30, 2006. Although it should have recorded turnover of 2,450,716,000 yen and a net loss before taxes of 230,973,000 yen, by employing such methods as recording fictitious sales, the report included a profit and loss statement in which turnover was stated as 5,885,618,000 yen, and a net income before taxes was stated as 694,202,000 yen;
3. On September 27, 2007, the suspected offender submitted to the Director-General of the Kanto Local Finance Bureau, a false annual securities report of the company for the business year ended June 30, 2007. Although it should have recorded turnover of 3,118,488,000 yen and a net loss before taxes of 729,658,000 yen, by employing such methods as recording fictitious sales, the report included a profit and loss statement in which turnover was stated as 9,704,000,000 yen, and a net income before taxes was stated as 1,223,761,000 yen;
4. On November 16, 2007, when the company was making public offering of shares, the suspected offender submitted to the Director-General of the Kanto Local Finance Bureau, a securities registration statement which made reference to the annual securities report described in paragraph 3 above.

## 6) Future Challenges

### 1. Challenges relating to Administrative Monetary Penalty Investigations

Four years have passed since the administrative monetary penalty system was introduced as a measure for achieving the administrative objectives of curbing violations of the FIEA and ensuring the effectiveness of regulation. During this time, there has been an increasing number of recommendations for the issuance of an order to pay an administrative monetary penalty, both for cases relating to market misconduct and cases relating to disclosure. Administrative monetary penalty investigations (including investigations for both cases relating to market misconduct and cases relating to disclosure; the same shall apply hereinafter in this section) are administrative investigations, and they are administrative actions, that is, orders for payment of administrative monetary penalties. A feature of the administrative monetary penalty system is that it requires the establishment of less evidence than for criminal trials and criminal case investigations.

In the context of changes in the current environment surrounding Japan's financial and securities markets, such as more complex, diversified and globalized financial instruments and transactions, and in the context of the spread of internet-based securities trading and so forth, the mode of violations has also undergone considerable change since the introduction of the system. In order to respond to these market changes in a timely and flexible manner, the SESC will be required to utilize the administrative monetary penalty system more than before, and it should serve as an effective tool.

To this end, the pressing issues for the SESC will be to make the most of the special qualities of the administrative monetary penalty system, and to further utilize the system to conduct swift and efficient investigations.

(1) Devising investigative techniques and improving investigative capacity for swift and efficient investigations

The SESC will put effort into devising investigative techniques as well as improving investigative capacity and developing human resources though training and so forth, thereby making investigations quicker and more efficient.

(2) Appropriate enforcement based on the review of the administrative monetary penalty system

In particular, the SESC will conduct even more fine-tuned surveillance of actions that have recently become subject to the administrative monetary penalty system, namely the non-submission of disclosure documents, the non-notification of tender offers, the non-submission of large shareholding reports and so forth, fictitious buying and selling of stocks, exchange of based on collusive arrangements, and illegal stabilization operation trade. One way it will do this is by properly enforcing the expanded administrative monetary penalty system, such as by putting effort into ensuring the effectiveness of deterrence through administrative monetary penalties.

(3) Contributing to the realization of highly flexible and strategic market surveillance

As part of its arsenal, the SESC will flexibly and strategically utilize disclosure documents inspections and administrative monetary penalty investigations to combat new ploys arising amid developments in IT, globalization and changes in the economic situation, as well as against cases of unfair financing and cases that intricately entwine insider trading, market manipulation, spread of stock markets and other such offenses.

(4) Sending out a message

The *Casebook on the Administrative Monetary Penalties under the FIEA* is a compilation of the recommendations made by the SESC for administrative monetary penalties, and is published for the purpose of increasing the transparency of market surveillance administration and encouraging self-discipline among market participants. The SESC will enhance the deterrent effect of penalties by making active use of this casebook.

**2. Challenges relating to Criminal Case Investigations**

Responding flexibly and quickly to changes in the environment surrounding the markets, and increasing the effectiveness of its market surveillance are key issues for the SESC. Therefore, by addressing the following issues, the SESC commits itself to investigate criminal case more effectively and efficiently.

(1) Efforts for complex and malicious composite cases, including strengthened surveillance of primary markets

Recently, amongst listed companies in the doldrums, there have been corporate financing cases where the rights of existing shareholders are substantially diluted, such as allocation of shares to third parties subscribed by foreign registered investment funds and the like. Some of these cases could be regarded as criminal acts, such as the use of fraudulent means prescribed in Article 158 of the FIEA. Moreover, recent criminal acts in the markets including the above mentioned fraudulent financing cases are composed of complicated schemes that entwine a diverse mixture of transactions; and among these, some could be seen as complex and malicious composite cases that involve a variety of criminal acts such as market manipulation, insider trading, submission of false annual securities reports,

spreading of rumors, and other fraudulent schemes. Under the policy statement, *Towards Enhanced Market Integrity*, the SESC commits itself to conduct market surveillance targeting both primary and secondary markets, actively address complex and malicious composite cases including fraudulent financing, and take necessary action in a vigorous manner.

Furthermore, when investigation has detected the possible involvement of so-called "anti-social groups or individuals", the SESC deals with such cases in cooperation with the police authorities as occasion demands.

(2) Enhanced cooperation with overseas regulators

Under the policy statement, *Towards Enhanced Market Integrity*, the SESC works on closing "surveillance loopholes" through enhanced cooperating with overseas regulators. In BY 2008, the SESC filed its first formal complaint for a cross-border insider trading case. Moreover, in February 2008, the Financial Services Agency of Japan signed the IOSCO Multilateral MOU. As a result, the network with overseas market surveillance authorities expanded a great deal, and by using this framework actively, the SESC continues to tackle cross-border cases

(3) New types of market misconduct brought by the widespread use of online trading

The evolution of online trading in the markets has made the mainstream of market misconduct brought via the Internet, and as a corollary, new types of criminal cases which exploit the characteristics of online trading are on the increase. For example, with respect to market manipulation, the trend has changed from traditional techniques employed by professional speculator groups to new techniques where, for instance, amateur day-traders using online trading gain a profit by, repeatedly and within a short period of time, placing a large volume of false buy orders which they never intend to be executed. These new types of manipulation using online trading are not limited to professional speculators; indeed anyone can conduct such market misconduct. The SESC therefore commits itself to respond to this new trend.

(4) Building up the infrastructure for digital forensics

Amid the ongoing evolution of information technology, such operations as the seizure of computers, mobile phones and other types of electronic devices, the preservation, restoration and analysis of electromagnetic records saved on those devices, and making those records admissible as evidence (hereinafter referred to as "digital forensics") are growing increasingly indispensable. Therefore, by recruiting IT professional and equipping itself with mechanical devices necessary for conducting digital forensic activities, the SESC will build up the infrastructure and human resources for digital forensics.

(5) Development of specialist human resources

In criminal case investigations, questioning suspected offenders and analyzing seized articles requires specialist knowledge and skills; it is an important issue to develop specialist human resources equipped with these requirements. The SESC will enhance the specialist capacity of their personnel, not only by mid-career recruitment of professional personnel including attorney-lawyers and certified public accountants, but also by improving training programmes and systematic human resource management in a long-term perspective.

In March 2009, the Ordinance to Implement the Public Prosecutor's Office Act was amended, and as a result, when securities and exchange investigators have experience of more than 3 years, they are now qualified to sit for the examination for the selection of assistant public prosecutors, who are engaged in criminal investigations and trials relating to larceny and other cases which come under the jurisdiction of summary courts. This

opportunity will help the SESC to establish criminal case investigations as one of professional career paths for those engaged in financial services administration.

# 4. Policy Proposals

## 1) Outline

To establish a fair, highly transparent and sound market, and to maintain investor confidence in that market, the rules of the market should respond to changes in the environment surrounding it. So that the rules are maintained appropriately to reflect the actual conditions of the market, the Securities and Exchange Surveillance Commission (SESC) can submit policy proposals to the Prime Minister, the Commissioner of the Financial Services Agency (FSA), or the Minister of Finance. Based on the results of inspections, investigations or other relevant activities, where necessary, the SESC can propose that they take measures to ensure fairness in trading or to secure investor protection and other public interests (Article 21 of the Act for Establishment of the Financial Services Agency).

Policy proposals are submitted after the SESC has comprehensively analyzed the important issues identified in the results of its inspections and investigations. These proposals clarify the SESC's views on laws, regulations and self-regulatory rules, and it is intended that they will be reflected in the policies of the administration and of self-regulatory organizations. The policy proposals submitted by the SESC serve as an important consideration in the policy response of regulatory authorities.

In terms of the substance of specific policy proposals, when existing laws, regulations and self-regulatory rules are found to be insufficient in light of the realities of the securities market, the SESC draws attention to that fact. It then presents issues to be considered regarding the state of laws, regulations and self-regulatory rules from a perspective of ensuring market integrity and securing investor protection and other public interests, and calls on them to be reviewed.

## 2) Specific Policy Proposals and Measures Taken Based on Policy Proposals

### 1. Specific Policy Proposals

From its inception in 1992 through to business year (BY) 2008, the SESC had submitted 19 policy proposals. During the period covered in this publication, based on the results of intensive inspections of financial instruments business operators dealing with foreign exchange margin trading, the SESC submitted four policy proposals to the Commissioner of the FSA: (1) review of methods for segregated management in relation to foreign exchange margin trading, (2) establishment of loss-cut rules in relation to foreign exchange margin trading, (3) deposit of appropriate security in relation to foreign exchange margin trading, (4) review of documents requested and collected at time of application for registration

### 2. Details of Specific Policy Proposals

The details of the specific policy proposals are as follows.

