

***Towards Enhanced Market Integrity
-Direction of SESC and
Role of Market Participants-***

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Agenda

1. **Changes in Market Environments**
2. **Trends in Market Misconducts**
3. **Measures for Market Integrity and Direction of SESC**



1. Changes in Market Environments

Global financial crisis

- Subprime loan problems
- Lehman shocks
- Credit crunch
- Decline of stock prices
- Solvency of banks
- Regulatory responses; G7, G20, FSB ...

Risks of market misconducts

1. Market abuse under financial turmoil

- Spreading rumors
- Price manipulation
- Insider tradings

2. Misconducts under downturn of real economy

- Deferring losses, false disclosures
- Price manipulation and suspicious financing to maintain listing at stock exchanges

Solvency issues of securities firms

- **Losses in securitization business and principal financing**
- **Losses in proprietary trading**
- **Decline of broking fees**



2. Trends in Market Misconducts

Conventional misconducts

- Insider trading, market manipulation, false disclosures and other abuses
- Misconducts in secondary markets
- Simple, plain vanilla
- Domestic
- Limited participation of players
(securities brokers and investors)

Recent trends

- **Larger in scale: losses, manipulations**
- **More complex: financial products and schemes**
- **Wider participation of various players: investors, funds, law firms, audit firms, stock exchanges**
- **Cross border: bilateral and multilateral**
- **Interrelation between corporate financing in primary markets and misconducts in secondary markets**
- **Abuse of net trading**
- **M&A, TOB, MBO related**

Abuse of primary markets

Suspicious or questionable, but not illegal, financing in primary markets, including

- **New shares allocated to SPVs in OFCs**
- **Private placement of shares and CBs**
- **MSCB**

Links to misconducts in secondary markets

Abuse of listed companies; *Corporate vehicles for funding*

- **Listed at new markets; Mothers, JASDAQ..**
- **Non-performing business and losses**
- **Difficult to get financing from banks**
- **Allocation of new shares to third parties, including suspicious SPVs or funds overseas**
- **Management changes; links to underground economies**
- **Corporate vehicles solely for funding from markets**

Issues for abuse of financing in primary markets

- **Dilution; losses to existing shareholders**
- **Transfer of management or ownership**
- **Absence of effective corporate governance**
- **Unlawful conducts**
- **Market misconducts; price manipulation, spreading false rumors, insider dealings, false disclosures...**

Increasing abuse of financing in primary markets

- **Global financial turmoil and tightened credit conditions**
- **Drop of stock prices and risks of delisting**
- **Increased suspicious financing around 2Q, 3Q, and 4Q FY2008**
- **In addition to new companies listed at new markets, established companies at TSE 1 and 2 section involved**
- **Financial institutions enhancing capital base**

Regulatory responses to abuse of financing in primary markets

1. FSA

- New disclosure rules on financing (Dec 09)

2. Stock Exchanges

- New listing and disclosure requirements (Aug. 09)

3. SESC

- Enhanced surveillance on financing
- Collaboraion with FSA and Stock Exchanges

Cross border trading

- **Increasing use of cross border transactions in market misconducts;**
 - **anonymity of beneficial owners**
 - **difficulty for tracing by authorities**
- **Abuse of offshore financial centers: Hong Kong, Cayman, BVI ...**
- **Abuse of offshore corporate vehicles**
- **Abuse of private banking overseas**

Increasing cases of insider tradings

- Efficiency of Civil Monetary Penalty System
- Weakness of internal control on confidential information among firms
- Abuse of insider information by outside parties;
 - business partners
 - mass media and journalists
 - printing company
 - accountant
 - lawyer
 - investment banks
- Increase of cases relating to TOB

Issues of disclosures

- **Pressures to external auditors**
 - SESC, FSA
 - Market participants
 - Clients
- **External audit is getting more stringent**
 - Correction of financial statements in previous years
 - Delay in submission of financial statements
 - Resignation or change of external auditors



3. Measures for Market Integrity and Direction of SESC

New Policy Statement of SESC *(Sep 2007) (1)*

- Timely and comprehensive oversight with more strategic focus;
 - Best-mixed combination of tools of oversight
 - Proactive oversight for potential risks and misconducts
 - Enhanced cooperation with SROs and overseas regulators

New Policy Statement of SESC *(Sep 2007) (2)*

- **Outreach to stakeholders for market integrity**
 - **To enhance self regulatory functions by SROs**
 - **To encourage self discipline among market participants**
 - **Enhanced dialogues and communication with market participants**

Policy focus (1); *Comprehensive oversight*

- **both primary and secondary markets**
- **suspicious but not illegal transactions**
- **backgrounds behind individual cases and market developments**

Policy Focus (2); *Administrative monetary penalty system*

- **Introduced in 2005**
- **Efficient and quick response**
- **Review of the current system**
 - scope
 - level of penalty

Policy Focus (3); *Implementation of FIEL*

- **Expanded scope of regulated entities for inspection, including funds**
- **Revision of Inspection Manual (Sep 07)**
- **More risk based approach; focus on internal-control/ governance of regulated entities**

Policy focus (4); *Enhanced cooperation with SROs*

- **Examination of member firms**
- **Listing examination**
- **Surveillance of listed stocks**
- **Rule making**
- **Outreach to members**

Policy Focus (5); *Cooperation with overseas regulators*

- **Information exchange**
 - transactions
 - investors
 - brokers and regulated entities, including their staff
 - SPVs ...
- **Enforcement**

Focus under the current financial crisis (1)

1. Risks of market misconducts

- Abuse of financing in primary markets
- Insider dealings to avoid losses
- False disclosures to defer losses

2. Enhanced oversight of new/non-regulated products and markets

- CDS and OTC derivatives
- DMA, Dark pools ...

Focus under the current financial crisis (2)

- 3. Solvency of investment banks and securities brokers; more risk based approach of examination (credit risk, liquidity risks, market risks...)**
- 4. Oversight of rating companies and establishing examination approach**
- 5. Enhanced cooperation with self-regulatory organizations (SROs)**

Collaboration with stakeholders

- Market integrity cannot not be ensured only by regulators/supervisors
- Collaboration between regulators and other stakeholders for market integrity is essential.
- Enhancing discipline among stakeholders for their respective role for market integrity by
 - supervisory oversight; off-site and on-site
 - enhanced dialogue
 - enhanced outreach

Outreach to stakeholders for market integrity

- **Securities firms and financial institutions**
- **Lawyers**
- **Accountants**
- **Listed companies**
- **Professional gate keepers (tax accountants..)**
- **Media**
- **Investors education and etc.**



Thank You

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<http://www.fsa.go.jp/sesc/index.htm>