

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9733 / February 27, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74395 / February 27, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31489 / February 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16412

In the Matter of

HAJIME SAGAWA,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTIONS 15(b)
AND 21C OF THE SECURITIES EXCHANGE
ACT OF 1934, AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Hajime Sagawa (“Sagawa” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the

Investment Company Act of 1940, Making Findings, And Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

Summary

1. These proceedings arise out of the involvement of Hajime Sagawa (“Sagawa”), the principal and minority owner of a now-defunct registered broker-dealer, in a cover-up of billions of dollars in losses by Olympus Corp. (“Olympus”).

2. From the late 1990s to 2010, two Olympus executives hid billions of dollars in Olympus’s losses by transferring them to a secret web of entities in the Caymans and British Virgin Isles (collectively, “Off B/S Entities”) that they controlled but, contrary to Japanese GAAP at the time, did not consolidate in Olympus’s financial statements. These Off B/S Entities “purchased” Olympus’s soured investments at their historical cost with bank loans secured by collateral pledged by Olympus.

3. After completing these sham sales, the Olympus executives needed to find a way to repay the banks that had loaned the Off B/S Entities the amounts they had transferred to Olympus. To repay some of these loans, they retained Axes America, LLC (“Axes”), a registered broker-dealer partially owned by Sagawa, to serve as its financial advisor in connection with an acquisition. With Sagawa’s assistance, the Olympus executives devised a scheme whereby Olympus would pay a disproportionate financial advisory fee to Axes that Axes would then transfer to the Off B/S Entities so that they could repay the bank loans.

4. Axes began advising Olympus on a possible acquisition of a manufacturer of medical devices which had shares of common stock that traded on the New York Stock Exchange. After talks with the manufacturer’s Board of Directors broke down, Axes and Olympus identified Gyrus Group PLC (“Gyrus”), a UK company that specialized in endoscopes, as another possible target. In February 2008, Olympus acquired Gyrus for approximately \$2 billion. Olympus then paid Axes an “advisory fee” in the form of cash and Gyrus preference shares worth approximately \$687 million, *i.e.*, 38% of the purchase price.

5. In 2008 and again in 2010, Sagawa offered the Gyrus preference shares back shares to Olympus. In April 2010, the Olympus Board of Directors approved the purchase of these shares for \$622 million. Axes and an affiliate, Axam Investments, Ltd. (“Axam”), routed this \$622

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

million as well as other funds that Axes received to the Off B/S Entities, which in turn used the money to repay the bank loans they had used to purchase Olympus's soured investments.

Respondent

6. Hajime Sagawa, age 67, is a resident of Boca Raton, Florida. From 1997 to 2008, he was a registered representative, a founding member, minority owner, and a director of Axes as well as its President and CEO. From 2007 to 2010, Sagawa was also the sole director of Axam. From 2006 to 2010, Sagawa resided in the United States and lived at different times in New York, Connecticut, and Florida.

Other Relevant Entities

7. Olympus Corp. is a Japanese corporation that sells cameras, microscopes, endoscopes, and other medical equipment. Olympus's ordinary shares are listed on the Tokyo Stock Exchange.

8. Axes America, LLC was a Delaware corporation with a last known principal place of business at 420 Lexington Ave., Suite 225, New York, NY 10170. Axes was a registered broker-dealer from April 1997 to May 5, 2008, when it voluntarily withdrew its registration. Axes was dissolved on March 12, 2008.

9. Axam Investment, Ltd. is a Cayman Islands limited company that was established in November 2007 and struck from the Cayman Islands corporate registry in June 2010. While active, it appears to have had no business purpose other than transferring funds to Olympus. Sagawa was the sole director of Axam.

10. Olympus Executive No. 1 worked in the accounting department of Olympus from 1980 to 2009 and in 2011 was appointed as the company's internal auditor.

11. Olympus Executive No. 2 was an employee of Olympus from 1981 to 2011, and during most of this period was the subordinate of Olympus Executive No. 1. From 2005 to 2011, he served as the head of management planning.

Background

A. Olympus Accrues Losses

12. To combat a decrease in operating income due to a sharp rise in the Japanese yen beginning in the mid-1980s, Olympus's management began supplementing that income through *zaiteku*, a Japanese word for speculative investments. Over the next several years, Olympus conducted an aggressive financial asset management program led by Olympus Executive No. 1, then the company's assistant manager of the Finance Group. When the bubble burst in the Japanese economy in 1990, Olympus sustained substantial losses in these speculative investments. Olympus's response was to doubly commit to its strategy by making even riskier investments that

it hoped would wipe out its recent losses. This approach backfired, and at the end of 1990, Olympus's losses had piled up to approximately ¥100 billion (\$691 million).²

13. Olympus Executives Nos. 1 and 2 avoided a mark-down of these assets by placing them in *tokkin* trusts.³ These trusts held a basket of assets, and, under accounting rules at the time, Olympus was required to disclose losses only if the aggregate market value of the trust declined by 50% or more. Therefore, filling a *tokkin* trust with several assets that were performing well would obviate the need to disclose the substantial decline in value of other assets in the trust.

