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# Improving the Quality of Securities Markets

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## **I. Introduction**

It has been argued that the stock market needs to play a greater role in Japan's financial system, as in the debate over moving funds "from savings to investments," but it is not just a question of expanding the stock market's volume. Raising the quality of that market is also important.

Many of the measures taken up thus far for fostering development of securities markets and market-based finance have of course included measures related to improving market quality, and raising quality has been an important component of expanding market-based finance. The issue of raising quality, however, should go beyond specific measures and be viewed as an important goal in and of itself.

The volume of market-based finance is affected by historical events and economic conditions, but regardless of the whether that volume is large or small, as long finance through the market plays a substantial role in the economic system, market participants have a clear obligation to remain vigilant and ensure the market functions at an extremely high quality level.

From this perspective, there is a problem with the recent spate of events that have cast doubt over the quality of the securities market, a traditional set of institutions for which adherence to market-based finance is taken as a given. It is also unfortunate that part of this problem seems in certain respects to be a side effect of measures taken with the objective of promoting securities markets, including measures to encourage new entrants into the securities industry, the creation of a stock market for new ventures, and stock splits.

There are typically increased calls for tightening regulations and strengthening supervisory agencies every time a problem like this occurs, but as will be shown below, it is essential that efforts to improve the quality of markets go beyond strengthening the legal framework and official supervisory agencies and include improving the self-discipline and self-regulation of the market participants

themselves.<sup>1</sup> If these market participants can succeed on their own without having to rely on the government, it will be possible to avoid having to tighten regulations and vest greater authority with bureaucrats.

Further credence was lent to this perspective by the establishment within the FSA's Supervisory Bureau of a study group on the market intermediary function of securities firms in March 2006, as explained later.

Below, we begin by listing the items we consider important to realizing quality improvements in securities markets, and end with a brief introduction of the study group mentioned above. Corporate governance and internal corporate rules, as well as the role of auditing firms and other financial gatekeepers, are also important components to improving market quality, but these have already been discussed elsewhere and we will not deal with them in this report.<sup>2</sup>

## **II. Establishing ethics and basic rules and principles**

The first critical issue in improving market quality is to make it clear that the law defines the minimal, inviolable hurdle, and that participants, especially professionals, must strive to behave in accordance with a higher, self-imposed standard.<sup>3</sup>

Attempting to improve quality through legislative means alone will inevitably result in a highly regulated and controlled market. Furthermore, as long as the prevailing attitude is to only adhere to those rules expressly included in the regulations, there is bound to be a high degree of inappropriate behavior in search of loopholes.

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<sup>1</sup> In an opinion paper on the Financial Instruments and Exchange Law dated 11 April 2006, the Japan Association of Corporate Executives argued the following. "Whether a market is good or bad depends on the level of awareness and capabilities of the individual participants more than anything else, and reform of the market must begin with the people rather than the government, and must be shouldered by the people. Regulations do nothing more than establish the minimum hurdle that market participants must clear, and each market participant must behave in accordance with a higher, self-imposed standard. We must not fall into the habit of relying on the government or bureaucratic patronage and opting only to tighten regulations every time there is a problem."

<sup>2</sup> See Yasuyuki Fuchita and Robert E. Litan ed., *Financial Gatekeepers -Can they protect investors?*, Brookings Institute, 2006.

<sup>3</sup> A final report by the IOSCO's technical committee published in March 2006, "Compliance Function of Market Intermediaries," had the following to say. "It is equally important, however, that firms develop a business "culture" that values and promotes not only compliance with the "letter of the law," but also a high ethical and investor protection standard."

It is therefore desirable that financial market professionals<sup>4</sup> establish and uphold a set of ethics and basic rules and principles covering market activity.

Respect for such ethics and basic rules and principles has already been established in the UK and US markets. For example, the handbook published by the UK's Financial Services Authority (UK FSA) begins by outlining high-level standards, including the 11 fundamental principles of business, the basic obligations of all businesses subject to FSA regulation.<sup>5</sup> Below these high-level standards are more specific standards, including prudential standards and business standards.