#### (1) Review of methods for segregated management in relation to foreign exchange margin trading

As a result of the intensive inspections of financial instruments business operators dealing with foreign exchange margin trading, many cases were found where, despite securities received from customers being managed through deposits with covering companies, the operators did not have a proper understanding of the amounts of securities received from

customers, and were not appropriately managing their own assets separately from the assets of their customers.

In some cases:

(i) the securities deposited by customers had been withdrawn from the covering company and had been misappropriated; and

(ii) as a result of repeated proprietary trading based on customer securities that had been deposited with a covering company, sudden changes in foreign exchange rates had magnified losses, the business operator had collapsed, and customers had sustained losses.

Consequently, appropriate measures need to be taken with regard to segregated management by financial instruments business operators dealing with foreign exchange margin trading, such as, in cases where the security deposits are cash, limiting the methods of management to money trusts.

**(2) Establishment of loss-cut rules in relation to foreign exchange margin trading**

A "loss-cut rule" is a rule by which a transaction is automatically settled by way of a reversing trade if the loss against a security exceeds a certain ratio. If the said rules are not functioning properly, customers may incur unexpected losses, and the business operator's financial position may be negatively affected, or in the worst case, the business operator may go bankrupt, causing considerable losses to all its customers. For this reason, it is extremely important that loss-cut rules relating to foreign exchange margin trading are managed appropriately.

As a result of the intensive inspections of financial instruments business operators dealing with foreign exchange margin trading, cases were found where:

(i) customers' losses had been magnified because business operators had not established loss-cut rules; and

(ii) despite loss-cut rules being established in an agreement relating to foreign exchange margin trading, receipt of additional security had been deferred at the request of the customer.

Consequently, appropriate measures need to be taken for financial instruments business operators dealing with foreign exchange margin trading, such as making the establishment of loss-cut rules compulsory.

**(3) Deposit of appropriate security in relation to foreign exchange margin trading**

When it comes to financial instruments business operators dealing with foreign exchange margin trading, it is extremely important that appropriate risk management systems be built. This is partly due to a specific characteristic of foreign exchange margin trading, that is, large transactions can be conducted which exceed the security deposited by a customer.

As a result of the intensive inspections of financial instruments business operators dealing with foreign exchange margin trading, cases were found where appropriate action had not been taken at times of sudden changes in exchange rates.

Under existing law, there is no regulation of securities deposited for foreign exchange margin trading: financial instruments business operators dealing with foreign exchange margin trading have designed leverage without restraint. With so-called "high-leverage products," even a slight exchange rate fluctuation can lead to security shortfalls, and there is a risk of customers incurring unexpected losses, or the business operator's financial position

being negatively affected.

Consequently, appropriate measures need to be taken for financial instruments business operators dealing with foreign exchange margin trading, such as making it compulsory for them to accept deposits of security at a level that takes currency fluctuations into account.

**(4) Review of documents requested and collected at time of application for registration**

When registering financial instruments businesses, the documents submitted at the time of applying for registration are extremely important for the purpose of determining its eligibility.

As a result of the intensive inspections of financial instruments business operators dealing with foreign exchange margin trading, a case was found where a business operator had prepared a final balance sheet and a final profit and loss statement which contained false statements, and had also stated false matters in its written calculations of net assets and capital-to-risk ratio, and which had then obtained registration, having applied for registration effectively as a person to whom the conditions for refusal of registration did not apply.

Consequently, appropriate measures need to be taken for the registration of financial instruments businesses, such as requiring applicants to provide *prima facie* evidence and the like which substantiates the fact that the figures for net assets, capital-to-risk ratio and so forth contained in their application documents are not false.

## 3. Measures Taken Based on Policy Proposals

**(1) Measures taken based on the policy proposal for the review of methods for segregated management in relation to foreign exchange margin trading**

The FSA revised the Cabinet Office Ordinance regarding Financial Instruments Business, etc., prescribing that the methods for segregated management in foreign exchange margin trading should be standardized to money trusts (enforced on August 1, 2009).

**(2) Measures taken based on the policy proposal for the establishment of loss-cut rules in relation to foreign exchange margin trading**

The FSA revised the Cabinet Office Ordinance regarding Financial Instruments Business, etc., prescribing that the development and observance of loss-cut rules in relation to foreign exchange margin trading should be compulsory (enforced on August 1, 2009).

**(3) Measures taken based on the policy proposal for the deposit of appropriate security in relation to foreign exchange margin trading**

The FSA revised the Cabinet Office Ordinance regarding Financial Instruments Business, etc., prescribing that, regarding foreign exchange margin trading with individual customers, based on the notion of securing, as a margin, a level that can cover a single day's fluctuations in exchange rates, as a regulation common to both exchange transactions and over-the-counter transactions, business operators should be prohibited from conducting transactions unless they receive a margin deposit equal to at least 4% of the notional principal (to be enforced on August 1, 2010).

**(4) Measures taken based on the policy proposal for the review of documents requested and collected at time of application for registration**

The FSA revised the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., clarifying that, as a point to note in cases where a new application for registration as a type I financial instruments business is received, applicants should be required to submit *prima facie* evidence in order to confirm that conditions for refusal of registration do not apply (applicable from August 1, 2009).

### 3) Future Challenges

As described in point 3 above, three of the four policy proposals have been/will be reflected in the Cabinet Office Ordinance regarding Financial Instruments Business, etc., and the other policy proposal has been reflected in the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. This is indicative of the significant contribution that the SESC has made to the development of market rules based on the realities of the securities market.

Based on the results of conducting inspections, issuing orders for the submission of reports and materials, questioning and collecting opinions, and conducting criminal case investigations pursuant to the Financial Instruments and Exchange Act (FIEA) and other laws, with regard to measures believed necessary to ensure fairness in the trading of financial instruments or to secure investor protection and other public interests, the SESC will submit policy proposals with the aim of having them reflected in the measures implemented by the administration and self-regulatory organizations. Furthermore, with regard to matters that do not require a revision of laws or regulations, and with regard to matters that are not directly linked to policy proposals, the SESC will strengthen its function of providing information, such as actively communicating its awareness of issues to the FSA, self-regulatory organizations and so forth, aiming to share its awareness of issues.

# 5. Efforts to Strengthen Surveillance Activities and Functions

## 1) Reinforcement and Strengthening of the Market Surveillance System

### 1. Reinforcement of Organization

(1) Reinforcement of Organization

In addition to enhancing and strengthening the market surveillance function of the Securities and Exchange Surveillance Commission (SESC), as seen in the delegation of authority to conduct administrative monetary penalty investigations and the expansion of its authority to conduct inspections, the SESC has reinforced its organizational structure by expanding its organization from the previous two-division system, comprised of the Coordination and Inspection Division and the Investigation Division, to the current five-division system.

In fiscal 2009, amid the severe conditions for overall quotas of national public service personnel, as a result of requesting an increase in personnel as one of the main pillars of improving the system of administrative monetary penalties and disclosure documents inspection, an increase of 22 officers was approved. This brings the total SESC staff quota as at the end of BY 2009 to 374.

As for securities transactions surveillance officers (divisions) at local finance bureaus, an increase of 25 officers was approved, mainly for improving the system of administrative monetary penalties and disclosure documents inspection, bringing the quota as at the end of BY 2009 to 300. Combined with the staff quotas of the SESC, the total number stands at 674.

(2) Appointment of Private-Sector Experts

From the perspective of ensuring accurate market surveillance and boosting professional expertise among its officers, during business year (BY) 2008, the SESC reinforced its investigation and inspection systems by employing a total of 23 private-sector experts with specialized knowledge and experience in the securities business, including lawyers and certified public accountants. The appointment of private-sector experts started in 2000, and as of the end of June 2009, 104 such professionals were employed at the SESC.

### 2. Improvement of Capacity for Collecting and Analyzing Information

(1) Utilization of the Securities Comprehensive Analyzing System (SCAN-System)

Due to the need to ascertain all the facts relating to securities transactions by analyzing complicated and massive amounts of data, the SESC has been developing a system supporting its operations called the "Securities Comprehensive Analyzing System (SCAN-System)" since 1993 in order to enhance operational efficiency. The SCAN-System is a comprehensive computer system that can be widely used in the operations of the SESC, including in the investigation of criminal cases, the investigation of administrative monetary penalties, the inspection of disclosure documents inspection, the inspection of financial instruments business operators, day-to-day market surveillance, and in market oversight. Even after the completion of its fundamental development in 2001, efforts to review and enhance each of its functions have been continuously made aimed at achieving more efficient operations.

In BY 2008, at the phase of finalizing the requirements definitions for the next-generation

system (Integrated FSA Business Support System) based on the "Optimization Plan of Business Processes and Systems on the Inspections and Supervision of Financial Institutions and the Securities and Exchange Surveillance," which was founded on the philosophy of the Program for Building e-Government (as per the decision dated March 28, 2006 by the e-Government Promotion Conference, FSA), the SESC has considered ways of getting the necessary system functions for each business process reflected in the requirements definitions.

Moreover, with respect to Digital Forensics, the SESC is committed to considering means of incorporating those techniques and technologies into the SESC, and to urgently providing the necessary system equipments and materials.

The SESC has also being ascertaining the needs in related divisions including Investigation Division and is considering how to best lay the groundwork so that Digital Forensics technology can be used in market surveillance.

Note: The SCAN-System consists of two major functional modules: the "Securities Companies Inspection System" and the "Market Oversight System." In addition, there are some supporting systems in the SCAN-System: the "SCAN-Internet Patrol System (SCAN-IPS)," the "SCAN-Surveillance by Technical Analysis of Corporation Finance System of Electronic Disclosure (SCAN-STAF)," and the "Information Control System" for efficiently processing information provided from the general public.

(2) Better Staff Training

The SESC has built up expertise on various surveillance methods through actual inspections and analysis of their results, and it has provided officials with such expertise through on-the-job training and seminars to develop their talent.

