ABHANDLUNGEN / ARTICLES

Financial Markets Regulation in Japan

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I. Institutional Framework

1. Corporate Landscape

The Japanese corporate landscape is characterized by joint stock companies. More than 2.9 million Japanese firms are using this organizational model.[1]

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*** This article is a comprehensively updated and amended version of H. Kanda/ H. Baum, Finanzmarktrecht, in: Baum/Bälz (eds.), Handbuch Japanisches Handels- und Wirtschaftsrecht (Köln 2011) 279–316.

Nevertheless, the majority of these companies are small or medium-sized firms, whose shares are privately held. In this regard, it is customary to speak of closed companies. Alongside these stand only some 10,000 companies which are classified as large companies.[2] Out of these about half are publicly owned. Around 3,500 joint stock companies were listed in 2016 on the Tōkyō Stock Exchange, the most important stock exchange in the country.[3] The Japanese Companies Act of 2005[4] accommodates companies of different sizes through the provision of diverging organizational requirements.[5]

However, in the past the majority of publicly owned companies, including numerous listed companies, *effectively* resembled closed companies. This was due to their specific share-holding structure.[6] From the late 1940s to the mid-1990s this was characterized by long-term business and financial relationships which were safeguarded through stable ownership structures. Until the start of the 1980s, Japanese companies predominantly raised capital indirectly through banks (the so-called "Main Bank System")[7] and to a far lesser extent directly through the capital market. Today the opposite is

1 This figure includes the former limited liability companies (now: *tokurei yūgen kasiha*) that are treated as closed stock corporations since the company law reform of 2005. The other three types of companies – the general partnership company, limited partnership company, and limited liability company – jointly amount to just slightly over 170,000 companies (figures as of 2014). For an overview see H. BAUM/G. GOTO, Die japanische LLP im gesellschaftsrechtlichen Kontext, ZJapanR/J.Japan.L. 41 (2016) 89, 97 f., with further references.

2 A company is classified as large if it has capital of at least 500 million Yen or liabilities of 20 billion Yen on its balance sheet, Art. 2 Nr. 6 Companies Act (see *infra* notes 4 and 5 for further references).

3 See JAPAN SECURITIES DEALERS ASSOCIATION, Fact Book 2017 (Tōkyō 2017) 32.

4 *Kaisha-hō,* Act No. 86/2005 as amended; English translation at *www.japaneselaw translation.go.jp*

5 E. TAKAHASHI/M. SHIMISU, The Future of Japanese Corporate Governance: The 2005 Reform, ZJapanR/J.Japan.L. 19 (2005) 35 ff.; M. DERNAUER, Die japanische Gesellschaftsrechtsreform 2005/2006, ZJapanR/ J.Japan.L. 20 (2005) 123 ff.

6 For a detailed analysis see H. BAUM/M. SAITO, Übernahmerecht, in: Baum/ Bälz (eds.), Handbuch Japanisches Handels- und Wirtschaftsrecht (Cologne 2011) 317, 319 ff.; J. FRANKS/C. MAYER/H. MIYAJIMA, The Ownership of Japanese Corporations in the 20th Century (February 17, 2014). European Corporate Governance Institute (ECGI) – Finance Working Paper No. 410/2014. Available at SSRN: *https://ssrn.com/abstract=2397142*

7 Cf. M. AOKI/H. PATRICK (eds.), The Japanese Main Bank System (Oxford 1994); Y. MIWA/J. M. RAMSEYER, The Multiple Roles of Banks? Convenient Tales from Modern Japan," in: Hopt et al. (eds.), Corporate Governance in Context: Corporations, State and Markets in Europe, Japan, and the US (Oxford 2005) 527 ff.; C. MILHAUPT, On the (Fleeting) Existence of the Main Bank System and Other Japanese Economic Institutions, Law & Social Inquiry 27, No. 2 (2002) 425 ff.

true: around 58% of financing is carried out through the placing of shares and bonds on the national and international financial markets, while bank borrowings account for only 23%.[8] In the course of the 1990s financial crisis in Japan, the shareholding structure changed significantly. The characteristically high percentage of shares in listed Japanese companies that were owned by banks and insurance companies went from almost 42% in 1990 to around 21% in 2016; at the same time the percentage of shares owned by foreign investors climbed from under 5% in the early 1990s to 30% in 2016.[9] This internationalization of the Japanese financial center brought with it a change in the country's regulatory architecture.

2. *Development of the Regulatory Architecture After 1945*

a) *The Regulatory Model from the 1950s to the Early 1990s*

In the course of economic reforms following the end of the Second World War, Japanese financial market law also found itself extensively revised according to the American model.[10] Directly mirroring the structure of the US *Securities Act* of 1933 and the *Securities Exchange Act* of 1934, the Japanese Securities and Exchange Act came into force in 1948;[11] it was subsequently redrafted in 2006, and renamed the Financial Instruments and Exchange Act (hereafter FIEA), taking effect from 30 September 2007.[12] The Act details fundamental regulations pertaining to financial services

8 Figures for 2014, see JAPAN SECURITIES RESEARCH INSTITUTE (hereafter JSRI), Securities Markets in Japan 2016 (Tōkyō 2016) 5. This corresponds to the situation in the first half of the twentieth century; at the time widespread share-ownership predominated in many fields, and companies raised capital to a large extent through the capital market rather than through the banks; for more detail see FRANKS/MAYER/MIYAJIMA, *supra note* 6.

9 Figures from JAPAN SECURITIES DEALERS ASSOCIATION, *supra* note 3, 38. It should be noted, however, that despite the high percentage of international institutional investors engaged in Japanese companies, *none* of the (few) hostile takeover attempts of listed Japanese companies has been successful so far; for details see BAUM/SAITO, *supra note* 6, 323 ff.; J. BUCHANAN/D. H. CHAI/S. DEAKIN, Hedge Fund Activism in Japan (Cambridge 2012).

10 An analysis of the influence of US and German law on the formation of company law and capital markets regulation can be found with H. KANSAKU, Der Einfluss des deutschen und amerikanischen Rechts auf das japanische Gesellschafts- und Kapitalmarktrecht, in: Baum/Bälz/Riesenhuber (eds.), Rechtstransfer in Japan und Deutschland (Cologne 2013) 143 ff.

11 *Shōken torihiki-hō,* Act No. 25/1948.

12 *Kin'yū shōhin torihiki-hō,* Act No. 65/2006 as amended. English translation under the title "Financial Instruments and Exchange Act", *www.japaneselawtranslation.go.jp* and EHS Law Bulletin Series Vol. VI, MA, No. 6600.

market law.[13] Contrary to the US-shaped regulatory architecture, legislation on the Japanese financial market adopted different institutional parameters from the outset. In essence, the dominant regulatory model from the 1950s to the 1990s was characterized by the following elements:[14]

At the center of financial market regulation and supervision was the Ministry of Finance, made up of elite bureaucrats and assigned an unusual abundance of responsibilities and areas of competence. Alongside extensive fiscal jurisdiction, it was until 1998 tasked with the supervision of almost all sectors of the finance industry. In addition, the ministry conceived all laws and decrees pertaining to the financial market. Legislation was characterized by the paradox of formalization and informality, accompanied as it was by a network of regulations and the non-transparent application of laws. Legislative requirements were initially applied in a strictly formalistic way, whereby attention was focused more on ensuring that an individual regulation was properly observed than on what its economic objective might be.[15] Nevertheless, when it came to statutory orders, discretion was often applied flexibly, that is to say informally. This occurred partly by means of written waivers *(tsūtatsu),* but predominantly through "suggestions" made orally, in short through informal administrative action *(gyōsei shidō).* In terms of day-to-day practice, observing the informal requirements was crucial.

Such specific legislative implementation went hand in hand with strict market access controls. For a long time there existed an (unwritten) general ban subject to the possibility of authorization for all activities on the financial market, according to which any new business activity was forbidden until it had been expressly approved by the Ministry of Finance.[16] The granting of such permission was largely subject to the Ministry's discretion.

