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Bill for Amendment of the Financial Instruments and Exchange Act, etc. enacted

Series of reports on the 2008 amendments to the Financial Instruments and Exchange Act

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Legal and Tax Research Dept
Jun Yokoyama

Summary

- The Bill for Amendment of the Financial Instruments and Exchange Act, etc. was enacted on 6 June.
- Based on a December 2007 Financial System Council report, the purposes of this bill included creating new exchange markets for professionals, diversifying ETFs, revamping the regulations on firewalls between securities firms and banks, and strengthening the system of administrative monetary penalties.
- Following the case in January 2008, when fictitious large shareholding reports were published, a system is being adopted to stop publication of disclosure documents where the authorities have issued a correction order.
- The amendments shall come into effect from a date to be specified by a Cabinet Order, within six months (one year for the firewall regulations) from the day of promulgation.

Bill for Amendment of the Financial Instruments and Exchange Act, etc. enacted

The Bill for Amendment of the Financial Instruments and Exchange Act, etc. was enacted on 6 June by a vote in a full session of the Upper House of the Japanese Diet, becoming the Act for Amendment of the Financial Instruments and Exchange Act, etc.¹.

This purpose of this legislation is to amend the Financial Instruments and Exchange Act, etc. following the proposals of the Financial System Council's Sectional Committee on Financial System' report² released on 18 December, 2007.

The principal contents are as follows.

- (1) Creation of new exchange markets exclusively for professional investors
- (2) Diversification of exchange-traded funds (ETFs)
- (3) Revamp of the firewall regulations among securities firms and banks

¹ The Bill is available in Japanese on the FSA website (<http://www.fsa.go.jp/common/diet/169/index.html>), with an outline in English (<http://www.fsa.go.jp/en/refer/measures/20080606.html>).

² Available in Japanese on the FSA website (http://www.fsa.go.jp/singi/singi_kinyu/tosin/20071218-1.html etc.).

- (4) Strengthening of the system of administrative monetary penalties
- (5) Permitting financial instruments exchanges to establish markets related to emission trading
- (6) Restriction on public access to disclosure documents for which a correction order has been issued.

No. (6) is based on the "Summary of Issues for the Improved Operations of EDINET" report³ released on 19 February by the Working Group for the Improved Operations of EDINET that was established in response to the publication of fictitious large shareholding reports on the EDINET system in January 2008.

With regard to the establishment of a framework for alliances among financial instruments exchanges and commodity exchanges, an item proposed by the Financial System Council, no specific revisions are included in the current bill. However, liaison with interested government agencies is expected to continue.

Significant points of the Act for Amendment of the Financial Instruments and Exchange Act

Of the points included in the Act for Amendment of the Financial Instruments and Exchange Act, the following are particularly significant.

1. Creation of new exchange markets exclusively for professional investors

- Creation of exchange markets that limit participants to professional investors (markets for professional investors)
- Exemption of securities for professional investors from current disclosure regulations under certain conditions, such as restrictions on resale to general investors
- Establishment of a framework including the following points for providing information to professional investors
 - Requiring the provision of information (specified securities information) about the financial instrument and its issuer when the instrument is offered
 - Requiring the provision of information about the issuing company (issuer information) at least once a year

2. Diversification of exchange-traded funds (ETFs)

- Introduction of investment trusts that are transferable to commodities in kind ("investment trusts managed with the aim of investing mainly in assets readily convertible into cash")

3. Revamp of the firewall regulations among securities firms and banks

- Establishment of a legal requirement to establish systems for managing conflicts of interest by securities firms and banks, etc
- Abolition of the ban on holding concurrent posts at securities firms and banks⁴

4. Strengthening of the system of administrative monetary penalties

- Raising the amount of administrative monetary penalties
- Addition of the the following acts to the list of violations subject to administrative monetary penalties

³ Available in Japanese on the FSA website (<http://www.fsa.go.jp/news/19/syouken/20080219-1.html>).

⁴ Relaxation of the restrictions on the sharing of undisclosed corporate customer information between banking and securities businesses proposed in the Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council is likely to be handled through ordinances introduced after the bill is passed.

