

I. Outline

1. Purpose of and authority for investigations of criminal offenses

The authority for investigation of criminal offenses was created especially for the SESC at its establishment, in order to ensure market fairness and soundness, as well as to protect investors. With this authority, the SESC traces illegal actions violating laws and regulations, then calls for criminal prosecution by making formal accusations.

Investigations of criminal offenses are carried out by SESC staff by their particular authority under the SEL, the Law on Foreign Securities Firms (LFSF) and the Financial Futures Trading Law (FFTL). In contrast, inspections against securities companies and other related financial institutions are conducted under authority delegated by the Minister of Finance. The SESC's authority is not limited to securities companies, but includes all parties involved in securities transactions, including investors themselves.

Specifically, the SESC may conduct non-compulsory investigations of criminal offenses (SEL Article 210, LFSF Article 38(2), FFTL Article 106), including making inquiries of suspects or related parties, inspection of materials in the possession of or left behind by

suspects, and the confiscation of materials supplied or left behind by suspects. The SESC may also conduct compulsory investigations with legal warrants (SEL Article 211, LFSF Article 38(2), FFTL Article 107). Such investigations include visiting and searching the premises of suspects and seizing related evidence.

2. Scope of criminal offenses

The scope of criminal offenses covers those that violate securities transaction fairness prescribed in the relevant Cabinet Order (SEL Enforcement Order Article 38, LFSF Enforcement Order Article 17, FFTL Enforcement Order Article 12). These mainly involve submission of securities reports with falsified information, providing loss compensation and guarantees on securities transactions, market manipulation, insider trading and circulation of rumors.

The results of investigations are reported to the SESC by the investigating SESC staff (SEL Article 223, LFSF Article 38(2), FFTL Article 119). When convinced of a suspect's guilt, the SESC sends an accusation to a public prosecutor's office, together with evidence seized during its investigations and lists of said evidence, if any (SEL Article 226, LFSF Article 38(2), FFTL Article 122).

II. Status of Accusations of Criminal Offenses

1. Investigations of criminal offenses

During SESC year 1996, compulsory investigations—including visiting and searching the premises of suspects and related parties, and the seizure of evidence—were conducted in three cases. Two of these related to suspected insider trading by Nippon Orimono Kako Co., Ltd., and Shintom Co., Ltd. The other case covered suspected loss compensation by Nomura Securities Co., Ltd. The SESC also exercised its authority to conduct non-compulsory investigations as deemed necessary.

2. Accusations

Based on investigation results, the SESC sent a total of five accusations to public prosecutors' offices concerning possible SEL violations. These consisted of three cases of suspected insider trading, one case of circulating rumors and one case of loss compensation. The five cases are summarized below.

(Case 1)

On August 2, 1996, the SESC, concerning suspicion of insider trading by Nippon Orimono Kako, sent accusations against one person to the Tokyo District Public

Prosecutor's Office for offenses under the SEL (Article 166(1) "Prohibited acts of company insiders").

Outline of facts

The suspect (a lawyer), an auditor and representative of Unimat Corporation, received information about a decision by Nippon Orimono Kako to allocate new shares to Unimat and other third parties. Before the said information was made public, the suspect allegedly purchased new shares in the name of a female acquaintance and also instructed another female acquaintance to purchase new shares.

Note: On July 28, 1997, the Tokyo District Court handed down a sentence of six months in prison (as demanded by the prosecution), followed by three years of probation and a fine of ¥26,216,295. It was the first insider trading case in Japan to draw a prison sentence. On August 7, 1997, the defendant made an appeal to the Tokyo High Court.

(Case 2)

In the case of "circulation of rumors" relating to an article that appeared in the magazine *Gamble Taitei*, on January 17, 1997, the SESC sent accusations against one person to the Tokyo District Public Prosecutor's Office for offenses under the SEL (Article 158 "Prohib-

iting circulation of rumors”).

Outline of facts

The suspect, a writer of stock recommendation articles and representative of an investment management company, purchased stock in Boso Oil & Fat Co., Ltd., and other companies. Then, between September and November 1994, the suspect used his regular column in *Gamble Taitei* to circulate rumors about Boso Oil & Fat and other companies for the purpose of inflating the prices of the stocks purchased, and then selling those stocks, thus influencing the market through stock securities transactions.

Note: On January 24, 1997, the accused was charged by the Tokyo Summary Court and received a ¥500,000 fine. The case is closed.

(Case 3)

In relation to the insider trading case concerning Suzutan Co., Ltd., on April 8, 1997, the SESC sent accusations against one company and four individuals to the Nagoya District Public Prosecutor’s Office for offenses under the SEL (Article 166(1) “Prohibited acts of company insiders”).