The UK FSA has recently stated it would take a more principles-based approach,<sup>6</sup> and it is worth noting that it will be placing greater importance than before on the question of whether these high-level principles are being adhered to.

In the US, meanwhile, Rule 10b-5 of the Securities and Exchange Commission (SEC) serves as a blanket provision covering violations of basic principles, but the National Association of Securities Dealers (NASD) has set forth "standards of commercial honor and principles of trade" in Rule 2110, and much of the rules governing the behavior of securities firms can be found in this and related NASD rules. These rules are not merely spiritual guidelines, and their violation will elicit sanctions.

The SEC revised its rules covering investment advisors in August 2004, requiring firms in that sector to implement a code of ethics (effective 7 January 2005). It appears that the SEC itself had to take the initiative, since investment advisors do not have a self-governing body like the NASD. Although violations of a company's code of ethics are merely a violation of internal company rules, a company's failure to enforce the code is a violation of SEC rules.

In June 2006, the SRO (self-regulatory organization) consultative committee of the International Organization of Securities Commissions (IOSCO) published a model code of ethics for financial services professionals.<sup>7</sup> These developments alone make it clear that there is a global trend toward holding firms working in the securities industry to higher ethical standards than before.

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<sup>4</sup> This report is about securities firms, the primary intermediary for securities transactions, but much of the basic thinking here also applies to the market's varied other participants, including institutional investors, investment advisors, financial planners, and the rating agencies. With the FIEL becoming the basic legal framework, it is necessary to think of the rules as taking up the regulation of securities firms first, to be followed by applying the relevant items to other financial instruments businesses, rather than as singling out only securities firms to shoulder responsibilities unique to them. There is also a need to be careful not to lump all securities firms into a single basket in a way that prevents them from pursuing later on a diverse range of business models, including specializing in execution and settlement or in offering advice.

<sup>5</sup> (1) Integrity, (2) Skill, care and diligence, (3) Management and control, (4) Financial prudence, (5) Market conduct, (6) Customers' interests, (7) Communications with clients, (8) Conflicts of interest, (9) Customers: relationships with trust, (11) Clients' assets, (11) Relations with regulators

<sup>6</sup> Margaret Cole, the UK FSA's Director of Enforcement, said on 11 April 2006, "I want to emphasize today that where appropriate, we can and do take Enforcement action on the basis of principles alone." From the UK FSA website.

<sup>7</sup> SRO Consultative Committee of the IOSCO, "Model Code of Ethics", June 2006.

### III. Establishing best practices

Even after ethics, basic rules, and principles are laid out, they remain abstract until there is a body of case law and interpretations to refer to, leaving the risk that they will be interpreted either too broadly or too narrowly. Furthermore, the question of how these issues can be handled by a particular industry to ensure that neither ethical standards nor basic rules and principles are being violated will be answered differently, depending on the size of the company, the other services it offers, and the types of customers it deals with.

Accordingly, in those sectors for which it is best to clarify exactly how to comply with ethics, basic rules, and principles, it would seem beneficial to put together a set of best practices (or sound practices, the same holds below).

Best practices are not meant to be one-size-fits-all rules that all firms must follow; it is best that they be introduced after being adapted to each firm's circumstances. A failure to follow these practices does not immediately constitute a problem---there is a need to interpret each case on its own merit.

Best practices can be put together under the direction of governmental authorities or self-regulatory organizations. Recent examples of best practices compiled in the US and the UK are shown below.

In April 2004, the NASD proposed best practices for the review of new financial products, based on the concern that complex new financial products, the number of which has been growing recently, were being introduced without being fully understood by either investors or registered persons, and that their introduction created concerns over suitability or potential conflicts of interest.<sup>8</sup>

In May 2006, the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the SEC issued a joint statement on best practices for elevated-risk complex structured finance transactions (CSFTs).<sup>9</sup> In light of the involvement of the leading banks and securities firms in structuring the illegal transaction schemes of Enron, the statement describes some of the internal controls and risk management procedures that may help deal with the legal and reputational risks of complex structured transactions.