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13 See II.1. *infra*.

14 Comprehensive analysis in H. BAUM, Der japanische "Big Bang" und das tradierte Regulierungsmodell: ein regulatorischer Paradigmenwechsel?, Rabels Zeitschrift für ausländisches und internationales Privatrecht 64 (2000) 633 ff.; for a different emphasis see H. KANDA, Finance Bureaucracy and the Regulation of Financial Markets in Japan, in: Baum (ed.), Japan: Economic Success and Legal System (Berlin 1997) 305 ff.; ID., Globalization of Financial Markets and Financial Regulation in Japan, ZJapanR/J.Japan.L. 4 (1997) 9 ff.; C. MILHAUPT/J. MILLER, A Regulatory Cartel Model of Decision Making in Japanese Finance, ZJapanR/J.Japan.L. 4 (1997) 18 ff.; A. PARDIECK, The Formation and Transformation of Securities Law in Japan: From the Bubble to the Big Bang, UCLA Pacific Basin Law Journal 19 (2001) 1 ff.; from a comparative perspective S. KONOE, The Politics of Financial Markets and Regulation: The United States, Japan and Germany (Basingstoke 2014).

15 H. KANDA, Politics, Formalism, and the Elusive Goal of Investor Protection: Regulation of Structured Investment Funds in Japan, University of Pennsylvania Journal of International Business Law 12 (1991) 569, 585 f.

16 KANDA*, supra note* 14, 312 f.

In the past, this "licensing system" allowed intense market *supervision*, which largely replaced any market *regulation*.[17] The effect of these market access controls was further reinforced through clear market segmentation. On the whole financial innovations and changes were only allowed to the extent that the weakest institutions in a given market segment were able to cope with them (the so-called "convoy system"). In this way, the Ministry of Finance saw itself as fulfilling a dual role: on the one hand, it supervised the financial industry; on the other hand, it protected it from the pressure of competition. Correspondingly, until the spectacular collapse of the country's then fourth largest investment firm, *Yamaichi Securities*, in 1997, not a single Japanese financial institution had gone into receivership for more than half a century. Financial administration and the financial industry were closely linked.[18] Such a regulatory model was characterized by prior coordination of interests *(ex ante monitoring)* rather than subordinate legal controls placed on market behavior *(ex post monitoring).*[19] Correspondingly, there have been almost no instances of legal challenges mounted in Japan against administrative decisions taken by financial institutions. From an institutional point of view, those taking part in this regulatory practice have also been described as a *"regulatory cartel",* the decisions of which are coordinated in such a way as to allow profits to be generated for those involved that would not have been realized without such interplay.[20]

Such interplay between private and public interests in the formation and application of laws is probably unique amongst modern industrialized countries.[21] At any rate, its roots extend beyond the war economy of the 1940s to the latter half of the nineteenth century and a formidable period of Japanese modernization. The regulatory model of the 1940s was based on *three* pre-conditions. As these gradually eroded, by the 1990s the whole structure started to implode. The first of these pre-conditions was shielding off the market from the exit of domestic players and the access of foreign ones. As a result of the dynamics of globalization, however, Japan was forced to abandon this strategy and increasingly open its market. The second pre-condition related to the possibility of authorized bureaucratic supervision. Nevertheless, the requisite public trust in administration for such a condition disappeared as the initial mismanagement of the early 1990s financial crisis made it clear that the responsible parties were not merely

17 MILHAUPT/MILLER, *supra* note 14, 452.

18 See MILHAUPT/MILLER, *supra* note 14, for more detail.

19 See KANDA, *supra* note 15, for a more detailed discussion, 583 ff.; and ID., *supra* note 14, 312 ff.

20 MILHAUPT/MILLER, *supra* note 14, 20.

21 KANDA, *supra* note 15, 582.

overwhelmed but had engaged in a range of scandalous undertakings, which indicated a transition between market players and supervision that had progressed smoothly from cooperation to collusion.

Even the basic consensus, agreed by all parties, that the primary aim of Japan's financial market policy was to provide the country's industry with cheap credit – the third pre-condition of the system – yielded to a growing sense of disillusionment.[22] Thus, alongside the international pressure to open its market *(gaiatsu),* there increasingly came domestic pressure for reform *(naiatsu);* both were aimed at achieving a more consumer-orientated society in Japan.[23] An inability to adapt and to innovate as a result of over-regulation and bureaucratic market supervision were soon posited as two important causes of the country's economic crisis.[24] The pressure to carry out financial market law reforms was intensified by the rapid development in information and communications technologies. In the second half of the 1990s, the government introduced strong regulatory counter measures that occurred in parallel to the actual changes in the corporate landscape mentioned above.

b) Changes and Reforms since the Mid-1990s

A comprehensive strategy paper[25] presented by the Japanese government in 1998 served as the trigger for numerous far-reaching legislative and administrative reforms that were set in motion in rapid succession. In the course of these reforms, more than twenty financial market laws were newly created or comprehensively revised by the Japanese legislature.[26] The reform strategy

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22 For the political dynamics shaping the reforms cf. T. TOYA/J. AMYX, The Political Economy of the Japanese Financial Big Bang: Institutional Change in Finance and Public Policymaking (Oxford 2006); J. AMYX, Japan's Financial Crisis: Institutional Rigidity and Reluctant Change (Princeton, NJ 2004).

23 KUSANO, Deregulation in Japan and the Role of Naiatsu (Domestic Pressure), Social Science Japan Journal 2 (1999) 65 ff.

24 This according to the findings of a comprehensive OECD country study, Regulatory Reform in Japan (1999); similar NAKATANI, A Design for Transforming the Japanese Economy, Journal of Japanese Studies 23 (1997) 399 ff.

25 "Structural Reform of the Japanese Financial Market – Toward the Revival of the Tōkyō Market by the Year 2001" (Tōkyō 1998).

26 For a detailed discussion, see H. KANDA, Globalization of Capital Markets: A Perspective from Japan, in: Basedow/Kono (eds.), Legal Aspects of Globalisation – Conflict of Laws, Internet, Capital Markets and Insolvency in a Global Economy (2000) 69, 71 ff.; BAUM, *supra* note 14, 651 ff.; on the start of the reforms in the 1980s H. BAUM, Die japanischen Finanzmärkte in den achtziger Jahren: Ein Jahrzehnt der Liberalisierung, Internationalisierung und Gesetzreformen, Wertpapier-Mitteilungen 1989, Special Supplement No. 4/1989.

pursued two aims: first it aimed to solve the massive debt problem of the Japanese banks, which had been so excessive in awarding credit in the 1980s that the stability of the Japanese financial system had been endangered.[27] Second it aimed to create a transparent market-orientated regulatory regime in which, on the one hand, market forces were given priority over traditional administrative governance and, on the other hand, transparency was increased along with the protection granted to investors. At the heart of these reforms was a fundamental paradigm shift from a consensus-orientated to a rule-orientated regulation of the financial markets, according to which market players were obliged to keep to a clear and binding code of conduct, with its observance and violation being monitored or sanctioned *ex post*.[28] This shift made a swift development of the country's judicial branch indispensable, since *ex post* monitoring pre-supposes an efficient judicial system, which, in the Japanese context, above all meant that a drastic increase in the number of lawyers and judges was required. This was also, therefore, one of the main aims of the judicial reforms set in motion after the turn of the millennium.[29]

In sum, three characteristics of the reforms can be recorded here. First, the remarks above show that the driving force for regulatory reorientation arose from national events. Second, it is clear that international developments played a role. Increasingly international standards emerged, and though these are characterized as *soft laws*, that is, lacking in any legally binding force, they become *hard laws* upon implementation in the national regulations of individual legal systems. In this regard, the Japanese "Big Bang of 1998" and subsequent reforms thereafter made Japanese financial markets law both more international and more competitive. The third characteristic is the growing significance of private law in the context of financial market regulation. This is surely a direct consequence of deregulation, which gives players on the financial market an unprecedented freedom to develop and market new financial products, which in turn assigns increasing significance to questions pertaining to private law.

