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Democratic Party of Japan: Securities and Financial Policy

New Administration Will Move Towards Implementing Japanese-Style FSA, Public Companies Act, and Comprehensive Financial Markets and Services Legislation

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Legal and Tax Research Dept
Kazuhiro Yoshii

Summary

- On 30 August the Democratic Party of Japan won 308 seats in the House of Representatives, a landslide victory.
- The DPJ's "INDEX 2009" policy document calls for the creation of a Japanese version of the UK's FSA, the enactment of a public companies act, and the enactment of comprehensive financial markets and services legislation.
- These are all important topics, and they will attract much attention as the details are hammered out.

1. Creating a Japanese Version of the FSA

In February 2006 the DPJ submitted a bill in the House of Representatives that would have established a Japanese version of the US Securities and Exchange Commission. To significantly strengthen the market oversight function, this bill aimed to establish a securities and exchange commission outside of the Cabinet Office as a so-called Article 3 Commission (independent regulatory commission). This would have given it equal standing with the Fair Trade Commission. The new securities and exchange commission would have differed from the existing Securities and Exchange Surveillance Commission in that it would have had its own power to hand down administrative dispositions. The bill failed in the House of Representatives on 16 May.

Then, on 25 May 2006, the DPJ submitted a bill to establish a financial instrument trading oversight board (a Japanese version of the UK's FSA) in the House of Councillors. This financial instrument trading oversight board would have overseen not only securities trading, but also commodities futures trading, and it would have been established as a so-called Article 3 Commission (independent regulatory commission). This body would have had the authority to file formal complaints of securities trading violations with prosecutors. However, for commodities futures trading, the duty to file complaints of violations would have remained with the civil

servants of the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Economy, Trade and Industry, which have jurisdiction in this area, and the details of the coordination between the proposed commission and the ministers were to be clarified in a separate law. In the end, the bill was shelved.

Nevertheless, this bill will probably serve as a reference for future deliberations. The jurisdiction of a Japanese FSA will probably be expanded to encompass the formulation of comprehensive financial services and market legislation.

2. Enacting a Public Companies Act

By "public company" we mean a company that is required to submit a yukashoken hokokusho (year-end annual securities filing). This includes listed companies, companies that have conducted a public offering, and companies with more than a certain number of shareholders.

In its present form, the Companies Act defines a public company as one with no restrictions on the transfer of its shares, and there is no provision limiting this to companies whose shares and other instruments are traded on a securities exchange. Protecting investors who participate in securities trading falls under the jurisdiction of the Financial Instruments and Exchange Act.

Waseda University Professor Tatsuo Uemura has been advocating for a public companies act for some time. Under Professor Uemura's guidance, the Japan Association of Corporate Directors drew up the "Draft Outline for a Public Companies Act (Draft No. 11)", with Tokyo University Professor Hideki Kanda also signing off on the proposal, according to the association. The draft contains the following proposals:

1) Integration of the Financial Instruments and Exchange Act and the Public Companies Act

For public companies, information disclosure, financial statements, auditing, audit certification, rules for issuing new shares, and rules for public tender offers should follow the systems spelled out in the Financial Instruments and Exchange Act.

2) Corporate governance that can meet the demands of securities markets
Maintain the choice between the "company with committees" structure and the "board of directors/auditors" structure; review the status of committees and autonomy under the articles of incorporation when the majority of board members are outside directors; require the executive officers and directors to establish fair internal controls; balance the executive officers' and directors' obligations to third parties and the Financial Instruments and Exchange Act's obligations to investors; examine the executive officers' and directors' obligations to the company; and focus on providing information to shareholders

3) Making the "company group" a basic element of the public companies act

Although the details of the DPJ's public companies bill are still unclear, it has been reported that while based on the above draft, it will also include a provision that some of the auditors be elected from among employee representatives. Considering the nature of the auditor's role, questions still remain about what will be improved by having employee representatives take some of these spots.

Furthermore, the Diet committee working on the bill and the presiding agency will differ according to on whether the public companies act is designated as a special case law under the Companies Act, such as the former Law for Special Exceptions to the Commercial Code, or as market legislation as part of the Financial

Instruments and Exchange Act. That decision will also affect the bill's temperament and operating philosophy. Attention will be focused on how the bill is positioned and how this question is addressed.