A Dear CEO<sup>10</sup> letter from the UK FSA on 10 November 2005 outlined best practices on executive responsibility related to conflicts of interest and non-standard transactions.<sup>11</sup>

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<sup>8</sup> NASD, "NASD Recommends Best Practices for Reviewing New Products," April 2005, Notice to Members 05-26.

<sup>9</sup> Interagency statement on sound practices concerning elevated risk complex structured finance activities. This summarizes comments on the draft statement published 19 May 2004.

<sup>10</sup> A Dear CEO letter is a reminder of the existence of a regulation to traders that may be concerned with the regulation at times, rather than notice of a new regulation, but expresses the UK FSA's awareness of a problem and its expectations of traders.

<sup>11</sup> UK FSA, "Senior Management Responsibilities: Conflicts of Interest and Non-standard Transactions", November 10, 2005.

#### **IV. Improving the role and function of self-regulatory organizations**

Self-regulatory organizations (SROs) should be playing a critical role in ensuring compliance with ethical standards. NASD chairman Robert Glauber said, "Self-regulation can and does extend beyond enforcing just legal standards to adopting and enforcing ethical standards - such as just and equitable principles of trade. Government regulation is well-suited for policing civil or criminal offenses, but less so for ethical lapses, which, while not necessarily illegal, may be unfair or compromise the freedom and openness of markets. Self-regulation is uniquely capable of protecting investors from those sorts of failures."<sup>12</sup>

Of course, it will be a different story if Japan follows the model of the UK FSA and creates a combined regulatory institution that oversees both official regulations and self regulations, but assuming it continues on its present course, following the US model, of using SROs and expressly asking them to fulfill the roles as outlined above, there is a need to keep the following points in mind.

First, there is a need to examine whether Japan's securities SROs currently have the proper authority to fulfill that role and the organization and personnel to execute, and then to make the necessary changes to realize a form that is suitable for the expected role.

Second, it is likely that such changes to the authority and organizational makeup of SROs will require revisions to a range of regulations and board resolutions, and we think this requires at a minimum a systematic approach to the entire issue. For example, it is probably inappropriate to introduce ethics rules simply in the form of another new board resolution. The better approach would be to put together a rule book, modeled after the NASD Manual and the UK FSA Handbook, that is both more systematic and easier to use, and then position the rules noted earlier as ethics rules within that rule book.

Board resolutions from the Japan Securities Dealers Association are in the form of voluntary rules, but currently, as the name suggests, each time a problem occurs the resolutions are listed in order of oldest to newest. This is not merely due to the lack of a system, but rather symbolizes the reactive nature of the association. That is, its inability to move forward with creating standards without an actual problem occurring. Having a well-thought out rule book is probably a prerequisite to becoming a proactive organization.

Third, in the US recently, with exchanges having been converted into for-profit corporations and the overall cost of compliance for traders rising, there is increasing talk of using a combined SRO. When considering the nature of Japan's SROs, as well, it is important not to view the current demarcation between the exchanges and the securities industry association as permanent, but rather to think in terms of closely following trends in the US while looking for a more desirable framework.

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<sup>12</sup> He made this comment the NASD Spring Securities Conference held 19 May 2006.

In the US, the many industry associations and professional associations outside of the SROs that are prescribed by law, like NASD, also play an important role, of course.

For example, the CFA Institute, a global organization for investment professionals with a growing membership base in developing as well as industrialized countries,<sup>13</sup> revised its Code of Ethics and Standards of Professional Conduct in the wake of the Enron scandal, also established the CFA Center for Market Integrity in 2005, promotes the protection for investors in capital markets worldwide, and clearly stands for improving professional ethics. For example, its Standards of Professional Conduct for Asset Managers was also used by the Managed Funds Association for its Sound Practices for Hedge Fund Managers. Additionally, in December 2004 it published jointly with the National Investor Relations Institute (NIRI) its Guidelines for the Analyst-Corporate Issuer Relations, and the guidelines are being increasingly used thanks to both the NYSE and NASDAQ encouraging use of the guidelines by its members and listed companies.

With a good voluntary program in place, participants will probably gladly implement methods to promote more proactive use.