3. *Financial Market Supervision*

A central element of the financial market reforms outlined above was the creation of an independent supervisory body. The first step was the estab-

27 This aspect will not be discussed here. At the end of 1998, a new authority was created with responsibility for the rehabilitation and winding up of insolvent financial institutions; see also below III.3.b).

28 KANDA, *supra* note 26, 75f.; BAUM, *supra* note 14, 654 f.

29 Cf. K. ROKUMOTO, Overhauling the Judicial System: Japan's Response to the Globalizing World, ZJapanR/J.Japan.L. 20 (2005) 7, 18; ID., Law and Culture in Transition, American Journal of Comparative Law 49 (2001) 545 ff.

lishment, in 1998, of the *Financial Supervisory Agency (Kin'yū Kantoku-chō),* which was assigned to the Prime Minister's cabinet office as an external department. This supervisory body, which was explicitly tasked with bringing about a change from a system of discretionary *ex ante* monitoring to a system of transparent *ex-post* monitoring, incorporated its predecessor, the *Securities and Exchange Surveillance Commission (Shōken Torihiki-tō Kanshi I'in-kai)*, hereafter SESC. Though the SESC had come into being as early as 1992, unlike the Ministry of Finance it enjoyed only semi-independent status and lacked the authority to impose sanctions. In 2000 and 2001, the country's entire supervisory structure was reorganized, causing the Ministry of Finance to be split up. Out of this process emerged the *Financial Services Agency*, hereafter FSA, which was split off from the Ministry of Finance and, like the competition authority, is obliged to report to the Prime Minister's office. The newly established FSA superseded the earlier FSA-like entity that had been created in 1998. The SESC remains part of the FSA and has retained its function as a department with supervisory powers over the capital market.[30]

The FSA exercises its supervisory powers over almost every segment of the Japanese financial market. Its authority was delegated by the Japanese Prime Minister to the Director General (the President) of the FSA under Article 194-7 (1) of the FIEA. Insofar as the Prime Minister retains overall responsibility according to the letter of the law, in practice legal competence is conferred to the FSA, assuming that it has not delegated matters further itself. In the past the FSA has delegated competence to the SESC in matters of supervisory authority regarding securities and investment firms. Such authority also includes the right to conduct on-site inspections. In addition, the SESC is responsible for implementing the FIEA with respect to all market players. If it establishes any criminally relevant behavior, it passes this on to the public prosecutor; in the matter of imposing fines (administrative penalties) it makes suggestions to the FSA leadership. The responsibility for supervising banks and insurance companies, meanwhile, does not lie with the SESC but with other FSA departments. Sometimes, for example in matters pertaining to the receipt of capital market law documentation, the FSA has also transferred competence to the directors of the Kanto Local Finance Bureau.[31] For the sake of simplicity (and to the extent

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30 Informative on the complex background: H. AOKI, The New Regulatory and Supervisory Architecture of Japan's Financial Markets, ZJapanR / J.Japan.L. 12 (2001) 101 ff.

31 More accurately, by delegation of the FSA, the Kanto Local Finance Bureau *(Kanto Zaimu-kyoku)* is in charge of administering disclosure as to certain large-scale issuer companies (with legal capital of 5 billion yen or more), disclosure relating to

possible), we refer to the various financial market supervision entities as a uniform body ("financial market authority").

There are certain exceptions when it comes to the division of competences. Thus, for example, the Bank of Japan *(Nippon Ginkō)* has certain supervisory powers regarding credit institutions. At the same time, those financial institutions that are promoted by the government are subject to the scrutiny of the Ministry of Finance *(Zaimu-shō).* Measures that serve to promote small businesses fall under the remit of the Ministry for Economy, Trade and Industry *(Keizai Sangyō-shō).* The same goes for consumer credits connected to the purchase of goods. The real estate trade and any funding related to it falls (partly) under the remit of the Ministry for Land, Infrastructure and Transport *(Kokudu Kōtsū-shō).*

In practice, the "No Action Letters" system, introduced in 2001 and based on the US model, is of significance here. According to it, natural or legal persons seeking to introduce a financial product or service on the Japanese market may ask the FSA in writing through a lawyer, accountant or any other (qualified) professional representative whether their planned activity is permissible. This is valid with regard to all legal regulations (together with any legal sub-regulations that have been enacted) which fall under the jurisdiction of the FSA. The information is then published.[32]

II. THE REGULATION OF THE CAPITAL MARKET

This section provides an overview of capital market law;[33] banking law is then discussed in Section III. Insurance law is not discussed here.[34]

1. Financial Instruments and Exchange Act

a) Overview

The above-mentioned Financial Instruments and Exchange Act (FIEA)[35] contains the central tenets of capital market regulation, including takeover

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tender offers and ownership disclosure by foreigners. Otherwise other local finance bureaus are in charge of administering certain matters by delegation of the FSA.

32 Information on the FSA's homepage at *www.fsa.go.jp/en/refer/noact/index_menu.html*.

33 A detailed English account can be found in JSRI, *supra* note 8.

34 An overview can be found, e.g., with S. KOZUKA, Versicherungsrecht, in: Baum/Bälz (eds.), *supra* note 6, 373 ff., and S. KOZUKA/J. LEE, The New Japanese Insurance Act: Comparisons with Europe and Korea, ZJapanR/J.Japan.L. 28 (2009) 73 ff.; see further N. KOBAYASHI et al., Insurance Law in Japan (Alphen aan den Rijn 2011); K. KINOSHITA, Case Law Trends in the Japanese Insurance Law and their Impact on the Japanese Insurance Act 2008, ZJapanR/J.Japan.L. 36 (2013) 165 ff.

regulation and prospectus law.[36] It regulates virtually all the important sectors of the financial market with the exception of banking and insurance regulation. In the course of the 2006 amendments, several laws, such as the Investment Advisors Act or the Act for Financial Derivatives, were integrated into the FIEA.[37] The at times broad discretionary requirements of the law are set out in over 40 statutory orders and guidelines.[38] In addition, various special laws supplement the FIEA.[39] As regards the listing of financial instruments for trading in organized markets, namely the stock exchanges, various regulations also apply. Here, the regulations pertaining to admission to trading on the Tōkyō Stock Exchange (TSE) are particularly important,[40] as that is where most Japanese companies are listed.[41]

The structure of the Securities and Exchange Act of 1948[42] was largely retained following its amendment in 2006 and thus continues to define the FIEA. The numerous reforms since the 1950s may have given the Securities and Exchange Act/FIEA a very distinct profile, but they have not changed the fact that at heart it remains shaped by US capital market law.

The Act, which in the course of its various amendments now encompasses more than 400 articles,[43] is supplemented by various ordinances. It is divided into the following 19 chapters:[44]

I. General Provisions (Article 1 and Article 2)
II. Disclosure of Corporate Affairs (Article 2-2 – Article 27)
II-2. Disclosure in a Tender Offer (Article 27-2 – Article 27-22-4)

35 Details on the Act, *supra* note 12.

36 See H. ODA, The New Financial Instruments Exchange Law, ZJapanR/J.Japan.L. 24 (2007) 5 ff.; C. WISENBAKER, Japan's Financial Instruments and Exchange Law: Hercules or Hydra?, Georgia Journal of International and Comparative Law 38 (2010) 473 ff.

37 Tabular overview in JSRI, *supra* note 8, 337.

38 Tabular overview in JSRI, *supra* note 8 (2014 edition), 325.

39 The official collection of laws, statutory orders, guidelines and (published) decrees *(Shōken Roppō)* relating to capital market law encompasses several thousand pages.