In recent years, the environments surrounding financial and capital markets are drastically changing day by day. For example, the mechanics of transactions have become more complicated and diverse, new financial instruments have been developed one after another, cross-border transactions and online trading have been rapidly expanding, and there has been the occurrence of the global financial crisis. To respond appropriately to such circumstances, in addition to basic operational training designed for staff to individually acquire highly specialized knowledge and skills, the SESC also provides training so that staff can increase their understanding of new financial instruments and transaction methods which reflect the new trends in financial and capital markets, and so that they can become more familiar with investigative techniques, such as for digital forensics, for which there is a growing social need. The SESC also conducts training for staff to deepen their understanding of the details of the various reforms pertaining to the Financial Instruments and Exchange Act (FIEA).

As the development and utilization of the SESC personnel becomes more significant, the role played by middle-level supervisors in providing guidance to their subordinates is becoming more and more important. Therefore, meetings for middle-level supervisors are held in an attempt to foster their awareness.

Furthermore, in order for the SESC's officials to learn the surveillance and inspection techniques used by regulatory authorities overseas, and to then apply those techniques in market surveillance operations at the SESC, the SESC has sent staff from the SESC Executive Bureau to participate in training hosted by the US Securities and Exchange Commission (SEC), the US Commodity Futures Trading Commission (CFTC) and by the UK Financial Services Authority (UKFSA), and has also deployed staff temporarily to the SEC and the CFTC.

## 2) Dialogue with Market Participants and Efforts to Strengthen the Provision of Information to the Market

As part of its "collaboration with stakeholders for market integrity," which is the second mainstay of the policy statement, *Towards Enhanced Market Integrity*, the SESC mentions enhancing dialogue with market participants and providing more information to markets. As such, the SESC is making efforts to communicate with individual investors and other market participants actively and widely. The SESC uses a variety of creative means to do this, including informal meetings to exchange views, lecture meetings, public talks, press releases, interviews and the SESC website. By providing details of its activities and other information in a timely fashion, the SESC aims to increase the understanding of its efforts among market participants and to deepen their confidence in the financial and capital markets.

A feature of its efforts during BY 2008, was that the SESC adopted a positive approach for opening up new channels for disseminating information in order to further strengthen the provision of information to the market.

## 3) Cooperation with Relevant Authorities and Organizations

### 1. Outline

In addition to further strengthening its cooperation with the FSA (the regulatory authority for financial and capital markets in Japan) such as by exchanging information rigorously, the SESC has also strived to maintain a close relationship of information exchange with Japan's financial instruments exchanges and with the Japan Securities Dealers Association (JSDA) and other self-regulatory organizations. The SESC has also been exchanging views and ideas with market participants such as the Japan Securities Clearing Corporation and the Japan Securities Depository Center, who play an important role in strengthening market discipline, and with interested participants such as the Japan Federation of Bar Associations and the Japanese Institute of Certified Public Accountants, who are concerned with preserving the fairness of markets. Moreover, as criminal cases become more geographically widespread, as well as strengthening its cooperation with the police and public prosecutors, the SESC has been exchanging views and ideas with such authorities, with the aim of eliminating the involvement of anti-social forces in financial and capital markets.

With the rapid increase in cross-border transactions of financial instruments in recent years, it has become more important than ever before to reinforce cooperation with overseas securities regulators in order to ensure fairness in Japan's markets, and in order to respond to the instability in the markets associated with the increased financial turmoil worldwide.

The SESC is therefore making every effort to enhance cooperation with overseas regulatory

authorities, such as through participating in major international conferences hosted by the International Organization of Securities Commissions (IOSCO) and other organizations and through exchanging opinions and information with senior officials from overseas securities regulators. The SESC intends to continue strengthening these activities to promote cross-border teamwork.

## 2. Cooperation with Overseas Securities Regulators

(1) Participation in IOSCO

IOSCO is an international organization acting with the aim of establishing international harmony of securities regulations and mutual collaboration among regulatory authorities. At present, IOSCO is composed of 193 organizations representing countries or regions. The SESC became a member of IOSCO in October 1993. (Note: The SESC is an associate member. As a body representing Japan, the FSA participates in IOSCO as an ordinary member.)

In IOSCO, the Annual Conference led by the Presidents Committee which is the supreme decision-making body of IOSCO is held every year, where the top-level officials of securities regulators from various countries meet together to discuss and exchange opinions on the current situation and challenges of securities administration. As the number of international transactions in financial and capital markets increases, it is extremely important to deepen international collaborative relationships through the exchange of information and opinions with regulatory authorities from various countries in order to carry out proper market surveillance in Japan, Therefore the SESC sends its Chairman or Commissioner to attend the Annual Conference of IOSCO. As for the most recent conference just past, Commissioner Kumano attended the 34th Annual Conference held in Tel Aviv (Israel) in June 2009. In addition, the SESC also participates in the Asia-Pacific Regional Committee (APRC) which is one of the Regional Standing Committees of IOSCO to discuss specific regional problems. In this way, the SESC is striving to strengthen cooperation with overseas regulators.

For the purpose of discussing major regulatory issues faced by international markets and proposing practical solutions for such issues, IOSCO has established the Technical Committee, which is made up of the regulatory authorities of developed countries or regions, and as a substructure, it has established six standing committees (SC). The SESC is a member of the Standing Committee 4 (SC4) on enforcement and exchange of information which was set up to discuss ways of cooperation among securities regulatory authorities from different countries concerning enforcement issues and information exchange in order to respond to international securities crimes. This year, the SC4 had a discussion on promotion of dialogues with uncooperative jurisdictions and some other issues.

With regard to the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information adopted in the Annual Conference in May 2002(Multilateral MOU), which is an information sharing framework among multiple securities authorities, the SESC also participates in meetings of the Screening Group (SG) to examine countries/jurisdictions applying for the signing of the Multilateral MOU.

At the Annual Conference held in Colombo in April 2005, the Multilateral MOU was positioned as an “international benchmark” for the cooperation and information exchange in relation to enforcement issues, and it was resolved that the IOSCO members would sign the Multilateral MOU, or make an official commitment to seek a legal authority to enable signing

the Multilateral MOU, by January 1, 2010 at the latest. In May 2006, Japan submitted an application to sign the Multilateral MOU, and in February 2008, Japan was approved as a signatory country. As a result, the SESC has become able to mutually exchange information necessary for enforcement with other signatory countries of the Multilateral MOU. Furthermore, since December 2008, the SESC has contributed together with the FSA at the SG in terms of the screening of signatories.

(2) Bilateral Cooperation with Overseas Regulators

(i) Conclusion of Information Sharing Agreements

Information sharing among securities regulatory authorities from different countries is absolutely essential, because market misconduct that may impair fairness of trading in multiple countries' markets are expected to occur more frequently with an increase of cross-border transactions in financial and capital market. In order to exchange information smoothly with overseas regulators, the FSA has entered into information sharing agreements with the following regulatory bodies:

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

As mentioned above, the FSA became a signatory to the Multilateral MOU in February 2008. As a consequence, it became possible for the FSA including SESC to mutually exchange information necessary for surveillance and law enforcement with other securities authorities from all over the world which are signatories to the Multilateral MOU, and intends to ensure fairness in further cross-border securities markets under international cooperation.

In April 2009, in cooperation with the Monetary Authority of Singapore, the SESC filed its first ever formal complaint against a malicious act using cross-border transactions. Going forward, the SESC will actively cooperate with overseas regulators, and will work on preventing any gaps from opening up in its market surveillance.

(ii) Exchange of information and opinions

In an effort to enhance cooperation with overseas securities regulators, the SESC is proactively exchanging information with them based on bilateral information sharing agreements.

Specifically, the SESC has exchanged information about suspected cases of market misconducts with the SEC of the United States, the Financial Services Authority (FSA) of the United Kingdom, the MAS of Singapore, the SFC of Hong Kong, and other overseas regulators.

The SESC also exchanges opinions with senior officials of overseas securities regulators as needed. In BY 2008, during a visit to the United Kingdom by Commissioner Kumano, opinions were exchanged with Callum McCarthy, Chairman of the FSA of the United Kingdom; and during the 34th IOSCO Annual Conference in June 2009, views were exchanged with senior officials of the SEC of the United States, the CFTC of the United

States, the FSA of the United Kingdom, the Financial Supervisory Service (FSS) of the Korea, the SFC of Hong Kong and the MAS of Singapore.

(3) Seminar for Overseas Regulators

In March 2009, the SESC held the "Tokyo Enforcement Conference", inviting 16 officials in charge of law enforcement at securities regulators in nine emerging countries in Asia. The aim of this conference was to assist emerging Asian countries in developing human resources and to contribute to the development of their securities administration and markets. At the conference, in addition to lectures delivered by the SESC officials on the investigation, inspection and market oversight work of the SESC, there were also practical and participatory activities, including a presentation with participants from each country as panelists, a free discussion session, as well as participatory group workshops.

# 6. Expansion of the SESC Operations under the Revised FIEA

## 1) Outline

For the purpose of responding to the current turmoil in global financial markets and strengthening the functions of Japan's financial and capital markets, one of the urgent tasks is to build reliable and vibrant financial and capital markets by developing fair, transparent and highly convenient market infrastructure.

Based on this perspective, by means of the recent revisions to the Financial Instruments and Exchange Act (FIEA), regulations targeting credit rating agencies have been introduced to further ensure the fairness and transparency of the markets, and an alternative dispute resolution system in the financial sector (financial ADR system) has been established to enhance user protection.

## 2) Expansion of the SESC Operations under the Revised FIEA

### 1. Introduction of Official Regulations for Credit Rating Agencies

In connection with subprime mortgage problems, issues have recognized regarding credit rating agencies, such as the validity of their procedures for credit ratings and conflicts of interest. Efforts are being promoted worldwide in relation to introducing or strengthening the regulation of credit rating agencies.