Known as "soft law," these actions taken by SROs, the best practices mentioned earlier, and the guidelines published by the different industry organizations, are the standards that the countries and corporations in our current socioeconomic system feel compelled to follow, despite the lack of any ultimate guarantee of performance forced by the courts, as in the case of law. Soft law, which has been playing an increasingly larger role in recent years, also includes the monitoring guidelines, inspection manuals, and compilations of past interpretations put together by the government. To improve the quality of securities markets, instead of relying solely on the government bureaucracy it is better for the private sector to make greater progress in forming voluntary soft law.<sup>14</sup>

## **V. Emphasizing a precautionary, preventative approach**

Japan's administrative system of a priori discretion has been criticized in the past, leading to calls for a shift to ex post monitoring, but even if a priori discretion is not a good thing, it is important to take a more precautionary, preventative approach rather than rely completely on exposing problems after they occur.

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<sup>13</sup> CFA stands for Chartered Financial Analyst. Most of the holders of this qualification are on the buy side, including a large number of fund managers as well as buy-side analysts. An increasing number of corporate employees working in finance-related areas of corporations are also getting the qualification, and it is being positioned more as an industry organization for investment professionals than an association for analysts.

<sup>14</sup> Soft law is included as a subject in the 21st century Center of Excellence (COE) program at Tokyo University. On the subject of soft law for securities markets, see Tomoaki Iwakura, *Shoken gaisha wo meguru sofuto roo: Jishu kisei wo chuushin ni* (Soft law for securities firms: focus on self regulatory rules) COE Soft Law discussion paper series, December 2005.

Based on its experience with the Enron scandal and view that in addition to catching problems it was also important to prevent them, the US SEC established the Office of Risk Assessment.<sup>15</sup> NASD, meanwhile, set up its Ahead of the Curve (ATC) task force so that it can keep an eye on potential problems.

Well before a problem balloons to the point where it gets written up in the newspapers and taken up by lawmakers, industry professionals should be in a position to sense the warning signs and identify a problem through reference to ethics standards. Both the SEC's Office of Risk Assessment and the NASD's ACT task force make effective use of input from these professionals.

If the authorities or SROs discover an area with the potential to become a problem, they could use such means as a fact-finding survey or sector sweep to make market participants aware of the authorities' warnings and possibly gain some preventative effects.

The UK FSA does industry surveys of segments of rising interest to authorities, provides feedback on the survey results and on the authorities' sense of the problem, and later opens up a roundtable discussion with industry players, with the authorities' thinking sometimes winding up permeating the industry. In other cases, it winds up absorbing the best practices taken by companies to deal with the problem and then turning around and promoting those practices to others.

Of course, even though there was a push in Japan to shift over to ex post monitoring, it is hardly the case that the government had abandoned its a priori regulatory function. Regarding this point, the FSA commented, "ex post monitoring decidedly excludes the a priori regulation of business scope, products, and services, but does not preclude preventative checks of the suitability of a securities firm's business in order to ensure the effective protection of investors. An important role of authorities is to check on a regular basis to confirm that a securities firm has put the mechanisms in place to manage its business, comply with the law, and administer internal affairs, including internal audits.

In fact, the world seems to interpret ex post administration more broadly, beyond just the monitoring of securities firms. In Europe and the US, the approach seems to be that prevention goes beyond just preventative checking of the suitability of a securities firm's business. The emphasis is on considering the broad the broad implementation of policy for anything that can seriously affect the functioning of the market. Accordingly, we think that the meaning of preventative and precautionary administration as taken in Europe and US could fairly be applied to the administration of securities in Japan, and that this is where the emphasis should lie.

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<sup>15</sup> See Yasuyuki Fuchita, SEC's Strategic Plan, Capital Market Quarterly, Fall 2004 issue.

## VI. Focus on misconduct in the wholesale market

An often-heard argument in Japan is that while professionals should be given more freedom, amateurs need more protection, but it is clear that in the wholesale markets where professionals operate, it is easy for wrongdoing with a huge impact on the overall market to occur. It is important to be aware of the heightened risk of conflicts of interest and insider trading under the current environment, as a result of: the increasing importance of the fund business and proprietary trading for securities firms in response to smaller margins for the traditional agency business; the lowering of the walls between securities firms and other type businesses, including banks and asset management firms, and increase in financial conglomerates; and the growing business between securities firms and hedge funds.