40 An English-language version of the admission to trading regulations and some 40(!) other regulations of the TSE can be found at *http://www.jpx.co.jp/english/rules-participants/rules/regulations/index.html*

41 See *supra* I.2.a).

42 See *supra* note 9.

43 In order not to have to change the entire numbering of a legal act that has been subject to multiple amendments, as has the FIEA, it is customary in Japan to begin a new count at those sections which are affected. The count is placed after the article and starts with the number 2; this practice can also be repeated within a section that has already been newly inserted: in this way the FIEA deals with tender offers and takeover bids in Articles 27-2 to 27-22-4.

44 The English translation encompasses around 700 pages, see *supra* note 10.

II-3. Disclosure of Status of Large Volume Holding of Share Certificates, etc. (Article 27-23–Article 27-30)
II-4. Special Provisions, etc. for Procedures on Carrying Out Procedures Via an Electronic Data Processing System for Disclosure (Article 27-30-2–Article 27-30-11)
II-5 Provision or Disclosure of Specified Information on Securities, etc. (Article 27-31–Article 27-35)
II-6 Disclosure of Material Information (Articles 27-36 - Article 27-38)
III. Financial Services Provider, etc. (Article 28–Article 65-6)
III-2. Financial Instruments Intermediaries (Article 66–Article 66-26)
III-3. Credit Rating Agencies (Article 66-27–Article 66-49)
III-4 High Frequency Trade Operators (Article 66-50 - Article 66-70)
IV. Financial Instruments Firms Association (Article 67–Article 79-19)
IV-2. Investor Protection Fund (Article 79-20–Article 79-80)
V. Financial Instruments Exchanges (Article 80–Article 154-2)
V-2. Foreign Financial Instruments Exchanges (Article 155–Article 156)
V-3. Financial Instruments Clearing Organizations, etc. (Article 156-2–Article 156-20-22)
V-4. Securities Finance Companies (Article 156-23–Article 156-37)
V-5 Designated Dispute Resolution Organization (Article 156-38–Article 156-61)
V-6 Trade Repositories (Article 156-62–Article 156-84)
VI. Regulations on Transactions, etc. of Securities (Article 157–Article 171-2)
VI-2. Administrative Surcharges (Article 172–Article 185-21)
VII. Miscellaneous Provisions (Article 186–Article 196-2)
VIII. Penal Provisions (Article 197–Article 209)
IX. Investigations into Criminal Cases (Article 210–Article 227)

Supplementary Provisions

Article 1 of the FIEA states as its overall legal aim the creation of a regulatory framework which guarantees that the issuing and trading of securities should protect investors' interests and be in the interests of the development of the Japanese economy. For this the FIEA allocates two types of norms, mandatory disclosure regulations and rules forbidding fraudulent behavior on the financial services market; in addition, it provides for the supervision of market actors.

b) Scope

The FIEA is applicable to securities and derivatives transactions within the meaning of the Act. The term "security" *(yūka shōken)* is defined in Article 2 (1) of the FIEA. Though broadly defined, it is nevertheless narrower in scope than the common definition of security, which also encompasses check and bill transactions. A common legal definition is lacking, however. In its place, Article 2 (1) clauses 1-21 of the FIEA contain a detailed enumerative list (which can be extended by government decree) of the types of securities that fall under the scope of the Act. Those securities not listed there *expressis verbis* fall outside its scope *in toto*. Fundamentally, the Act distinguishes between two types of security: those that may be represented by certified investment securities and are frequently traded (Article 2 (1)) and those that are not to be represented by certified investment securities and thus rarely traded (Article 2 (2)). Shares and bonds are part of the first category, while the second includes units in trusts and funds (except for those specifically listed as Article 2 (1) securities). The issuance of frequently traded securities leads to public disclosure obligations on the part of the issuer; and financial intermediaries who engage in securities transactions are subject to conduct and other business regulations such as, for example, the obligation to inform clients about risks and to check the suitability of a given securities acquisition. Although the acquisition of rarely traded securities does not oblige the issuer to make a disclosure unless they are addressed to 500 or more public investors, financial intermediaries remain subject to the conduct and other business regulations named above. The prohibition of fraudulent behavior on the financial market applies to both types of security.

Derivatives falling under the scope of the FIEA are determined by Article 2 paragraphs (20)–(25). Derivatives within the meaning of this regulation do not trigger the issuer disclosure mentioned above. Nevertheless, financial intermediaries remain subject to conduct and other business regulations; likewise, the prohibition of fraudulent behavior remains in force.

2. *Public Disclosure Orders and Transparency Requirements*

a) *Corporate Disclosure*

Businesses that make use of capital markets for funding are subject to various disclosure requirements.

aa) *Disclosure of Issuance*

Disclosure of issuance applies in the first instance to the placing of securities (shares, corporate bonds *inter alia*) on the public market. In this respect, Japanese capital market law is similar to its American counterpart. Both are founded on the principle of adequate disclosure as the sole *formal* admission requirement. A *material* verification of the issuer's suitability does *not* take place, however; this occurs only when admission to official trading is also being sought, and it transpires, moreover, in accordance with the admission requirements of the relevant stock exchange. Under Article 4 (1) of the FIEA, the issue or sale by public offering of new securities or securities that have already been issued but require registration may only occur when a request for registration has been lodged with the financial market authority. In such cases, the public offer or sale is to be delayed until the registration has taken effect (Article 15 (1) FIEA). An exemption from registration applies when the relevant information has already been made public (Article 4 (1)(i) FIEA); here only the issue prospectus need be provided (Article 15 (2), (13) FIEA). For Article 2 (1) securities such as shares and bonds, an offer is public if it is directed at fifty or more addressees.

Public placing is to be distinguished from private placings exempt from registration, for which various rules exist both for new issues and for the offering of securities already in circulation. Put simply, one can say that an offer which is directed at a restricted group of people or exclusively at institutional investors is not characterized as being public, provided that there is a corresponding agreement which excludes the resale of an issue to an unlimited number of people (Article 23-13 FIEA). In 1992, it became possible for issues to be offered exclusively to qualified investors *(tekikaku kikan tōshi-ka)* by means of a private placing, without the need for disclosure, as such investors fulfilled certain requirements in view of their professionalism. In order to protect public investors, specially designated securities of this kind are subject to restrictions regarding their handling.

For qualified issuers, there is a simplified registration procedure (Article 23-3 ff. FIEA). An issuer is regarded as qualified in this sense if their shares are listed on the Japanese stock exchange and have achieved a certain minimum market value; a qualified issuer must also have submitted a yearly securities report to the financial market authority for three years in succession (Article 24 FIEA). For such issuers the waiting period is reduced; and they may also make reference in their application to documents that have been previously submitted. Further, they have the possibility of submitting an application that corresponds to the US *"shelf-registration"*, whereby the most essential data is registered before issue and individual details are then subsequently added.

bb) Ongoing Disclosure Requirements

Businesses whose shares are listed on the stock exchange, who have been admitted to other regulated markets for the trading of financial instruments (Regulated Unofficial Market), or whose issue has been registered with the financial market authority in line with Article 4 of the FIEA are subject to periodically recurring accountability requirements and special information obligations (Article 24 ff. FIEA). The same goes for businesses whose registers contain details of 500 or more shareholders over a long period of time. Such businesses are obliged to prepare a detailed yearly securities report *(yūka shōken hōkoku-sho)* updated and furnished with an auditor's certificate. In addition to this, businesses are obliged to provide quarterly reports. The reports are to be submitted to the financial market authority. They are also to be retained at a business's headquarters for the purposes of inspection. Listed businesses (or those registered on the Unofficial Regulated Market) are further required to send copies of all reports submitted to the financial market authority to the relevant stock exchanges as well as market operators.