In light of these trends, credit rating agencies, which play an important role as part of the information infrastructure in financial and capital markets, have become subject to regulation and supervision, such as through the introduction of a registration system. In terms of the framework of the regulation and supervision of credit rating agencies, registered credit rating agencies are: (i) required to exercise a duty of good faith; (ii) required to disclose information, that is, publish their rating policies and processes, and make available their explanation documents; (iii) required to establish control systems in order to prevent conflicts of interest and ensure the fairness of the ratings process; and (iv) prohibited from issuing credit ratings if the agency holds the rated securities.

The Securities and Exchange Surveillance Commission (SESC) has been delegated the authority to order registered credit rating agencies to submit reports and the authority to conduct on-site inspections. This authority is subject to: (i) the credit rating agency; (ii) persons who conduct transactions with the said credit rating agency (orders for the submission of reports only); (iii) persons who have been subcontracted by the credit rating agency; and (iv) the relevant corporations of credit rating agencies (see Note).

(Note) A "relevant corporation of a credit rating agency" is defined as a corporation with certain capital ties with the credit rating agency, which conducts the issuing or providing credit ratings in the course of its business. Specifically, it is envisaged that the corporation would belong to the same group as the credit rating agency and would conduct some of the credit rating operations without entering into an outsourcing contract, such as participating in the rating committee, but which would not have obtained registration as a credit rating agency.

## 2. Establishment of an Alternative Dispute Resolution System in the Financial Sector (Financial ADR System)

As financial instruments and services become more diverse and complicated, it is important that an alternative means of resolving problems related to financial products and services easily and quickly be provided, and that users be protected and the credibility of financial products and services for users be improved through dispute resolution that is acceptable to users.

In the past, complaint arbitration and dispute resolution related to financial products and services had been conducted voluntarily by industry associations and the like. However, the following issues were also raised:

- From a perspective of neutrality and fairness, dispute resolution has not fully earned the trust and satisfaction of users;
- Compliance with procedures and respect for the results of mediation by financial institutions have not been institutionally ensured, and are not sufficiently effective.

In light of these circumstances, for the purpose of improving effectiveness and gaining the trust and satisfaction of users in the resolution of problems related to financial products and services, a new legal framework for financial ADR has been established, in which a private-sector organization for arbitrating complaints and resolving disputes is designated by the competent minister (designated dispute resolution body), and which continues to ensure the neutrality and fairness of the resolution of disputes, while requiring financial institutions to comply with procedures and respect the results of mediation and so forth.

Furthermore, as a development of the supervisory regulation of designated dispute resolution bodies, the SESC has been delegated the authority to order such bodies to submit reports and the authority to conduct on-site inspections.

# Supplements

*The SESC has got new Board members in July 2007. The SESC, under the new Board, has issued a policy statement to pursue its missions in the coming years.*

# Towards Enhanced Market Integrity
# - Policy Statement of New SESC –

**(Tokyo, September 5, 2007)**

## 1. Missions

The SESC is committed to achieving two objectives:

- To ensure integrity of capital market
- To protect investors

## 2. New Board Members

Three members of the Board were newly appointed on July 20, 2007.

- Chairman Mr. Kenichi Sado
- Commissioner Mr. Shinya Fukuda
- Commissioner Mr. Shozo Kumano

## 3. Directions of new SESC

Japanese capital market has been experiencing dynamic changes. New and more complex financial products and transactions continue to develop under fast moving capital flows across countries. The regulatory environment has also evolved to address such changes in the markets, including the introduction of the Financial Instrument and Exchange Act (FIEA) in September 2007.

Noting the rapidly changing market environment, the SESC is determined to make its best efforts as a market regulator, setting out the following directions.

**(1) Timely and comprehensive oversight with more strategic focus**

- Prompt and effective market oversight by strategically adopting the best-mix of regulatory tools endowed to the SESC, including daily market surveillance, inspection of regulated entities, administrative monetary penalty investigation, disclosure document inspection and criminal investigation

- Proactive oversight for potential risks on top of current market misconduct
- Enhanced cooperation with Self Regulatory Organizations (SROs) and overseas regulators in order to achieve effective market oversight across market places

**(2) Collaboration with stakeholders for market integrity**

- Contribution to rule-making processes by the FSA and other relevant authorities, reflecting challenges identified through market oversight by the SESC
- Enhancement of self-regulatory functions of SROs
- Outreach to market participants to encourage their self-discipline for market integrity
- Closer dialogue and communication with market participants

We believe that effective market oversight by the SESC and consequent high level of market integrity are essential for the Japanese capital markets to be further active and competitive in global market places.

## 4. Policy Focus

The SESC is determined to strategically mobilize its regulatory tools and resources with particular emphases on the followings in order to conduct effective and efficient market oversight.

**(1) Comprehensive and timely market oversight**

- Seamless oversight on both primary and secondary markets
- Extensive surveillance on suspicious transactions
- Analysis on backgrounds behind individual cases and market developments to help timely market oversight

**(2) Enhanced use of administrative monetary penalty system**

- Further exploitation of administrative monetary penalty system to expeditiously address market misconducts

**(3) Implementation of FIEA**

- Expansion of the scope of inspection to cover collective investment schemes and quarterly corporate disclosure
- Increased focus on internal-control and governance of regulated entities

**(4) Enhanced cooperation with SROs**

- Further cooperation with SROs in areas including oversight of member firms, rule-making, as well as outreach to market participants

**(5) Enhanced cooperation with overseas regulators**

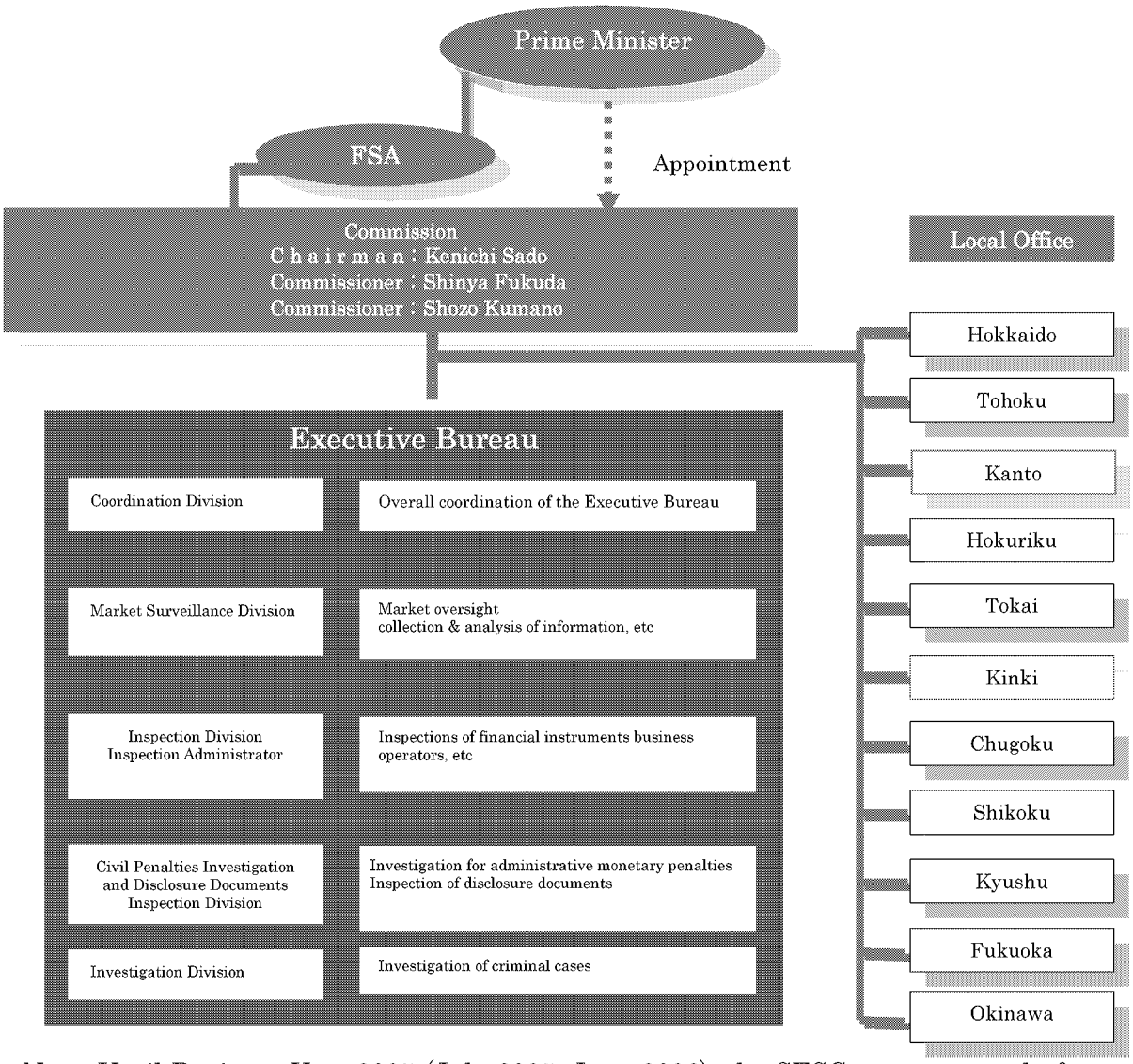
- Further cooperation with overseas regulators, including proactive information exchange as well as surveillance of electronic trading, thus precluding any loopholes in market oversight

## *- Message to Market Participants -*

*The SESC alone cannot secure integrity of the market; individual market participants' effort is crucial. Let us work together to enhance integrity of the capital market for everyone to participate with comfort.*