The basis for having different rules for wholesale versus retail is the asymmetry of information, and this explains the emphasis on protecting amateur investors. At the same time, it is the information advantage of professionals, which is also what enables front running and other actions that constitute conflicts of interest, that explains why simply easing the regulations on professionals is not the answer. Although not the same as front running, securities firms are in a position to observe the overall market color of agency orders, and thus have the ability to give priority to trades on their own account, and there is growing interest in the US regarding what to do about this and other actions based on information asymmetry.

The UK FSA has been criticized for discovering small-scale transgressions by individuals and levying fines, but not adequately regulating much bigger problems involving hedge funds and proprietary trading by securities firms.<sup>16</sup> Recently, however, the UK FSA has announced plans to strengthen its regulatory control over institutional market misconduct.<sup>17</sup>

The UK FSA's decision to have two separate divisions to handle problems, one for retail and one for wholesale, may be instructive when considering how to maintain the proper balance in handling problems between the retail and wholesale markets.

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<sup>16</sup> See, for example, the article in the 12 April 2006 edition of the Financial Times entitled "FSA starts to flex its muscles." "The FSA had been heavily criticized for its pursuit of relatively small cases of market abuse while failing to tackle what some see as rampant abuse involving hedge funds and investment banks' proprietary trading desks."

<sup>17</sup> See the statement by a UK FSA executive quoted in the Financial Times article noted above. Sally Dewar, director of the UK FSA's Market Division, made the following comment at a seminar on 17 May 2006. "While we intend to continue bringing enforcement action against individuals committing market abuse, we have become increasingly concerned by the risk generated by institutions exploiting the information they legitimately receive for illegitimate purposes or engaging in other unacceptable behavior."



## **VII. Building up the market infrastructure**

The quality of the market is determined by the suitability of the behavior of its individual participants as well as by the market infrastructure. It is important to have not only a trading system and settlement system, but also to create a system for monitoring misconduct as well as a business continuity plan (BCP) to maintain market quality during times of stress.

The study group on the market intermediary function of securities firms mentioned above is also discussing the Electronic Blue Sheets (EBS), a system used by US authorities to gather data on trades. When an SRO identifies an improper trade through its surveillance system, it can request that the securities firm submit trading data via email, receive that data electronically, and then use the EBS to automatically analyze the data and generate a summary report. Although it does not appear that other countries have digitized their systems to the same level, they are moving forward with specific plans in that direction. Regards the outlook for the globalization of securities transactions, if Japan is going to start designing such a system, we think it would probably be best to begin from the outset with the idea of standardizing the format internationally.

Also of interest is the effective use in the US and Europe of social security numbers and pension beneficiary numbers for identification related to improving market reliability and monitoring misconduct. The use of consumer credit bureaus is also increasing. Use of this information makes for more efficient background checks of market participants (including investors, registered persons, and investment advisors). The protection of personal data has attracted more attention in recent years, but anyone wanting to benefit from the market mechanism will probably be required to supply the market with ample information on their creditworthiness. Many aspects of the personal identification mechanisms and use of consumer credit information in Europe and the US would probably be instructive for Japan.

Discussion of business continuity plans should be delineated between those aimed at continuity of the services of individual securities businesses and those for the continuity of critical financial systems. Furthermore, rather than relying on voluntary mechanisms, the extent of the plan and when it needs to be ready should be clearly spelled out, and compliance should be mandatory.

In the US, NASD Rules 3510 and 3520 deal with the business continuity plans of individual members. The NASD carried out a BCP survey of 1000 registered traders, 20% of the total, that ended in October 2005.