3. Enacting Comprehensive Financial Services and Markets Legislation

In its current form, the Financial Instruments and Exchange Act doesn't directly regulate deposits, insurance, or commodities futures trading. The DPJ's INDEX 2009 policy document calls for enacting comprehensive financial services and market legislation that also encompasses these.

Under the current legal system, investor protection for deposits, insurance products, commodities futures, REIT-type products, and other instruments with investment characteristics is addressed through other industry legislation. It is as yet unclear whether the planned comprehensive financial services and market legislation will leave industry legislation intact and apply the rules of the Financial Instruments and Exchange Act to these other instruments through this other industry legislation, or whether the definition of Financial Instruments Business will be expanded to encompass the banking and insurance industries.

The UK's Financial Services and Markets Act 2000, which is being used as the model for Japanese reforms, consolidates all forms of unfair trading under the heading of "market abuse," and as a result there is much attention on whether Japan will also address insider trading, market manipulation, Article 157's comprehensive prohibitions against fraud, and Article 158's rules about rumor-mongering and fraudulent trading through comprehensive regulation as "market abuse." Furthermore, the UK's Financial Services and Markets Act 2000 protects not only investors who make reasonable decisions, but also consumers—and not just those who make reasonable decisions. Japan's Financial Instruments and Exchange Act classifies investors as either professionals or amateurs, and regulations protecting them differ according to the classification. Furthermore, laws are beginning to tilt more heavily towards consumer protection, as evidenced by the introduction of alternative dispute resolution as part of the June 2009 reforms, and this shift may continue.

Excerpt from the DPJ's INDEX 2009 Policy Document

Addressing the financial crisis

The financial crisis that started in the US is having a severe impact on business and household finances in our country. We will swiftly enact a number of measures to help business and household finances, including: 1) expand the availability of credit guarantees to more types of businesses; 2) make the inspection manual for small- and medium-sized enterprises more flexible (e.g. not classifying a loan as nonperforming as long as interest payments are being made); and 3) support the easing of repayment terms for home loans.

Foster healthy financial markets

We will reconstitute the Securities and Exchange Surveillance Commission as a "financial instruments trading oversight board" (Japanese version of the FSA) with greater independence and stronger authority, giving it broad authority to oversee financial instruments trading, while at the same time endeavoring to foster the required human resources.

To raise the international standing of Japan's financial markets and stimulate the economy, it is important to accelerate the shift from savings to investment. To accomplish this, we will build sound and reliable markets that will not be disrupted by speculation.

Enact a public companies act

Companies that have offered their shares to the public should fulfill their responsibilities to a variety of stakeholders, including investors, business partners, workers, and local communities. We will consider the enactment of a public companies act aimed at strengthening information disclosure and auditing practices and ensuring sound governance as a special law that will apply to public companies.

Enact comprehensive financial services and markets legislation

The problems associated with financial products seem endless as new financial products are developed and marketed. We will work to put in place a comprehensive and cross-disciplinary investor protection legal system that covers all financial products sold by banks, securities firms, insurance companies, and commodities brokers (spot commodities and futures).

Make the inspection manual for small- and medium-sized enterprises more flexible

To pave the way for SME financing, along with recommending that the focus be on cash flow, rather than collateral, we will devise ways to make the inspection manual for SMEs more flexible (e.g. not classifying a loan as nonperforming as long as interest payments are being made) to alleviate the credit crunch and the withdrawal of credit.

Enact a "community finance facilitation act"

We will enact a "community finance facilitation act" to promote sound competition and good management among financial institutions by disclosing information about community participation and lending terms for SMEs.

Reduce the Burden on NPO Banks and Small Mutual Aid Groups

We will exclude NPO banks and other small non-profit organizations that collect money from local residents to finance community activities, such as community centers and environmental improvements, from the asset requirements spelled out in the Money Lending Business Act.

Small, short-lived, self-governing mutual aid groups operate on a not-for-profit basis to provide insurance that addresses specific risks not easily addressed by conventional insurance companies and also provide an inexpensive mechanism for transferring risk. These organizations have a certain place in society, and we will classify them separately from the "insurance businesses" that are strictly regulated under the Insurance Business Act.