Alongside these capital market reporting obligations are those that have their foundation in company law. Consequently, Japan has a double-entry system comprised of recurring accountability requirements. There are historical reasons for this. Shaped as it was by its German counterpart, Japanese company law contains detailed rules pertaining to accounting. In addition to these rules come those obligations outlined above, which are the result of the post-1945 restructuring of Japanese capital market law. Since these obligations have become increasingly aligned over time, in practice the double-entry system does not create a significant additional burden.

cc) Internal Control Report

Since 2008, businesses required to submit a securities report under Article 24 of the FIEA (hereafter "reporting companies") are also obliged to submit an additional yearly report to their internal control system, which is responsible for ensuring that accountability requirements are being fulfilled (Article 24-4-4 FIEA). The report is to be furnished with an auditor's certificate. This regulation is the functional Japanese counterpart to the US *Sarbanes-Oxley Act* of 2002.

dd) Ad-hoc Disclosure

Reporting companies must file an ad-hoc report *(rinji hōkoku-sho)* with the FSA when certain specific events happen (Article 24-5 (4) FIEA). An example here is filing the results the results of shareholder voting at the general meeting. Also, stock exchanges require listed companies to announce price-sensitive information promptly, in line with local regulations pertaining to the stock exchange. This includes both decisions taken by issuers themselves and matters affecting the issuers, which nevertheless occur without their intervention. Examples of the first are decisions regarding mergers, buybacks of shares and corporate actions; examples of the latter are a change in the majority shareholder, unexpired risks and changes within the parent company.[45] In the event that such information obligations are violated, the stock exchange in question can either make the issuer's misconduct publicly known – and identify their shares as belonging to a rule-breaker – or demand that a report on the violation be submitted and subsequently published. If that does not prove adequate, in the most serious cases admission to trading can be revoked and delisting procedures initiated.

As a result of various scandals, recent times have seen stock exchanges intensify their regulations pertaining to the guarantee of prompt and appropriate disclosure.

ee) Corporate Governance

Endorsed by the FSA, the Tokyo Stock Exchange introduced the Corporate Governance Code on 1 June 2015.[46] The Code consists of seventy-three conduct norms that apply to listed companies in the comply-or-explain fashion. Those norms are written in the form of "principles" rather than "rules". Thus, companies are not obliged to comply with the norms and are permitted not to comply with them if they state their reasons.

Also, the FSA promulgated Japan's Stewardship Code in 2014, which was amended in 2017. This Stewardship Code provides several principles for institutional investors. This Code applies to institutions which signed on to the code through the website of the FSA. As of 27 December 2016, 214 institutions have signed on to the Code.[47] Again, the Stewardship Code provides several norms of conduct in the form of principles, and institutions which signed on to the Code are subject to those norms in a comply-or-explain fashion.[48]

b) Transparency Requirements

aa) Public Tender Offers

Under Article 27-2 (1)(i) of the FIEA, an over-the-counter share purchase where more than five percent of shares already in circulation are to be acquired must occur by means of a public tender offer. An exception exists for

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45 For a helpful overview of reporting obligations pertaining to the Tōkyō Stock Exchange, see JSRI, *supra* note 8, 307.

46 See *http://www.jpx.co.jp/equities/listing/cg/tvdivq0000008jdy-att/code.pdf.*

47 See *http://www.fsa.go.jp/news/27/sonota/20160315-1.html.*

48 An analysis of the two Codes can be found in H. KANSAKU, Genuine Self-regulation in Japanese Capital Markets: The Stewardship Code in Comparison to the Corporate Governance Code, in: Baum/Bälz/Dernauer (eds.), Self-regulation in Private Law in Japan and Germany (Cologne 2018, forthcoming)

a purchase from less than ten people within a period of sixty days. If such an exempted investor, however, seeks to increase his stake in the target company to more than a third of the shares, he has to make a tender offer (Article 27-2 (1)(ii) FIEA). The entry into a formal tendering process brings with it detailed information and disclosure obligations for the investor in question.[49]

The bidder has to first make a public announcement of his offer either by an advertisement in a daily (Japanese) newspaper with nationwide circulation or by putting it on EDINET *(Electronic Disclosure for Investors' NETwork).* Second, he has to notify the FAS. Both have to be done on the same day the offer was made (Art. 27-3 (1)(2) FIEA). Third, the bidder has to send out copies of this notification to the target company and to the exchange (or other market place) where the target company's shares are listed.

Beside the public announcement and the notification, the bidder has to draft a tender offer prospectus *(kōkai kaitsuke setsumei-sho)* which he has to make available for all shareholders interested in tendering their shares (Art. 27-9 FIEA). The tender offer must offer the same price and the same conditions to all shareholders willing to tender their shares. But, unlike EU regulations, the bidder does not have to offer a reasonable price nor does a minimum bid price for such an acquisition of shares exist in Japan.[50]

After the offer period has expired the bidder has to make public how many shares were tendered, how many of these he acquired, and whether, in the event that more shares were offered then he wished to acquire, a pro rata purchase is planned.

bb) Reporting Obligations for Large Shareholders

Under Article 27-23 ff. of the FIEA, persons whose involvement in domestic or foreign joint-stock companies listed on the Japanese stock exchange exceeds the five percent limit of issued voting stock must disclose their share by submitting a report to the financial market authority (the so-called "five percent-rule").[51] Thereafter, any changes in share ownership that amount to one percent or more are to be reported immediately.

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49 For a detailed overview see BAUM/ SAITO, *supra note* 6, 344 ff.

50 For a comparison of the Japanese and the German (EU) takeover regulation see H. BAUM, Takeover Law in the EU and Germany – Comparative Analysis of a Regulatory Model, University of Tokyo Journal of Law and Politics 3 (2006) 60 ff.

51 For more detail on reporting obligations see S. OSAKI, Disclosure of Large Shareholdings, Nomura Capital Market Review 8 (2005) 13–20; H. BAUM, Aktienbesitz und Publizität, in: Leser/Isomura (eds.), Wege zum japanischen Recht, Festschrift für Zentaro Kitawaga (1992) 623 ff.

A large shareholder subject to notification obligations is defined not only as someone who holds a large number of shares in his own or a foreign name, but also as someone who, as a result of a contractual or legal delegation, has the authority to exercise voting rights or to issue directives pertaining to these, and thus acts with the intention of controlling the business activities of a given company; the same applies to investment advisors with the authority to manage assets who are able to independently effect investments in shares for clients. Therefore, determining who is subject to notification obligations depends not only on ownership structure but, more importantly, on possession and power of disposition. In the event of an arrangement by shareholders to coordinate with each other to acquire or transfer (additional) shares from the issuer or to exercise voting or other membership rights *(acting in concert),* their shares are combined (Article 27-23 (4)(5) FIEA). This is also true if a special relationship exists between two shareholders, in particular regarding the participation of legal persons or of natural persons related to one another.

As a rule, the report is to be submitted to the financial market authority in writing within five days of the occurrence of these conditions (Article 27-23 (1) FIEA). Institutional investors are obliged to submit the report twice monthly. A copy is also to be sent to the relevant stock exchanges or regulated markets where securities have been admitted for trade. A standard form has been created for these reports. Alongside personal details, it is also necessary, in particular, to provide details regarding the purpose of the acquisition (merely a passive investment or control of a business), its financing (internally or externally financed) and possible agreements with other shareholders, for example, arrangements concerning re- or onward sale, pledging and profit sharing.

cc) Proprietary Transactions

Under Article 163 (1) of the FIEA, directors, officers and major shareholders – in this case understood as those shareholders owning more than ten percent of issued shares in their own or a foreign name – of a listed company or a company whose shares are traded in OTC markets must submit a report to the financial market authority if they have effected proprietary transactions using securities issued from said company.[52] Should the transactions be carried out through a securities firm, then it is the latter which must submit a report (Article 163 (2) FIEA).