The FRB, OCC, and SEC jointly published an Interagency Paper on Sound Practices in 2003 to address the resilience of critical financial systems in the US. Although the paper was positioned as a set of guidelines, it appears to be very close to compulsory; Congress, for example, asked for a report, under the Patriot Act, on the status of implementation of the paper's recommendations. This was only required of the exchanges, settlement institutions, and market participants with a large share of trading volume, while smaller traders were exempt. This is an issue that each of the

departments of Japan's FSA and the Bank of Japan must cooperatively work on, while dealing with it as an issue for the entire financial system, rather than separately for the securities industry or banking industry.

In the US, the most stringent demands related to BCP are primarily concerning the threat of terrorist attack, probably based on the mentality that terrorist aggression must be defeated. In contrast, the biggest threat in Japan is generally perceived to be an earthquake, and thus the focus is more on how much the damage can be suppressed. Whether this difference in commitment between Japan and the US is acceptable as it is may be something that market participants will have to see for themselves.

## **VIII. Measuring quality**

Japan's industrial sector introduced quality control methods to improve quality and become globally competitive. An important feature of quality control is the statistical control component that has made it possible to numerically assess quality.

Quality in the context of securities markets is the same in that it does not refer to some vague notion of quality, but is significant when it is possible to confirm the effect of various policies, by quantifying that which is quantifiable and grasping the level of quality as objectively as possible.

One example of an attempt at that is the UK FSA Occasional Paper published in March 2006, *Measuring Market Cleanliness*. The basic approach is to measure the reaction of an issuer's share price prior to an important announcement by that issuer, gauge whether abnormal returns were generated, and then use the results as an indicator of the likelihood of insider trade having occurred. Using that approach, the paper examines whether introduction of the financial services and market law improved the cleanliness of the UK market.

Other conceivable approaches to measuring policy effectiveness include comparing the IPO price, the initial listing price, and the share price a fixed number of days after the listing to assess the fairness of the IPO price, and making the recent UK FSA survey on order-entry errors, initially conceived as a one-time survey, into an ongoing, periodic survey. The CFA Center for Market Integrity noted above plans on introducing a market integrity index that compares the level of integrity in each country's market based on a survey of fund managers handling globally diverse investment portfolios, and another approach worth discussing may be quantification of this survey, in the same way as done to understand economic trends.

## **IX. The study group on the market intermediary function of securities firms**

Confidence in Japan's stock markets has been shaken recently, in the wake of accounting scandals at Kanebo and Livedoor, as well as order-entry errors by securities firms and system-wide failures, and in response to this the FIEL was passed into law and debate over the nature of securities markets has progressed. Out of the need to shed more light on the market intermediary role of securities firms, however, the study group mentioned above was established within the FSA's Supervisory Bureau.

The thinking behind this move was that, in recognition of the commonality of securities firms' services, by having those firms perform their services in accordance with a specific ethical view and set of conduct standards, it should be possible to either prevent illegal conduct before it occurs or discover it at an early stage. Not only that, the idea is that this would provide a form of screening for those transactions in the "gray zone," that is, not directly covered by existing laws. Securities firms acting in this favorable manner should increase the fairness and transparency of, and the trust in, the market overall.<sup>18</sup>

The primary points of contention being addressed by the study group are shown in the Figure. Although the measures addressing segments where specific problems have recently occurred have particularly strong emphasis, as would be expected, the entire effort is admirable in that it includes the concepts for raising the quality of securities markets argued for in this paper, including focusing on the role of ethics and aiming at benefits from prevention. The emphasis placed on the role of SROs is also in alignment with what we advocate in this paper, although as pointed out above, we think there is a need to go beyond merely fobbing off responsibility to securities industry associations, to the point of gaining the cooperation of market participants to ensure the SROs are able to more than adequately fulfill their role.

Additionally, although the study group has focused its energies on securities firms, it is important not to forget that with the passage of the FIEL, it is financial instruments businesses in general, rather than securities firms in particular, that are the main actors in this drama. The issues being taken up at the study group should not be construed as being limited only to securities firms. IOSCO's model code of ethics is also aimed at financial service providers rather than just securities brokers. IOSCO's SRO consultative committee also includes futures exchanges and SROs for the futures market. Quality issues in securities markets arise in connection with a variety of other markets and market players, and the study group needs to actively keep other financial traders in mind as it frames its debates.