**Table 1**

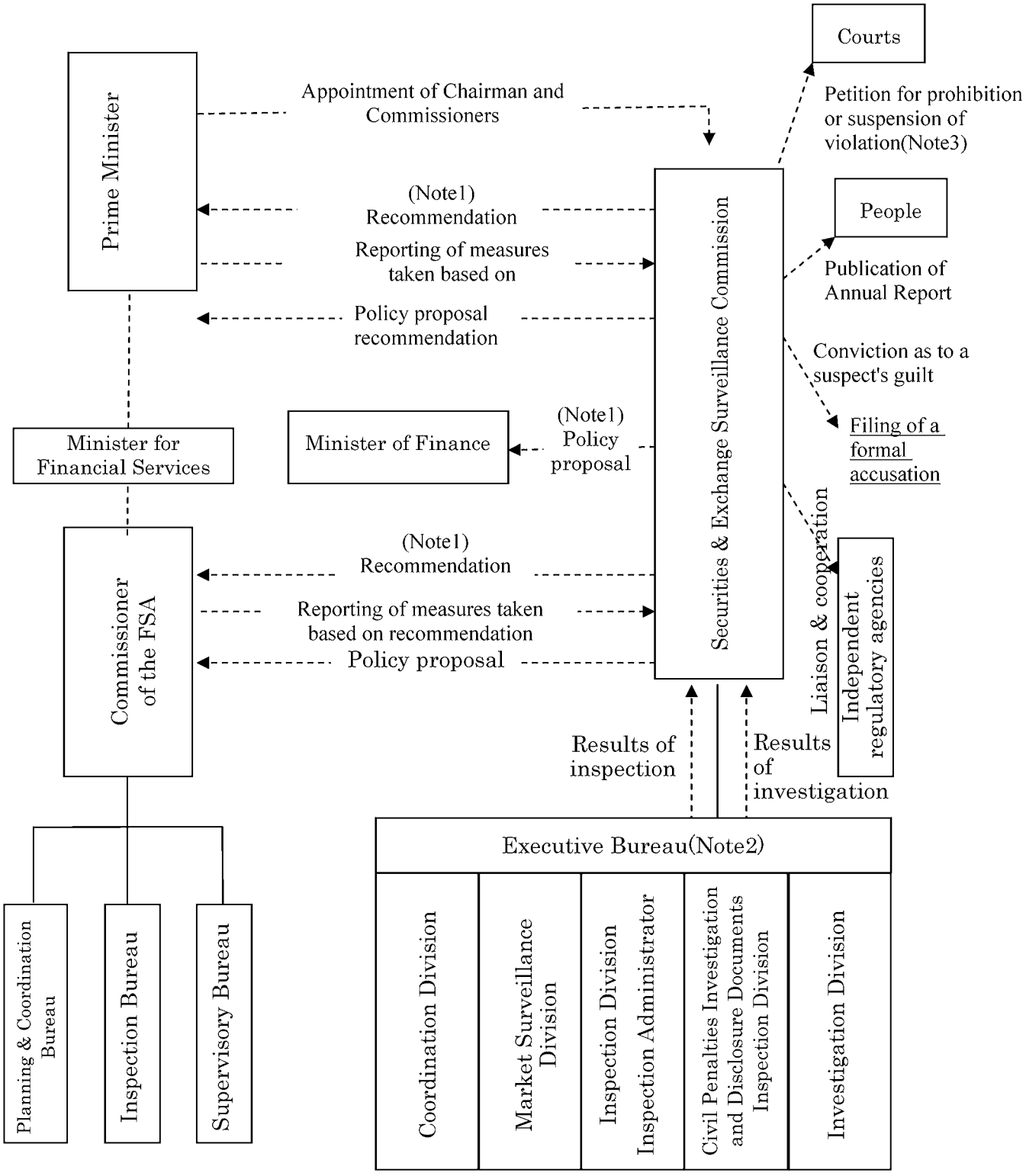
## Organization of the SESC




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

**Table 2**

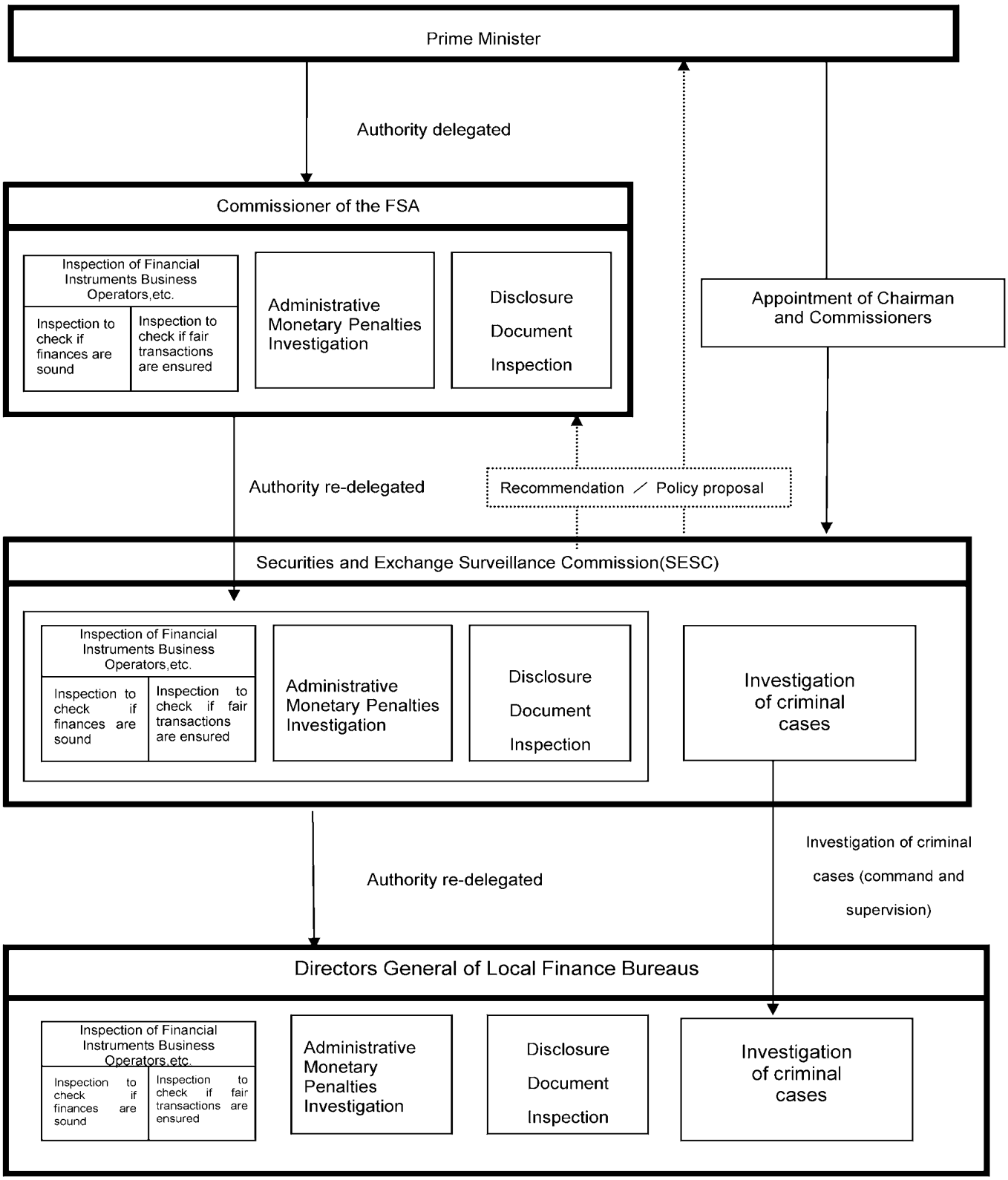
## Conceptual Chart for Supervision of Securities Transactions




(Note 1) Recommendations can be filed with the Prime Minister and the Commissioner of the FSA. Policy proposals can be filed with the Prime Minister, the Commissioner of the FSA or the Minister of Finance (Articles 20 and 21 of the Act for Establishment of the Financial Services Agency).
(Note 2) In July 2006, reorganized from a two-division system, comprised of the Coordination and Inspection Division and the Investigation Division, to a five-division system.
(Note 3) The June 2009 revision of the FIEA resulted in the authority to file the petition based on Article 192 of the FIEA being delegated from the FSA.