14. By 1995, the continuing decline in value of Olympus's assets in *tokkin* trusts made it increasingly difficult to offset them with other well-performing assets and thereby take advantage of the basket method of valuation.

B. Olympus Moves Its Losses Off of Its Balance Sheet

15. To avoid disclosing the losses incurred on soured investments held in the *tokkin* trusts, Olympus Executives Nos. 1 and 2 worked to transfer the failed investments to the Off B/S Entities, a secret web of entities in the Cayman Islands and British Virgin Isles that they created and controlled but did not consolidate in Olympus's financial disclosures. Through an exceedingly complex series of transactions that involved dozens of entities, Olympus "sold" its soured investments to the Off B/S Entities at prices that were roughly equivalent to their historical cost. In simplified form, these series of transactions took the following steps:

- i. Olympus entered into lending agreements with several banks. Pursuant to these lending agreements, Olympus would deposit funds into a time deposit held by the banks, and the banks would use that deposit as collateral for a revolving credit facility that they extended to entities designated by Olympus.
- ii. The banks extended the credit facilities to the *tokkin* trusts. In its financial statements, Olympus disclosed its deposits but did not disclose they were pledged as collateral for loans to the *tokkin* trusts.
- iii. The *tokkin* trusts initially drew \$535 million from the revolving credit facility and transferred these funds and their portfolios, which included Olympus's soured investments, to the Off B/S Entities. At the time of their transfer, the portfolios had a book value of approximately ¥68.3 billion (\$625 million) and a market value of approximately ¥11.6 billion (\$105 million). Therefore, the borrowed funds combined with the current market value of the portfolios were roughly equivalent to the investments' book value.

² Dollar conversions of amounts in Japanese yen reflect historical exchange rates.

³ A *tokkin* trust is a trust created under Japanese law in which a registered investment advisor appointed by the trustor instructs the trustee regarding the investment of the trust assets.

- iv. In exchange for the \$535 million and the *tokkin* trusts' portfolios, the Off B/S Entities issued units to the *tokkin* trusts, which then became the sole owners of the Off B/S Entities. Accordingly, the *tokkin* trusts held units in entities whose NAVs were collectively higher than the value of the portfolios. By failing to disclose the relationships between the entities and Olympus as well as the fact that the cash held by the Off B/S Entities was effectively a loan to Olympus, Olympus evaded its obligation to disclose the unrealized investment losses.

16. Because the complex nature of the scheme required devoted advisors, lawyers, and bankers to execute it, the fees charged proved extremely costly. Consequently, the losses that initially prompted Olympus Executives Nos. 1 and 2 to embark on their loss-hiding endeavor were eclipsed by what Olympus paid in scheme maintenance fees, interest payments, and other costs. To pay these costs, Olympus entered into additional lending agreements with the above-referenced banks to create revolving credit facilities that the Off B/S Entities could use to cover these costs.

C. The Repayment of Funds Borrowed through the Lending Arrangements

17. Having sold much of its severely impaired assets at their historical cost to the Off B/S Entities, Olympus now needed to find a way to repay the banks for financing these sales and their associated costs. Because Olympus had not disclosed that its deposits with the banks were pledged as collateral, it could not use these deposits to repay amounts borrowed by the various Off B/S Entities. Rather, Olympus Executives Nos. 1 and 2 hatched a plan in which they would take advantage of Olympus's existing business strategy of growing through a series of corporate acquisitions. Specifically, the two executives planned to siphon some of the funds paid by Olympus in connection with one of its upcoming acquisitions, book the siphoned funds as part of the goodwill of the acquired entity, divert those funds to the banks that made the loans, and then depreciate the goodwill of the acquired entity or record an impairment to goodwill.⁴ By transforming decades old losses into recently acquired goodwill, Olympus could account for the losses publicly and gradually over a twenty year amortization period.

18. In 2006, Olympus Executive No. 2 approached Sagawa, who had done work for Olympus in the past and at the time was Axes's principal and minority owner, with his idea of using an acquisition to hide Olympus's losses. Olympus Executive No. 2 proposed that they retain Axes as a financial advisor and then pay it an outsized financial advisory fee that could then be used to repay the loans extended to the Off B/S Entities.

19. On June 5, 2006, Sagawa, on behalf of Axes, and Olympus Executive No. 1, on behalf of Olympus, signed a financial advisory agreement whereby Olympus retained Axes to

⁴ This plan took two forms: the payment of an inflated financial advisory fee in connection with the acquisition of Gyrus and the overpayment for the majority stake in three small Japanese companies. Sagawa was not involved in the overpayment for the stakes in the three Japanese companies. Therefore, this overpayment is not relevant to this proceeding.

serve as a financial advisor on the acquisition of two possible targets, Target No. 1 and Target No. 2, both of which manufactured medical devices and were headquartered in the United States. At the time, Target No. 1 had shares of common stock that were listed on the New York Stock Exchange. Target No. 2 was a privately held company.