Outline of facts

The appraisal value of shares in a Suzutan subsidiary fell by more than ¥2.1 billion. If Suzutan performed its obligation of guarantee for the subsidiary, this may have led to claims for compensation that would have created a default of at least ¥3 billion.

(1) The chairman and three employees of Suzutan became aware of this serious matter affecting their business, and conspired to sell Suzutan shares held by the chairman before the information became public, in order to avoid losses on the expected decline of Suzutan shares.

(2) The accused company is Suzui Kosan Co., Ltd., a joint-stock company that manages the assets of the above-mentioned chairman. The accused individuals—the above-mentioned chairman, who is also a director of Suzui Kosan, together with auditors of Suzui Kosan—conspired to sell Suzutan shares held by Suzui Kosan prior to the public release of the above-mentioned information. Furthermore, the auditors sold their own holdings of shares in Suzutan before the said information was made public.

Note: On May 1, 1997, five suspect individuals (including one not accused by the SESC) and one suspect company were charged by the Nagoya Summary Court, which on the same day ordered four of the individuals and the company to pay fines of ¥500,000 each. The case is closed. The case of the other individual is pending trial at the Nagoya District Court.

(Case 4)

In relation to the insider trading case concerning Shintom Co., Ltd., on April 25, 1997, the SESC sent accusations against one suspect individual and three suspect companies to the Tokyo District Public Prosecutor's Office for offenses under the SEL (Article 166(3) "Prohibited acts of company insiders").

Outline of facts

(1) The suspect individual is the representative director of Vitec Co., Ltd., which has business dealings with Shintom. The suspects received information from Shintom that Shintom had decided to issue new shares to increase the portions allocated to Rainbow Star Co., Ltd., and other third parties, and that an agreement had been concluded for Shintom to form a new company jointly with Rainbow Star and others. The suspect then purchased shares in Shintom prior to public release of the information.

(2) The suspect companies in the case are Vitec and two others, and the aforementioned suspect individual is involved in all three companies, either as representative director or manager. The suspect individual, knowing details of the companies involved, purchased shares in Shintom prior to public release of the information.

Note: On May 27, 1997, one suspect individual and three suspect companies were charged, and on the same day received summary orders from the Tokyo Summary Court to pay fines of ¥300,000 each. The case is closed.

(Case 5)

In relation to the loss compensation case concerning Nomura Securities, on May 13, 1997, the SESC sent accusations against one suspect company and three suspect individuals to the Tokyo District Public Prosecutor's Office for offenses under the SEL (Article 50(3)1 "Prohibiting of loss compensation").

Outline of facts

The suspect company, Nomura Securities, and three suspect individuals, who were directors of Nomura Securities, undertook transactions for Nomura's account disguised as trading at the behest of a specific customer, in order to partially compensate for that

customer's losses incurred through securities trading. The funds were then diverted to said customer's trading account. The alleged violations were carried out a total of five times between January and June 1995. In March 1995, the suspects, noting that the prices of stock warrants held in Nomura's own account were rising, placed warrants in the customer's account disguised as transactions in which the customer purchased said warrants prior to the price increase. The warrants were immediately sold back to Nomura's account. As a result, total profit of ¥49.7 million was given to a customer by those means above.

Notes:

1. On June 4, 1997, one suspect company and two suspect individuals were charged by the Tokyo District Court (on suspicion of SEL and Commercial Code violations). On June 19, 1997, one suspect company president was charged by the Tokyo District Court (on suspicion of SEL and Commercial Code violations).

2. On July 9, 1997, one suspect company and two suspect individuals (one company president and one director) were

additionally charged by the Tokyo District Court on suspicion of providing ¥320 million to a customer to partially compensate for that customer's losses on securities trading (violations of SEL and Commercial Code) in March 1997.

3. On July 15, 1997, the SESC made a recommendation to the Minister of Finance to take administrative or other disciplinary actions against Nomura Securities in relation to the following matters:

(1) The ¥49.7 million and ¥320 million loss compensation payments made by the aforementioned president and director.

(2) Conclusion of a discretionary trading account transaction contract in which Nomura was entrusted to conduct transactions on behalf of the customer (contract effective from April 1, 1992, to July 1996).

(3) The above-mentioned violations reveal the existence of various inappropriate actions, illustrating a significant lack of awareness related to compliance with laws and regulations, as well as insufficient internal control systems.

Note: The titles indicated are those at the time of the alleged violations.