52 See BAUM, *supra* note 51, 636 f.

3. *Prohibited Conduct on the Secondary Market*

a) *General Prohibition of Fraud*

Like the US *Securities Exchange Act* with its *Rule 10b-5*, since 1948 Japanese capital market law (Article 157 of the FIEA, formerly Article 58 of the Securities and Exchange Act) has had a provision for a general ban on fraud and fraudulent behavior on the capital market. Under the law, it is forbidden to carry out securities transactions using unlawful methods, to use false, unclear, or incomplete advertising material in the procuring of financial means, or to entice third parties to conclude securities transactions by means of deceptive pricing. Unlike in the USA, where these regulations form the basis for the prevention of all kinds of fraudulent practice, until today Article 157 of the FIEA and its precursor have played *no* role in Japanese practice and indeed have almost never been brought to bear.[53] However, alongside the general ban there is a range of special regulations, some of which are of greater practical relevance, which forbid various specific activities relating to the capital market.[54] This applies in particular to market manipulation and insider trading, both of which will now be briefly considered.

b) *Market Manipulation*

Article 159 of the FIEA makes market manipulation a punishable offence in order to guarantee the integrity of price formation in the market. First of all, this forbids trade-based manipulations in the form of fictitious transactions. This targets the classic form of manipulation, whereby transactions for the party or parties concerned are economically neutral ("fictitious") and serve merely to simulate trading activity, liquidity and trends for the sake of boosting market prices. In such cases, the buyer and seller can be economically

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53 For a critical view see M. TATSUTA, Enforcement of Japanese Securities Regulation, Journal of Comparative Business & Capital Markets Law 1978, 95, 107 ff.; on the differences in the application of the ban on fraudulent conduct in Japan and the USA, see W. HORIGUCHI, Differences in Culture, Society, Economics, and Politics and Their Effect on Enforcement of Securities Laws, Hastings International Comparative Law Review 14 (1991) 303 ff.; D.F. HENDERSON, Security Markets in the United States and Japan. Distinctive Aspects Molded by Cultural, Social, Economic, and Political Differences, Hastings International Comparative Law Review 14 (1991) 263 ff.

54 A tabulated overview of forbidden conduct relating to the capital market can be found in JSRI, *supra* note 8, 290; further, see H. BAUM, Börsen- und Kapitalmarktrecht in Japan, in: Hopt/Rudolph/Baum (eds.), Börsenreform – Eine ökonomische, rechtsvergleichende und rechtspolitische Untersuchung (Stuttgart 1997) 1265, 1349 ff.

identical *(wash sales)* or it may be that two (or more) different market participants have come to an arrangement through which, though the beneficial owner changes, the economic outcome – through corresponding, opposed or perhaps even deferred orders *(matched orders, circular trade)* – remains the same (Article 159 (2) FIEA). Information-based manipulations are also banned. This includes, above all, the dissemination of false information in relation to the issuer and the spreading of rumors which might influence the decisions of investors (Article 159 (2) FIEA). Thirdly, the ban encompasses trade-based manipulations in the form of effective transactions, which take place outside the framework of admissible price management or stabilization, and have an effect on market prices (Article 159 (3) FIEA).

Flouting these bans carries with it a prison sentence of up to ten years or a fine of up to 10 million yen, or both (Article 197 (1)(v) FIEA). In addition, compensation must be paid to investors affected.

c) *Prohibition of Insider Trading*

Under Article 166 of the FIEA, insider trading is forbidden under threat of penalty.[55] Prohibited insider trading occurs – in brief – when persons who enjoy fixed, or more closely defined contractual or legal relationships to a company, or persons who have enjoyed such in the preceding twelve-month period, have received important information based on their position in, or relationship to, the company; and dealt in shares or other papers related to the company in question before such information has become publicly accessible.

Members of the administration or executive staff of the issuer are counted as insiders (*naibusha* or *insaidā*) insofar as they have received information in the course of their professional activities; likewise included are major shareholders,[56] insofar as they have received the relevant information in the exercise of their shareholder rights; and finally persons who have received the information in the exercise of their official duties or through

55 See M. THIER, Das japanische Insiderrecht (Tübingen 2016); ID., Insider Trading – Decision Regarding Carrying Out a Tender Offer, in: Bälz/Dernauer/Heath/Petersen-Padberg (eds.), Business Law in Japan – Cases and Comments. Writings in Honour of Harald Baum (Alphen aan den Rijn 2012) 347 ff.; J. M. RAMSEYER, Insider Trading Regulation, Discussion Paper No. 705, 08/2011, Harvard Law School, available at: *www.law. harvard.edu/programs/olin_center;* K. ASADA, Strafwürdigkeit von Insiderhandeln in Japan, in: Assmann et al. (eds.), Markt und Staat in einer globalisierten Wirtschaft (Tübingen 2010) 249 ff.; H. BAUM, Japanese Capital Markets – New Legislation, Law in Japan 1989, 1, 20 ff.; M. HAYAKAWA, Neue Maßnahmen gegen das Insidertrading in Japan, Rabels Zeitschrift für ausländisches und internationales Privatrecht 54 (1990) 269 ff.

56 Article 166 (1)(ii) FIEA.

contractually-based activities (Article 166 (1) FIEA). A third category is comprised by those who have received information from the above-named groups (Article 166 (3) FIEA). Those who receive information directly from insiders are forbidden to make use of it for their own ends. However, third parties who subsequently receive this information are not prohibited from making use of it, meaning the definition does not take the so-called tipping chain into account.

Article 166 (2) of the FIEA contains a detailed list of the types of unpublished or non-public information which could potentially be regarded as insider information. At the top of the list is the knowledge that an issuer's organ authorized to make decisions has approved a course of action that is of significance for the company, for example a capital reduction, the issuing of bonus shares, a stock split, merger or the introduction of an important new product. The same goes for knowledge of losses that have not been made public, the change in a major shareholder etc. Although regulated on a case-by-case basis, it is fundamentally a question of whether the information concerns a process or course of action that is of particular significance with regard to the earnings situation of the company and thus influences the market price of shares, bonds, etc. issued by that company; and, therefore, also the buying or selling decisions of third parties. As a result of the casuistry of the law, however, in practice it is difficult to distinguish between relevant and non-relevant information. A piece of information is only insider information insofar as it is not publicly known. Until such time, insiders and those who receive information directly from insiders are prohibited from purchasing or selling securities issued by the company in question.

Article 167 of the FIEA extends the ban to insider trading in connection with public tender offers.[57] During, or in the run-up to, an offer, trading with target company shares on the basis of information that has not yet been published is forbidden to all those who, in the view of activities undertaken on behalf of the bidder or in connection with the public tender offer, are regarded as insiders; the same applies to those who have received relevant information from such insiders.

d) Disgorgement of Profits Realized from Short-term Transactions

In order to prevent the unwarranted use of company secrets, an issuer can reclaim from directors, officers and major shareholders any profit made within a period of six months following the acquisition or sale of company securities through re-buying or re-selling (*short-swing profits,* Article 164

57 A case study can be found in S. OSAKI, The Murakami Fund Incident and the Regulation of Collective Investment Schemes, ZJapanR/J.Japan.L. 25 (2008) 89 ff.

(1) FIEA). Should this not occur within sixty days of the shareholder having asked the company, then the shareholder may request that the profit be transferred (Article 164 (2) FIEA). It is *not* necessary for insider trading to have taken place. If the financial market authority should discover profits of this kind while auditing a reported proprietary transaction, then it will request that a statement be made by the parties affected, only informing the company if such a request is unsuccessful (Article 164 (4) FIEA).

e) Prohibition of Delivery of Inside Information

The amendments in 2013 introduced new regulation prohibiting any insider who owns inside information from providing such information to any person outside if the insider has the purpose of having the recipient of the information obtain economic benefits or avoid economic losses (Article 167-2 FIEA). Similarly, such an insider is prohibited from, on the basis of inside information, recommending that someone engage in trades involving the relevant securities (Article 167-2 FIEA).

f) Fair Disclosure Rule

The amendments in 2017 introduced a new regulation known as the fair disclosure rule (Article 26-36 to 26-38 FIEA). While the rule should be considered as a part of disclosure regulation for issuers, we mention this rule here for convenience. This rule prohibits selective disclosure. If reporting companies provide non-public material information to someone outside the company, they would have to disclose such information to everyone. Exemptions permit providing such information to reporters and other mass media. The definition of non-public material information is defined more broadly than that of non-public "significant" information, which is used for the regulation of insider trading. Also, safe harbors permitted for insider trading regulation (known as insignificancy-scale exemptions) are not recognized for the fair disclosure rule.