Table3

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




(Note1) For the authority that the SESC delegates to Director General of Local Finance Bureau or the Director of its branch office, the SESC directs and supervises Director General of Local Finance Bureau or the Director of its branch office. (FIEA: Article 194-7 (7))

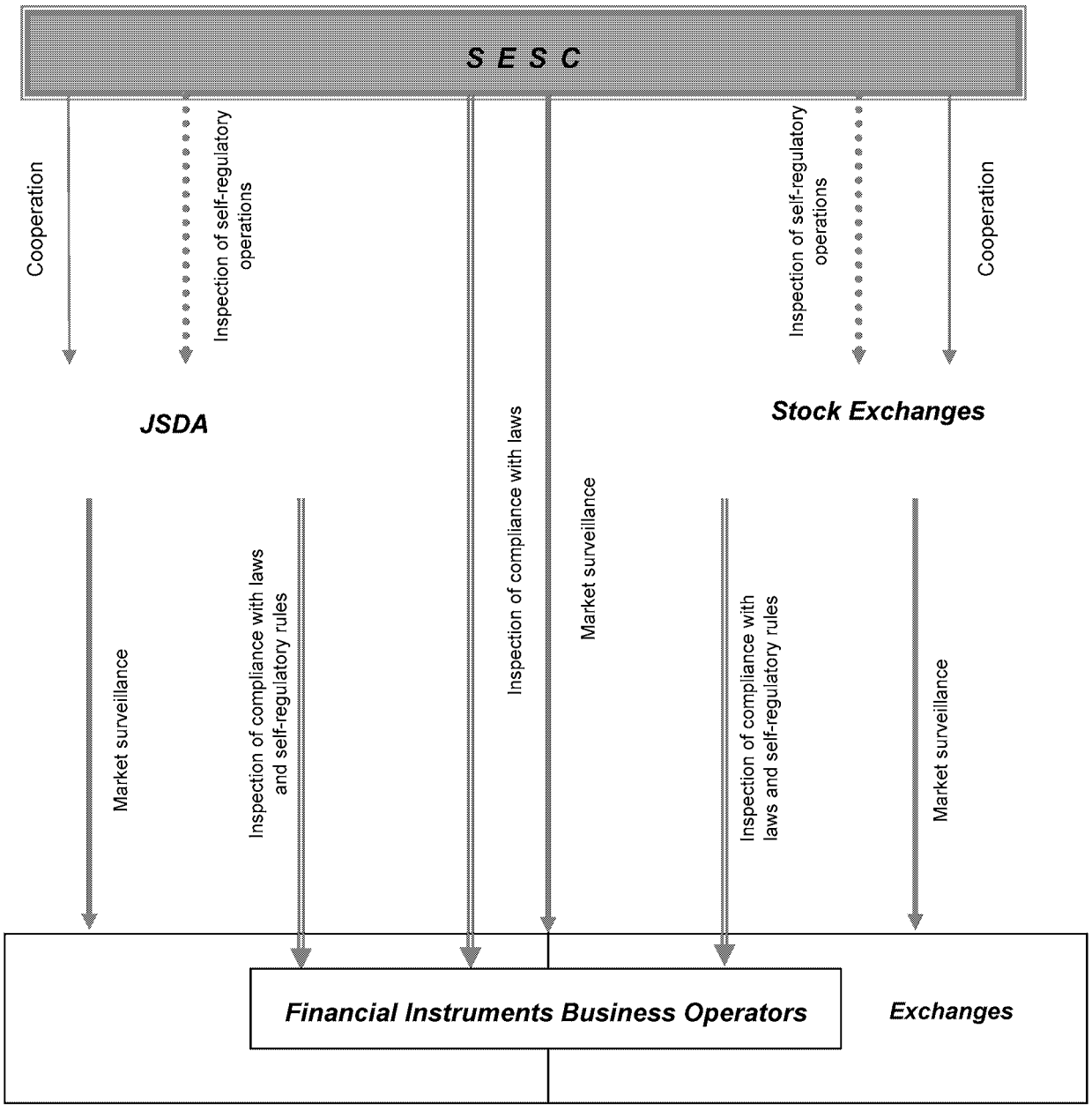
(Note2) For an investigation of a criminal offence, the SESC directs and supervises the Director General of a Local Finance Bureau or the Director of its branch office. The SESC may, deeming it necessary for investigating a criminal offence, direct and supervise firsthand an official of a Local Finance Bureaus or the Director of its branch office. (FIEA: Article 224(4) and (5))

(Note3) The SESC does not delegate authority to the Director-General of local finance bureaus, etc.related to financial instruments business operators etc designated in the following public notices

- The public notice to designate a financial instruments business operator, etc. under paragraph 5, Article 44 of the Order for Enforcement of the FIEA and paragraph 2, Article 136 of the Order for Enforcement of Act on Investment Trust and Investment Corporation
- The public notice to designate a financial instruments business operators, etc. under paragraph 6, Article 24 of the Order for Enforcement of Act on the Prevention of Transfer of Crime Proceeds

**Table 4**

## Relationship to Self-Regulatory Organizations




Note: The same system applies to financial futures.

# Summary of Notable Cases Subject to Recommendations Issued by the SESC during Business Year 2008

## Summary of Notable Cases Subject to Recommendations Issued by the SESC during Business Year 2008

(1) Recommendations based on inspections of securities companies

(Example)

◎ A case where the recommendation has been issued against the company and its officer(s) or employee(s)

○ A case where the recommendation has been issued against the company

(July 2008 - June 2009)