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<sup>18</sup> Makoto Kitamura, head of a section for supporting the markets function in the FSA's Securities Business Division within the Supervisory Bureau, "Overview of arguments at the Study group on the market intermediary function of securities firms---Proposed role of securities firms in regaining confidence in markets," *Kin'yu Zaisei Jijou* (Financial and Fiscal Conditions), 17 July 2006.

**Figure: Major issues regarding the market intermediary function of securities firms**

		Response completed	Response pending
(1) Improve confidence in market intermediary operations	(1) Prevent reoccurrence of order-entry errors	JSDA "Suitable management of order receipt/entry to prevent reoccurrence of order-entry errors (interim report of March 2006), JSDA Board Resolution "Establishment by members of a system of order control" (including preventative internal rules, suitable employee assignment and training, and the creation of a system to inspect and monitor internal rules), to be implemented October 2006	Consider system response at exchanges, disclosure regarding unusual orders, and canceling executed orders as an exceptional measure, and study the suitability of standardizing trading lots, increasing the severity of penalties for failure, and the imposition by the authorities of limits on positions and risk.
	(2) Collateral assessments for margin trading	JSDA Board Resolution "Treatment of changes in assessment of securities held as collateral for margin trading," (prior explanation and notice to customers), implemented May 2006	Changes in assessments for each issue, diversification of issues
	(3) System management	Report to the FSA pursuant to Article 59 of SEL	The government's Committee for Essential Issues on Information Security is promoting the establishment of an information sharing and analysis function, in line with the Action Plan on Information Security Measures for Critical Infrastructures
	(4) Business continuity plans	JSDA Board Resolution "Guidelines for establishing emergency business continuity plans for members," implemented from July 2005 Report on BCP for overall securities market (February 2006) Established Council on Securities Market BCP (April 2006) Response based on Disaster Prevention Basic Law and the Citizen Protection Law	Consider within the BCP Forum
(2) Maximize securities companies' ability to check on issuers	(1) Strengthen underwriting reviews	The liability of securities companies for damages related to the bad-faith use of a prospectus or falsified securities filings (SEL), JSDA self-regulations regarding underwriting reviews (1992)	Revise the focus and content of underwriting reviews Clarify items of concern in the underwriting and purchase of privately placed convertible bonds and other third-party capital increases (1) Strengthen underwriting review mechanisms Other (underwriting review in the Euro market and problems in the market for startup firms)
	(2) Set suitable issuance terms		Set provisional terms and specific standards for book building
	(3) Other		Promote cooperation and linkages between underwriters and auditors Respond to changes in conditions following end of underwriting review Response to collection and sharing of information related to antisocial influences
(3) Maximize securities companies' ability to check on investors	(1) Market manipulation	JSDA Board Resolution "Establishment of a trading control system by members to prevent unfair trading by customers" (implemented June 2006)	Establish mechanisms to receive and analyze trading data on individual transactions and exchange data on unfair trading
	(2) Insider trading	Providing registration cards for insiders at securities companies (JSDA self-regulations) Proposition by oversight committee on transmittal by securities companies of issuance information prior to announcement through pre-hearings (April 2006)	Build a database of information received by securities exchanges from listed companies on their executives Establish specific standards for the self-regulation of associations in response to Cabinet Office directives
	(3) Identifying customer and knowing the original trustor		Is there a need for authorities to have the ability, when necessary, of obtaining information on the original trustor for orders placed by funds?
	(4) Internal controls to prevent unfair trading	JSDA rules regarding customer management and internal administrators	Establish specific rules regarding the JSDA's internal control mechanisms
	(5) Other	Thorough notification to investors regarding the large shareholding reporting system; efforts by SROs to encourage the provision of information by member securities companies to the oversight committee when a violation occurs	Implement the efforts noted to the left continuously/periodically Facilitate the exchange of information with authorities in other countries on crossborder unlawful activity and aggregate information on antisocial activism at associations
(4) Ensure self-discipline of securities companies as market players			Establish code of ethics Establish corporate guidelines/rules and build internal control mechanisms Look at proprietary trading

Source: Nomura Institute of Capital Markets Research, based on FSA materials.