4. Sanctions and Liability

a) Punishment

In the past, the only available penalties for non-adherence to the FIEA were criminal sanctions in the form of prison sentences of up to ten years, fines of 500,000 to 10 million yen, or both imposed cumulatively (Articles 197 ff. FIEA). An infringement through the agent of a legal person resulted in liability of an additional 500,000 to 70 million yen.

b) Penalty Charges

In 2004 it became possible to impose milder sanctions, in the form of administrative penalty charges (Articles 172 ff. FIEA). Initially this was only possible for insider trading and violations of disclosure obligations in the primary market, where this new form of sanctioning rapidly gained in importance. Since 2005, it has been possible for penalty charges to be applied to violations of transparency obligations on the secondary market; and since 2008 the ruling has been extended to encompass the violation of rules pertaining to public tender offers and instances of major shareholders failing to observe their reporting obligations. The amendments in 2008 also raised the amount of administrative fines significantly in order to make this sanction more effective.

c) Naming and Shaming

As an additional sanction, amendments in 2013 gave the FSA the authority to make public the names of the persons who committed violations of the FIEA (Article 192-2 FIEA). All recommendations of the SESC pertaining to penalties and fines are now published on the FSA's website underneath the names of affected parties and businesses ("naming and shaming").[58]

d) Legal Remedies for Aggrieved Investors

In the event of any violation of behavioral codes in connection with the issuing of securities, the FIEA provides for special legal remedies under which aggrieved investors may demand compensation. The same applies to any violation of information obligations relating to public tender offers where investors incur losses through false, misleading or omitted statements. In such cases responsible persons are jointly and severally liable.[59] In recent years, issuer liability in the secondary markets under Article 21-2 of the FIEA has often been recognized by the courts in accounting and other fraud cases, and the amendments in 2014 made such liability arise only where the issuer is negligent. For the most part, however, and particularly when it comes to the observance of behavioral codes on the secondary market, appropriate legal remedies – for example, for losses incurred through insider trading – are lacking. An exception here is provided by Article 160 of the FIEA, introduced in 1992. Under this Article, those who have engaged in prohibited market manipulations are liable for any losses incurred by investors. Nevertheless, this regulation does not provide for a

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58 *www.fsa.go.jp/sesc/index.htm.*

59 For details see BAUM/SAITO, *supra note* 6, 357 f.

shift in the burden of proof in favor of the aggrieved party upon presentation of typical elements of a crime, with the result that the latter, as with the general clause contained in Article 709 of the Civil Code,[60] is obliged to substantiate all elements of the crime, from the deed itself and the damage incurred, and on through to causality and subjective pre-requisites. Aside from the FIEA, there are special private law liability rules in the Financial Products Trading Act of 2000.[61]

Note that the amendments in 2011 introduced a private law rule providing that any trade of unlisted shares by unregistered (namely, illegal) investment firms is legally void (Article 171-2 FIEA).

e) Financial ADR-System

In 2009, Japan created a comprehensive regime of sector specific financial alternative dispute resolution (ADR) covering each branch of the financial industry, e.g., securities, banking and insurance. For this, some seventeen different statutes were amended.[62] The pertinent regulations for the securities industry are Articles 156-38 to 156-61 FIEA. The institution dealing with complaints of the clients of investment firms is called FINMAC. Other entities handle clients in different financial areas, e.g. for the clients of banks the Japanese Bankers Association operates a slightly different system.

f) Fiduciary Principles

In March 2017, the FSA promulgated a number of principles under the heading of "client first" (known as fiduciary principles) and asked banks, investment firms and other financial institutions to sign onto these principles.[63] The principles provide a product-based code of best practices, and as of the end of June 2017, 469 financial institutions have endorsed the principles through the FSA website.[64]

5. Investment Firms, Investment Funds, Investment Advisors

a) Investment Services

In the course of the old *Securities Exchange Act's* transformation to the FIEA in 2006, a number of laws, such as the Securities Investment Advisors Act of

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60 *Minpō*, Act No. 89/1896 and No. 91/1898.

61 See *infra* 6.a).

62 An extensive analysis can be found in T. MAEDA / A. PARDIECK, ADR in Japan's Financial Markets & the Rule of Law (January 1, 2017). Available at SSRN: *https://ssrn.com/abstract=2911273*.

63 See *http://www.fsa.go.jp/policy/kokyakuhoni/kokyakuhoni.html*.

64 See *http://www.fsa.go.jp/news/29/sonota/20170728/fd_kouhyou.html*.

1986 and the Financial Futures Transaction Act of 1988, were abolished and integrated into the amended FIEA in order to arrive at a standardized arrangement for the different services relating to the capital market. When drafting the act, the legislature took into account the variety of financial instruments to be found today. This had terminological implications. Thus the objects of actors' activities are no longer defined as 'securities' *(yūka shōken)* but as "financial instruments" (or "financial products") *(kin'yū shōhin).* Likewise, in place of the earlier term *shōken kaisha,* or securities companies, the term *kin'yū shōhin torihiki gyōsha* is now used, which has been translated into English as *financial instruments dealers* or *financial instruments business operators*.[65] We use the term "investment firm". The abstruse, obscure nature of the legislative texts in question, which is a result of the high degree of complexity involved in their arrangement, appears to be a transnational phenomenon, and is equally true of the FIEA as it is of the US *Securities Acts* or the German *Securities Trading Act*.

The FIEA distinguishes between investment services (Article 28 ff.) and ancillary investment services (Article 35 ff.) The term investment service is defined in Article 2 (8) of the FIEA with a list of activities (which can be expanded through legislative decree). Included here are classic activities such as trading with securities and derivatives or other brokerage activities. In relation to investment services, Article 28 of the FIEA distinguishes between first class investment services, e.g., trading with securities, and their second class counterparts, e.g., the private placing of securities, as well as additional activities such as investment advice. The term ancillary investment services encompasses, *inter alia*, securities lending, granting of credit in relation to securities transactions and the furnishing of analyses (Article 35 (1) FIEA).

b) Investment Firms

Trading with financial instruments as defined by the FIEA may only be conducted by investment firms. Under Article 29 of the FIEA, any activity as an investment firm is subject to prior registration with the financial market authority. The discretionary granting of a license, as described above,[66] was replaced by the more liberal registration procedure in 1998. Since the FIEA is only applicable to securities and derivatives, which are expressly listed in Article 2 of the FIEA and in other relevant legislation, trading with *other* financial instruments does *not* require registration. Depending on the nature of the deal in question, there are different minimum capital requirements. In

65 Cf. the translations cited *supra* in note 12.
66 See *supra* I.2.a).

addition, investment firms are subject to strict behavioral regulations, these arising from the FIEA, the relevant legislation and the requirements of self-regulatory organizations, namely "The Japan Securities Dealers Association" *(Nihon Shōken-gyō Kyōkai)* and the stock exchanges.[67] In this way, it is not only forbidden to provide false or misleading information to clients but also for contact to be initiated by anyone other than clients themselves; the same goes for the compensation of losses or the consent to such.[68]

c) *Foreign Investment Firms*

Until the reform of 2006, the activities of foreign investment firms were regulated through an act bearing the same name.[69] Today, foreign financial institutions which want to offer investment services in Japan are subject to Article 29 ff. of the FIEA, under which a foreign financial institution is afforded two possibilities: either it establishes a Japanese subsidiary or it is active through branch offices on the Japanese market. Under Article 29-2 (1) of the FIEA, in such a case a representative is to be appointed in Japan. The registration for any Japanese branch office is to occur separately. Each branch office must also satisfy the minimum capital (and other) requirements individually. A practice-oriented exception can be made for the registration requirement if a foreign investment firm is merely conducting the deal on behalf of certain qualified Japanese institutions, or if it is not engaged in canvassing clients in Japan.

d) *Investment Funds*

There are different ways of structuring an investment fund under Japanese law.[70] For various reasons (*inter alia* liability, tax burden and distribution methods for fund certificates), in practice we now commonly see securities investmentfunds that are regulated by special laws and exist on a contractual basis with a fiduciary character (investment trusts). Alongside these, however, many investment funds take the form of mutual funds or investment companies. There are open funds without a fixed term and closed

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67 An overview of the financial instruments dealers' business can be found in: JSRI, *supra* note 8, 215 ff.