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
|---|---|---|
| July 11, 2008<br>(Fukuoka) | ○ Act of running advertisements that contain indications which are at considerable variance with the facts<br><br>During the period from August 1, 2006 to September 30, 2007, Golden Pyramid Inc. produced leaflets designed to find potential customers on three occasions (17,080 leaflets in total), and offered them for distribution in taxis.<br>The leaflets were produced by the head of the financial instruments business division, who concurrently serves as the head of the legal compliance division. They describe "date joined," "invested funds" and "performance" for a total of 12 customers (four customers for each of the three leaflets) and posted their excellent performance as their actual result. However:<br>(i) No one of the twelve "customers" exists among the company's customer base; and<br>(ii) "Performance" has not been calculated based on the actual results of any specific customers, and "invested funds" and "performance" has been fabricated based on the favorable imaginary scenario.<br>By creating false performance of its advisory service, and including them in leaflets to the public, the company made indications that are at considerable variance with the facts. | Disciplinary action against the company<br><br>Business suspension order<br>• Suspension of all services for investment advisory business for the period August 1 to August 31, 2008<br><br>Business improvement orders<br>(i) To clarify where the responsibility lies for these violation of laws and regulations<br>(ii) To enhance and strengthen internal control systems, to formulate recurrence prevention measures designed to eradicate violations of laws and regulations, and to boost awareness of employees with them<br>(iii) To improve business management systems for compliance<br>(iv) To implement measures for the enhancement of the internal inspection system<br>(v) To submit reports on the responses to (i) to (iv) above |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
|---|---|---|
| August 1, 2008<br>(Hokkaido) | ○ Registration of a financial instruments business under the false statement, and deficient capital adequacy ratio (under 120%), etc.<br><br>(1) Registration under the false statement<br>In November 2007, Asset Company Inc. applied for registration as a type I financial instruments business operator pursuant to Article 31(4) of the FIEA. However, the company has not meet the requirement of net assets and capital adequacy ratio at the end of September 2007, while Article 29-4(1)(v)(b) and Article 29-4(1)(vi)(a) of the FIEA requires net assets (50 million yen) and capital adequacy ratio (120%) for registration.<br>Thereupon, the company manipulated its balance sheets and profit and loss statements (Article 10(1)(i) of the Cabinet Office Ordinance regarding Financial Instruments Business, etc.) for the end of September and the end of October 2007. In addition, the company also stated false matters in the document calculating net assets (Article 10(1)(ii)(a)) and the document calculating the capital adequacy ratio (Article 10(1)(iii)(b)). The company then applied for registration as a person for which the conditions for refusal of registration are not applicable. The company obtained registration as a type I financial instruments business operator on November 28, 2007.<br><br>(2) Deficient capital adequacy ratio (less than 120%), etc.<br>(a) The company's capital adequacy ratio was below 120% throughout the period from the date of the application for registration (November 2, 2007) until the inspection (May 30, 2008). The company's net assets were also less than 50 million yen throughout the same period.<br>(b) However, no report which is required in case the ratio under 140% was submitted by the company despite that the ratio based on Article 46-6(1) of the FIEA had been below 140% during the period from the date of the application for registration until inspection. Moreover, false reports which were required every month were submitted stating that its capital adequacy ratio was satisfying the 120% requirement.<br>(c) In response to the order based on Article 56-2(1) of the FIEA, the company has been submitted monthly report regarding capital adequacy ratio and support documents such as (a) trial balances for every month, and (b) customer deposit balances. However, both of these documents contained false statements; (a) during the period from November 2007 to April 2008 and (b) during the period from February to April, 2008. | Disciplinary action against the company<br><br>Rescission of registration<br><br>Dismissal of the representative director<br><br>Business improvement orders<br>(i) To close customer transactions quickly, refund customers properly, and to sustain company asset<br>(ii) To take all possible measures for the of customers protection and fairness among customers<br>(iii) To thoroughly inform customers of the above rescission of registration, such as displaying at the company's office and posting on its website, and to take care of the customers appropriately<br>(iv) To report on the progress of (i) to (iii) above, and to report as required until all deposits and other monies have been returned to customers |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
|---|---|---|
| | (3) False on separate management between own property and customer belongings<br>The company claimed that it was separately managing its customers' property, such as customer deposit and equivalent amount of realized/unrealized gains and losses related to foreign exchange margin trading, by depositing with the counterpart of cover transaction (hereinafter referred to as the "amount to be separately managed"). However, deficit amount of separate management has been deposited from December 14, 2007 until May 30, 2008 (the base date of inspection). | |
| September 17, 2008<br>(Kinki) | ◎ Compensating customers for losses caused by transactions<br><br>(1) Compensating by fabricating fictitious transactions<br>The member of the FX Division at Panta Rhei Securities Co., Ltd. accommodated a request from the customer to compensate for losses caused by loss-cut related to foreign exchange margin trading in August 2007. At his own discretion, he provided financial benefits amounting to 12.58 million yen by six fictitious transactions on three days (September 5, September 10 and October 9, 2007). The methods he used were to produce settlement profits by entering fictitious new orders and settlement orders at a management terminal, and to lessen the settlement losses by changing the unit price of the contract data.<br>(2)Failing to report to the authority while compensating customers' losses due to system failures, etc.<br>(a) Between July 13 and September 4, 2007, the company provided compensation amounting to 7.888 million yen to ten customers who had incurred losses during eight system failures related to foreign exchange margin trading which occurred between July 13 and August 9, 2007. The company did not submit notification of these cases to the Director-General of the Kinki Local Finance Bureau. (b) On August 6 and September 4, 2007, the company compensated for 47,000 yen in excess of the amount of losses to three customers caused by two system failures that occurred on July 20 and August 9, 2007.<br><br>○ Insufficient management of electronic data processing systems<br><br>During the period from June to September 2007, the company caused no less than 18 system failures related to foreign exchange margin trading. A large number of these system failures caused losses to customer transactions. Nevertheless, the company had no procedure for responding to system failures, and it did not even identify that customers had incurred losses. There was no systematic response, only a manager dealing with the situation on an ad hoc basis.<br>Given that the company's IT risk management is left entirely up to certain employees and that no systematic IT risk management are in place, the company has failed to notice that in response to a request from a customer, a member of the FX Division had single-handedly provided financial benefit by entering fictitious transactions using a management terminal, as described in (3) (i) above.<br>Thus the company's IT risk management systems were found to be in an extremely inadequate. | Disciplinary action against the company<br><br>Business suspension order<br>・ Suspension of all over-the-counter derivatives trading for the period from September 29 to October 1, 2008<br><br>Business improvement orders<br>(i) To clarify where the responsibility lies for these violation of laws and regulations<br>(ii) To improve business management systems for compliance<br>(iii) To enhance internal control systems and to take appropriate measures in order to prevent violations of laws and regulations, and to familiarize officers and employees with them<br>(iv) To fully review of the system failures, to develop effective IT risk management systems by means of the implementation of audits and the establishment of rapid reporting of system failures, |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
|---|---|---|
| | | and to properly put such systems into practice<br>(v) To report in writing on the responses to (i) to (iv) above, and to report in writing every three months for the time being on the implementation of (ii) to (iv)<br><br>Disciplinary action against the sales representative<br>Suspension of duties for six weeks |
| November 14, 2008 | ○ Violation of duty of due care pertaining to the property acquiring from a stakeholder<br><br>Creed REIT Advisors, Inc. managed the entrusted assets owned by the Creed Office Investment Corporation based on an entrustment agreement. In March 2006, when acquiring properties from a stakeholder such as the company's parent company, Creed REIT Advisors, Inc., with respect to one property, failed to take action for meeting the criteria set out in the investment policy of the company pertaining to the acquisition of properties in which asbestos has been used, and caused the investment corporation to incur unnecessary expenses. Furthermore, with respect to another property, the company made the investment corporation acquire assets without taking into account the no rental earning period during extension and rebuilding work. | Disciplinary action against the company<br><br>Business improvement orders<br>(i) To clarify the management stance on legal compliance, to establish legal compliance systems and internal control systems in which management is responsible, and to review business operations to steadily achieve these systems, in an attempt to realize fair nad appropriate business operations as an investment management business operator<br>(ii) To make any arrangements so that, when acquiring and managing the operating property of the investment corporation, verification of appropriateness of materials provided to real estate appraisers and the reflection of the materials in the appraisal, so that properties are acquired based on an appropriate |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
|---|---|---|
| | | appraised value<br>(iii) To formulate and implement effective recurrence prevention measures, and to clarify where responsibilities lie<br>(iv) To submit business improvement plans regarding (i) to (iii) above, and to implement those plans immediately |
| June 26, 2009 | ○ Serious violation of laws and regulations which damaged public interest and investor protection in the solicitation for units in collective investment schemes<br><br>Gains Asset Management Ltd. (hereinafter referred to as "Gains Asset Management") obtained registration as a type II financial instruments business operator in May 2008, stating its principle business as soliciting investment for anonymous partnership agreements. The partnership funded to 2 projects ("the financed projects") including leasing high-concentration oxygen generators (hereinafter, the company managing the said project is referred to as "Company A").<br><br>From May 2008, Gains Asset Management solicited for seven types of units in the collective investment scheme related to the said oxygen generator lease project (hereinafter referred to as the "O2 Fund"). However, as described in (2) and (3) below, serious violation of laws and regulations in terms of public interest and investor protection were found in the said solicitation.<br><br>(1) Administration of the O2 Fund<br>(i) Dividends unsupported by the assets of the anonymous partnership or by the actual performance of the financed project<br>With respect to the financed project related to the O2 Fund, from November 2008, Gains Asset Management did not receive any performance reports on the said project from Company A. Furthermore, with the utilization rate on oxygen generators deteriorating considerably, the financed project had almost no earnings from December 2008, which meant that Gains Asset Management was in a position where either the receipt of earnings from Company A was delayed or there were no receipts.<br>Amid this situation, without ascertaining the condition of the assets of the anonymous partnership, or confirming the actual performance of the financed project, and despite not having any performance, Gains Asset Management paid dividends equivalent to an annual rate of return of about 10%, which was premised on a utilization rate of 70%.<br>(ii) Charging of large, unexplained costs borne by investors (promotional costs)<br>With regard to the fees, commissions and other costs, etc. borne by investors which are charged by Gains Asset Management (hereinafter referred to as the "costs borne by investors"), the promotional and sales materials and the pre-contract documents only go as far as stating "subscription fees" equivalent to 5% of the contribution (or 25,000 yen per contribution unit of 500,000 yen). | Disciplinary action against the company<br><br>Business suspension order<br>・ Suspension of all financial instruments business for the period June 26 to December 25,2009<br><br>Business improvement orders<br>(i) To quickly ascertain the circumstances of customers and how the investment assets have been used and managed, and to examine refund policies of the assets to customers and specific measures for refund<br>(ii) To explain to customers how the investment assets have been used and managed, and to take necessary procedures based on the wishes of customers<br>(iii) To take all possible measures for the protection of customers, with due consideration to equality among customers<br>(iv) To put in place the necessary staff assignment in order to explain and to return invested monies to |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
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| | However, in addition to the "subscription fees", Gains Asset Management also charged 200,000 yen for promotional costs from each contribution unit of 500,000 yen (equivalent to 40% of each unit of 500,000 yen) by means of receiving from Company A, thereby imposing this cost on investors.<br><br>(2) Misleading advertisements or other representations to investors<br>It was found that all of the facts mentioned in (1) above could have a significant influence on the investment decision on the O2 Fund, and that Gains Asset Management should have recognized these facts from March 2009 at the latest, or should have investigated.<br>However:<br>(i) Although Gains Asset Management was charging 200,000 yen in promotional costs to each contribution unit (500,000 yen), at the time of soliciting for the investment, in terms of the costs borne by investors which would be collected by Gains Asset Management from the investment contributions, the promotional and sales materials, etc. only showed "subscription fees" (25,000 yen). Despite these promotional costs should be expressed and explained to investors, Gains Asset Management neither expressed nor explained that such costs would be charged.<br>(ii) With regard to the dividends paid by Gains Asset Management, despite the fact that there was absolutely no ground of actual performance of the financed project, the Gains Asset Management website expressed remarkably misleading representation such information as an annual rate of return of "10.8%" and as the financed project "had a utilization rate of about 70%, and was supported by a suitable track record."<br>(iii) When soliciting investment for the O2 Fund, subscriptions for which began in March 2009, despite the facts that, at that time, the actual performance of the financed project could not be confirmed, that the actual utilization rate had deteriorated considerably, and that no earning for that period had been received from Company A, in addition to listing a table of expected yield focused on a utilization rate (50-90%) which could best be described as virtually unfeasible given the current conditions, the "Subscription Guidelines," namely the promotional and sales materials, also included such statements that the company would work to maintaining that utilization rate. Furthermore, the investment policy contained in the anonymous partnership agreement stated that the expected utilization rate would be set at above 60%. It was found that, on the whole, these kinds of representations caused customer's misunderstanding by which investors could believe that "a utilization rate of oxygen generators of 50-90% is feasible, and moreover, Gains Asset Management pays dividends having ascertained and confirmed actual utilization rates."<br><br>(3) Solicitation by lending the company's name to an unregistered business operator<br>From about December 2008, an employee at Company B solicited for investment related to the anonymous partnership agreements, as part of the company's business, using the name of Gains Asset Management and claiming to be a sales agent. Gains Asset Management lent its name to Company B, which | customers<br>(v) To sustain company asset<br>(vi) To report in writing by the deadline and as needed on the responses to and the implementation of (i) to (v) above |

| Date of recommendation | Details of violation(s) subject to recommendation | Details of administrative action(s) |
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| | had not obtained registration as a financial instruments business operator, and to the employee, and allowed the said solicitation to be conducted. | |

(2) Recommendations relating to orders for payment of administrative monetary penalties (market misconduct)

(July 2008 - June 2009)

| Date of recommendation | Details of violation(s) subject to recommendation | Developments following recommendation |
|---|---|---|
| December 19, 2008 | ・Market manipulation through actual transactions (Article 174(1) of the Securities and Exchange Act (SEA))<br><br>In an attempt to raise the price of Trinity Industrial Co., Ltd. shares and to induce active trading in the shares, through employing such methods as raising the share price by matching buy orders and sell orders at around the same time at prices higher than the price contracted immediately prior, during the period from January 5 to January 6, 2006, the person who was ordered to pay an administrative monetary penalty purchased a total of 170,000 Trinity Industrial Co., Ltd. shares while selling a total of 174,000 shares. As a result, the share price surged from 1,680 yen to 1,790 yen. In this way, the person conducted a series of transactions, causing the price of Trinity Industrial Co., Ltd. shares to fluctuate.<br><br>・Amount of administrative monetary penalty: 7,450,000 yen | Date of decision on the commencement of trial procedures:<br>December 19, 2008<br>Date of order to pay penalty:<br>January 20, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |
| March 12, 2009 | ・Insider trading (Article 175(2) of the former FIEA)<br><br>The person who was ordered to pay an administrative monetary penalty was an auditor of Pioneer Corporation. In the course of his duties, he became aware of the fact that Pioneer Corporation would make a tender offer for the shares of Tohoku Pioneer Corporation. During the period from April 27 to May 14, prior to this fact being publicized on May 15, 2007, the person purchased a total of 3,200 shares for a total of 5,598,000 yen.<br><br>・Amount of administrative monetary penalty: 1,440,000 yen | Date of decision on the commencement of trial procedures:<br>March 12, 2009<br>Date of order to pay penalty:<br>March 31, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |
| April 22, 2009 | ・Insider trading (Article 175(1) of the former FIEA)<br><br>The person who was ordered to pay an administrative monetary penalty was an employee of a client of Kurimoto, Ltd. In the course of his duties, he became aware of the fact that it had been confirmed that, in a strength test for hollow slab pipes used in expressways, which are manufactured and distributed by Kurimoto, Ltd., test figures and sheet thickness had been altered, and that this confirmation was a material fact concerning the operation, business or property of the company and may have a significant influence on investors' investment decisions. This was a fact which had become known to another employee at the same company in the course of executing a sales contract which had been concluded between Kurimoto, Ltd. On November 21, 2007, prior to this fact being publicized at 1:30PM on the same date, the person sold a total of 11,000 Kurimoto, Ltd. shares for a total of 3,454,000 yen.<br><br>・Amount of administrative monetary penalty: 1,210,000 yen | Date of decision on the commencement of trial procedures:<br>April 22, 2009<br>Date of order to pay penalty:<br>May 21, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |

| Date of recommendation | Details of violation(s) subject to recommendation | Developments following recommendation |
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| May 22, 2009 | ・Insider trading (Article 175(2) of the former FIEA)<br><br>The person who was ordered to pay an administrative monetary penalty received information on the fact that Canon Marketing Japan Inc. and four other companies had each decided to make tender offers for the shares of Argo21 Corporation and four other companies. The information had been received from an employee of a securities company, which was party to such agreements with Canon Marketing Japan Inc. and the four other companies to act as agent for the tender offers and to provide advice on the tender offers. The employee had come to know of the fact in the course of either performing those agreements or negotiating for their conclusion. During the period from April 25 to November 12, 2007, prior to these facts being publicized, the person purchased a total of 7,800 shares in Argo21 Corporation and the four other companies for a total of 6,833,900 yen.<br><br>・Amount of administrative monetary penalty: 2,580,000 yen | Date of decision on the commencement of trial procedures:<br>May 22, 2009<br>Date of order to pay penalty:<br>June 23, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |
| June 5, 2009 | ・Insider trading (Article 175(2) of the former FIEA)<br><br>One of the persons who was ordered to pay an administrative monetary penalty (Person A) was an employee of kabu.com Securities Co., Ltd., which had concluded agreements for a business alliance and capital tie-up with The Bank of Tokyo-Mitsubishi UFJ, Ltd.:<br>(1) In the course of his duties, Person A became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of The Bank of Tokyo-Mitsubishi UFJ, Ltd. had decided to make a tender offer for the shares of kabu.com Securities Co., Ltd. – a fact which had become known to another officer at the company in the course of performing the said agreement. On March 5, 2007, prior to this fact being publicized on March 6, 2007, Person A purchased a total of 26 kabu.com Securities Co., Ltd. shares on his own account for a total of 5,101,000 yen;<br>(2) In the course of his duties, Person A became aware of the fact that the organ which is responsible for making decisions on the execution of the operations of The Bank of Tokyo-Mitsubishi UFJ, Ltd. had decided to make a tender offer for the shares of kabu.com Securities Co., Ltd. – a fact which had become known to another officer at the company in the course of performing the said agreement. On November 14, 2007, prior to this fact being publicized on November 15, 2007, Person A purchased 7.5 kabu.com Securities Co., Ltd. shares on his own account for a total of 1,147,500 yen.<br><br>・Amount of administrative monetary penalty: 440,000 yen<br><br>The other person who was ordered to pay an administrative monetary penalty (Person B) received information on the fact described in (1) above from Person A. On March 5, 2007, prior to this fact being publicized on March 6, 2007, Person B purchased a total of 26 kabu.com Securities Co., Ltd. shares on his own account for a total of 5,101,000 yen.<br><br>・Amount of administrative monetary penalty: 380,000 yen | Date of decision on the commencement of trial procedures:<br>June 5, 2009<br>Date of order to pay penalty:<br>June 26, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |

(3) Recommendations relating to orders for payment of administrative monetary penalties (false statements in disclosure documents)

(July 2008 - June 2009)

| Date of recommendation | Details of violation(s) subject to recommendation | Developments following recommendation |
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| April 21, 2009 | ・Annual securities reports, etc. containing false statements<br>(Article 172-2(1), (2) of the former FIEA)<br><br>Zentek Technology Japan, Inc. submitted each of the following to the Director-General of the Kanto Local Finance Bureau:<br>(1) On June 25, 2008, the company submitted its annual securities report for the fiscal year ended March 31, 2008. Although it should have recorded a consolidated ordinary loss of 761 million yen, a consolidated net loss of 3,421 million yen, and consolidated net assets of 6,396 million yen (rounded down to the nearest million yen; hereinafter, the same shall apply for consolidated ordinary income, consolidated net income/loss and consolidated net assets), by overstating net sales, understating bad debts expenses, overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated profit and loss statement in which consolidated ordinary income was stated at 1,228 million yen, and consolidated net income was stated at 645 million yen, and it included a consolidated balance sheet in which a figure of 10,435 million yen was stated in the total net assets section, which corresponds to consolidated net assets;<br>(2) On August 14, 2008, the company submitted its quarterly securities report for the first quarter ended June 30, 2008. Although it should have recorded consolidated net assets of 6,514 million yen, by overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated quarterly balance sheet in which a figure of 10,041 million yen was stated in the total net assets section, which corresponds to consolidated net assets;<br>(3) On November 14, 2008, the company submitted its quarterly securities report for the second quarter ended September 30, 2008. Although it should have recorded consolidated net assets of 3,569 million yen, by overstating accounts receivable (trade) and goodwill, and by other means, the report included a consolidated quarterly balance sheet in which a figure of 6,137 million yen was stated in the total net assets section, which corresponds to consolidated net assets.<br><br>・Amount of administrative monetary penalty: 6 million yen | Date of decision on the commencement of trial procedure:<br>April 21, 2009<br>Date of order to pay penalty:<br>May 21, 2009<br><br>Since a written reply admitting these facts was submitted by the person who was ordered to pay the penalty, no trial was conducted. |
| June 26, 2009 | ・Prospectus containing false statements<br>(Article 172(5), (2) of the former FIEA)<br><br>BicCamera Inc. (hereinafter referred to as "BicCamera") had operated a real estate securitization scheme utilizing a special purpose company. The special purpose company had set up an anonymous partnership in which another company, Toshima Co., Ltd., had contributed funds along with BicCamera. The investment/financing circumstances were tantamount to Toshima Co., Ltd. being a subsidiary of BicCamera, and hence BicCamera's share of risk in the scheme amounted to approximately 31%. At the conclusion of the scheme, although by virtue of the above, on October 26, 2007, BicCamera could not accrue 4,920 million yen (rounded down to the nearest million yen) from the anonymous partnership as a dividend on liquidation of | Date of decision on the commencement of trial procedure;<br>June 26, 2009 |

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| | anonymous partnership, and although BicCamera could not record this amount as an extraordinary gain, by disguising the investors of Toshima Co., Ltd. as third parties unrelated to BicCamera, BicCamera asserted to come under the situation where a dividend on liquidation of anonymous partnership could be accrued, and where this could be recorded as an extraordinary gain.<br>The person who was ordered to pay an administrative monetary penalty (an officer of BicCamera) had used a prospectus to which had been attached as reference:<br>(1) The annual securities report for the fiscal year ended August 31, 2007, which contained explanatory notes for "material subsequent events" in the consolidated financial statements for the fiscal year ended August 31, 2007, that remarked, "As a consequence of the conclusion of the scheme, a dividend on liquidation of anonymous partnership of 4,920 million yen has been accrued, dated October 26, 2007"; and<br>(2) The semiannual securities report for the six months ended February 29, 2008, which contained an interim consolidated profit and loss statement which recorded the consolidated interim net income at 7,145 million yen (rounded down to the nearest million yen) although it should have been 1,398 million yen; this was partly the result of having recorded the dividend on liquidation of anonymous partnership.<br>Although aware of the fact that the said prospectus contained false statements, the person had been involved in its production, and on June 10, 2008, he had used a secondary distribution connected with the said prospectus to sell 80,000 BicCamera shares that he held for a price of 6,036,800,000 yen.<br><br>・ Amount of administrative monetary penalty: 12,0730,000 yen | |

# Introduction of Chairman and Commissioners

**Chairman　Kenichi SADO**

Kenichi SADO was appointed chairman of the SESC In July 2007.　Before being appointed to commission, he served as superintending public prosecutor of the Sapporo High Public Prosecutors Office (2005–2006) and superintending public prosecutor of the Fukuoka High Public Prosecutors Office (2006–2007).

**Commissioner　Shinya FUKUDA**

Shinya FUKUDA was appointed commissioner of the SESC in July 2007. Before being appointed to the commission, he served as a Senior Partner, TOHMATSU-AOKI Audit Corporation (present TOHMATSU Audit Corporation).

**Commissioner　Shozo KUMANO**

Shozo KUMANO was appointed commissioner of the SESC in July 2007. Before being appointed to the commission, he served as a Director, Board Member, Nomura Holdings Co., Ltd and Advisor to Chairman of the SESC.

**Securities and Exchange Surveillance Commission**

SESC

"for investors, with investors"

∗ Note: The two ellipses crossing each other symbolize the securities markets and financial futures markets, which are both subject to our surveillance; the cooperation between the SESC and other domestic authorities concerned; and, what's more, our relationship with investors.

And the slogan "for investors, with investors" represents the principle position of the SESC, which was established to protect investors and respect its relationship with them.

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