- Failure to submit offering disclosure documents (securities registration statements, etc)/ongoing disclosure documents (annual securities reports, etc.)
- False statements in or failure to submit Public Notice for Commencing Tender Offer, Tender Offer Notification, large shareholding disclosure documents, etc.
- Provision of false information etc. relating to issues for professionals (See 1. above)
- Market manipulation through illegal market stabilization or wash sales⁵
- Increasing the amount of administrative monetary penalties to 150% in cases where a person who has been subject to an administrative monetary penalty in the past five years has committed another securities violation (system for increased penalties)
- Reducing the amount of administrative monetary penalties by half in cases where any of the following acts of violation has been reported prior to an investigation by the authorities: False statements in offering disclosure documents and ongoing disclosure documents, failure to submit a large shareholding report, insider trading in sales and purchases of treasury stock (system for reduced penalties)
- Extension of the statute of limitation⁶ from the current three years to five years

5. Permitting financial instruments exchanges to establish markets related to emission trading

Addition of the business of opening markets related to emissions trading (trading in allocations) etc. to the scope of business for financial instruments exchanges

6. Restriction on public access to disclosure documents for which a correction order has been issued

Introduction of a framework in which the authorities may decide not to make available for public disclosure documents for which a correction order has been issued

Effective Date

The amendments to the Financial Instruments and Exchange Act, etc. shall come into effect from a date to be specified by a Cabinet Order, within six months from the day of promulgation

As an exception, the amendment regarding the revamp of firewall regulations (3. above, concerning the establishment of systems for managing conflicts of interest, and the abolition of the ban on holding concurrent posts) shall come into effect from a date to be specified by a Cabinet Order, within one year from the day of promulgation

For more information concerning the Act (Bill) for Amendment of the Financial Instruments and Exchange Act, etc., see the following DIR Legal and Tax Research Dept reports.

Jun Yokoyama, "Proposed Revisions to Market for Professionals and Disclosure Regulations" (Japanese language report dated 27 Mar, 2008)

Jun Yokoyama, "Proposed Revisions to Market for Professionals and Industry Participant Regulations" (Japanese language report dated 10 Apr, 2008)

Jun Yokoyama, "Bill for Amendments Concerning the Operation of a Market for Professionals" (Japanese language report dated 10 Apr, 2008)

⁵ The current system for administrative monetary penalties covers market manipulation for the purpose of causing fluctuation in market price (Article 174 of the Financial Instruments and Exchange Act). In contrast, the revisions extend coverage to types of manipulation for the purpose of stabilizing market prices or for the purpose of convincing third parties that there is active trading.

⁶ The statute of limitations is a system whereby authorities may not issue a decision on commencement of trial procedures (in other words, they cannot apply administrative monetary penalties) concerning a violation if a certain period has elapsed since the date of the violation (Article 178, Paragraphs (3)-(9) of the Financial Instruments and Exchange Act). This is equivalent to the statute of limitations applying to criminal procedures. Extending the period in the statute of limitations provides the authorities with a longer period in which to file charges after a violation.

- Yuuki Kanemoto, "Bill for Amendments to Permit Diversification of ETFs" (Japanese language report dated 27 Mar, 2008)
- Yuuki Kanemoto, "Bill for Amendments Concerning a Revamp of the Firewall Regulations" (Japanese language report dated 12 Mar, 2008)
- Yuuki Kanemoto, "Bill for Amendments Concerning the Management of Conflicts of Interest by Securities Firms and Banks, etc." (Japanese language report dated 13 Mar, 2008)
- Yuuki Kanemoto, "Bill for Extending the Scope of Business for Banks, etc." (Japanese language report dated 31 Mar, 2008)
- Jun Yokoyama, "Revisions to System of Monetary Penalties for TOB/Large Shareholding Report Violations" (Japanese language report dated 30 Apr, 2008)
- Jun Yokoyama, "Proposed Adoption of Systems for Increasing and Reducing Monetary Penalties" (Japanese language report dated 28 May, 2008)
- Jun Yokoyama, "Proposed Strengthening of Monetary Penalties for Insider Trading" (Japanese language report dated 29 May, 2008)
- Yuuki Kanemoto, Proposed Abolition of Ban on Financial Instruments Exchanges Establishing Emissions Exchanges (Japanese language report dated 10 Apr, 2008)