20. The financial advisory agreement stated that Olympus would pay Axes's expenses and would pay an advisory fee that consisted of (1) an up-front fee of \$3 million, (2) an additional fee of \$2 million payable on June 5, 2007, and (3) a Completion Fee paid after the acquisition in the form of (a) a cash payment equivalent to approximately 0.2% of the value of the target and (b) share options of the stock of the target equivalent to 4.9% of the fully diluted share capital of the target. At the time, Olympus Executives Nos. 1 and 2 envisioned an acquisition price of ¥600–800 billion (\$5.2–6.9 billion); therefore, the share options would be worth approximately \$294 million. According to Olympus Executive No. 2, the hope was that these options would greatly increase in value over the following five years and then could be used to wipe out most of the hidden losses.

21. As the financial advisor to Olympus, Sagawa, through Axes, worked on a possible acquisition of a majority stake by Olympus in Target No. 1 shares. Specifically, he (i) retained an investment bank as a sub-advisor to consult and provide analyses on the possible acquisition and its benefits, (ii) advocated for the acquisition of a majority stake in Target No. 1 and argued that alternative strategies, such as a leveraged partnership or a spin-off, were less appealing, (iii) worked to bring the parties together by advising Olympus on positions it should take during the negotiations and by proposing that Olympus increase its offer "in order to encourage [Target No. 1] to accelerate their [sic] timing."

22. Despite Sagawa's efforts, the Board of Directors of Target No. 1 indicated in June 2007 that it was not in favor of the deal.

23. Afterwards, Olympus chose not to focus on Target No. 2, but instead identified Gyrus, a publicly-traded endoscope manufacturer based in the United Kingdom, as a possible acquisition target.

D. Sagawa Works to Complete the Scheme by Offering Gyrus Preference Shares Back to Olympus

24. Sagawa acted as a financial advisor on Olympus's acquisition of Gyrus. As part of Axes's advisory fee, it received 177 million Gyrus preference shares. Although the nominal face value of the preference shares was \$1 per share and therefore \$177 million in the aggregate, these shares paid a dividend of 85% of Gyrus's net profits and therefore were worth much more. Axes transferred its rights to these preference shares to Axam, an entity based in the Cayman Islands that Olympus Executives Nos. 1 and 2 controlled and that had Sagawa as its sole director.

25. On November 25, 2008, Sagawa, acting pursuant to the instruction of Olympus Executive No. 2, emailed a letter on behalf of Axam to Olympus requesting that Olympus buy back the preference shares or allow Axam to sell them to a third party. Sagawa was in New York

when he sent the letter. To obscure the true purpose of the offer, Sagawa falsely claimed in the letter that he was requesting that Olympus repurchase the preference shares “[d]ue to an unexpected indication of redemption request from our investors.” In support of this request, Sagawa included two valuations for the preference shares, one of which estimated their value at \$592 million and the other of which estimated their value as in between \$522–\$536 million. Around the same time, a broker retained by Olympus to assess the value of the preference shares had valued them at \$557 million. On November 28, 2008, the Olympus Board of Directors approved a purchase price for the preference shares within the range of \$530–\$590 million.

26. While staged negotiations between Olympus Executive No. 2 and Sagawa dragged on, Olympus’s auditors requested that Olympus revoke the November 28 board resolution to repurchase the Gyrus preference shares because it viewed the exorbitant fee to Axes/Axam as problematic. In response, on June 5, 2009, the Olympus Board withdrew its approval for the repurchase. The following month, Olympus replaced its auditors.

27. Shortly thereafter, Sagawa and Olympus Executive No. 2 exchanged emails in which each gave the appearance of negotiating on behalf of Axam and Olympus, respectively. On March 10, 2010, Sagawa, who was in New York at the time, emailed a letter on behalf of Axam to Olympus Executive No. 2 requesting that Olympus repurchase the preference shares for \$730 million. Sagawa attributed the increase to the fact that the preference shares paid a dividend equivalent to 85% of Gyrus’s net profits and that two years’ worth of dividends had not yet been paid.

28. On March 19, 2010, the Olympus Board of Directors approved a repurchase of the preference shares at \$622 million. Olympus wired this amount to Axam, which in turn wired it to the Off B/S Entities so that they could use it to repay the revolving credit facilities extended to them.

29. As a result of the conduct described above, Sagawa willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities, and willfully aided and abetted and caused Axes’s violation of Section 15(c)(1)(A) of the Exchange Act, which prohibits a broker or dealer from effecting transactions, or inducing or attempting to induce the purchase or sale of any security, by means of any manipulative, deceptive, or other fraudulent device or contrivance.

Respondent’s Cooperation

30. In determining to accept the Offer, the Commission considered the cooperation Respondent afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1) and (a)(3) of the Securities Act and Section 15(c)(1)(A) of the Exchange Act.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent acknowledges that the Commission is not imposing a civil penalty based upon his cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior

notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil money penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields
Secretary