68 For a comparative overview of the information duties of investment firms see H. BAUM/T. YAMANAKA, The Information Model as a Means of Investor Protection: A Comparative Analysis of Secondary Markets Regulation in Germany and Japan (Paper, forthcoming 2018), on file with the authors.

69 *Gaikoku shōken gyōsha ni kansuru hōritsu*, Act No. 5/1971; repealed in 2007.

70 For more detail on what follows, see KANDA, *supra* note 15, 569, 570 ff. with further references.

(single) funds with a fixed term in which capital is fixed; in such a case investors cannot sell back their share to the fund.[71]

On the whole, the following parties are involved in an investment fund with a fiduciary character: the investor, an investment firm and a trust bank. Their relationship with one another is as follows: the investor subscribes to or buys units in the fund through an investment firm and receives a fund certificate issued by the trust bank. An asset management firm (as distinguished from an investment firm which stands between the asset management firm and investors and sells units to investors) concludes a trust deed with the trust bank as trustee. Under this contract, the trust bank, acting as depositary, administers the fund assets in exchange for the payment of an administration fee. Here two variants on the investment trust are possible: administration through the trust bank can occur either according to the instructions of the asset management firm or it can be done independently by the trust bank itself, but for securities investment trusts the latter form is prohibited.

Information pertaining to the legal regulation of the investment fund business is contained in the Investment Trust and Investment Corporation Act (ITICA)[72] and the FIEA. The ITICA regulates the form and the operation of the funds transaction. On the other hand, and with one notable exception, it is the regulations contained in the FIEA that are relevant for the distribution of fund units or shares, which Article 2 (2) of the FIEA expressly characterizes as securities. The exception can be found in Article 3 of the FIEA, which frees fund certificates that fall under the ITICA from disclosure obligations on account of the latter's more specific provisions.

When it comes to funds transactions, investment firms have a central role since, as a rule, a trust deed[73] can only be concluded in accordance with the ITICA and only then with a registered asset management firm on the one hand and an authorized trust bank on the other (ITICA Article 3). The trust deed must account for all details of the fund, such as duration, volume, dividends, certificates, etc. and must be shown to the financial market authority (ITICA Article 4). Asset management firms are subject to strict checks through the financial market authority as well as additional self-imposed checks through the Securities Investment Trust Association *(Shōken Tōshi Shintaku Kyōkai)* established in 1957.

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71 Overview in JSRI, *supra* note 8, 265 ff.

72 *Tōshi shintaku oyobi tōshi hōjin ni kan suru hōritsu*, Act No. 198/1951 as amended; English translation at *www.japaneselawtranslation.go.jp.*

73 More fully, a trust deed with the goal of portfolio management as the central part of the investment fund.

As previously mentioned and with the exception of disclosure obligations, the distribution of funds units occurs under the FIEA. It takes place through the investment firm (brokerage). For the purposes of subscription and sales, an investment trust is obliged to create a prospectus, which in turn must also be shown to the financial market authority. The prospectus must accurately reproduce all details regarding the make-up of the fund, which includes, among other things, the investment strategies followed, administrative costs and levies and the most important aspects of the trust deed.

Finally, deregulation of ETFs (exchange traded funds organized and regulated under the ITICA) has occurred over the past years. The amendments in 2008 permitted ETFs to obtain commodities. Beginning in 2017, the FSA has adopted an explicit policy of encouraging ETFs for individuals' personal wealth accumulation.

e) Investment Advice and Asset Management

Until 2006, investment advice was regulated by a special law, the Securities Investment Advisors Act.[74] Since then such activities have been regulated in Articles 28 ff. of the FIEA as part of the services provided by registered investment firms; in parallel, the FIEA's general protective regulations, strengthened by the amendment of 2006, are applied to investors. If the investment firm wants to provide asset management services in addition to investment advice, then, supplemental to registration, special permission is required from the financial market authority, with such permission being granted only upon thorough examination and the fulfilment of a range of conditions.

f) Other Business

aa) Rating Agencies

The amendments in 2009 introduced new regulation of credit rating agencies (Articles 66-27 to 66-49 FIEA). Under the regulations, credit rating agencies may register with the FSA, and those rating agencies who registered are subject to certain conduct rules. In other words, rating agencies are not required to be registered, but investment brokers are obliged to inform their clients if they use ratings of unregistered rating agencies.

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74 *Yūka shōken ni kakaru tōshi komon-gyō no kisei-tō ni kansuru hōritsu*, Act No. 74/1986; repealed in 2007; see U. SCHAEDE/ H. BAUM, *Tōshi-komongyō* – Anlageberatung in Japan, Recht der Internationalen Wirtschaft (RIW) 1989, 704 ff.

bb) Crowd Funding Operators

The amendments in 2014 introduced regulatory measures for crowd funding. Investment firms which engage in crowd funding (namely, public offering of securities made over the Internet) are subject to special conduct regulations (Article 29-2, 29-4-2 ff., and 43-5, etc. FIEA). Since such crowd funding was prohibited before the amendments, the purpose of these new regulations is to permit crowd funding under certain conditions.[75]

cc) Financial Benchmark Operators

The amendments in 2014 also introduced new regulations for the operators of financial benchmarks which calculate and publicize specified financial indicators (Articles 156-85 to 156-92 FIEA). The FSA designates certain financial benchmark operators, and these designated operators are subject to conduct rules.

dd) High Frequency Trades

The amendments in 2017 introduced new regulations on high frequency trades (Articles 2 (41)(42), 29-2 (1)(vii) and 66-50 to 66-67, etc. FIEA). Those who engage in high frequency trades are required to be registered with the FSA, and they are subject to conduct rules such as establishing proper risk management and providing pertinent information to the FSA on the regular basis.

6. Private Law Regulations Pertaining to the Capital Market

The remarks above refer to the (public-law) principles of Japanese capital market regulation. However, financial transactions also feature various private law, namely contractual, aspects. Without making any claim at being exhaustive, this section outlines several examples that introduce some of the regulations which are characteristic of Japanese law.

a) Financial Products Trading Act

Within the framework of Japanese financial market architecture, the Financial Products Trading Act (FPTA),[76] passed in 2000, represents something of an anomaly. Here the legislature has moved away from the traditional model of investor protection by means of a public-law regulation featuring

75 For an overview see JSRI, *supra* note 8, 194 ff.

76 *Kin'yū shōhin no hanbai-tō ni kansuru hōritsu*, Act No. 101/2000 as amended; for a detailed analysis see C. SCHULTE, Das Gesetz über den Verkauf von Finanzprodukten, ZJapanR/ J.Japan.L. 19 (2005) 123, 147 ff.

the central involvement of the financial market authority; instead it has chosen a regulatory scheme that is governed by private law and in which the FSA plays no role. Instead, aggrieved investors must turn to the courts and demand compensation if they are of the opinion that their trading partner, be it an investment firm, bank or insurer (the FPTA applies to all kinds of financial products), has infringed upon its obligation to provide information and thus caused them damage or harm.[77]

The aim of the Act is to make legal enforcement easier for aggrieved investors. Unlike before, investor protection is now the top priority, taking the place of the promotion of healthy economic development, which in older acts, such as the Banking Act, was the main, if not the only, priority. This last goal, i.e., healthy economic development, is now to be arrived at *by means of* satisfactory investor protection.[78] In the past, Japan – as is the case in Germany – has witnessed numerous actions for compensation on account of failed investments. However, court litigation was time-consuming and expensive. In addition, it proved difficult for investors to push their claims through. Whether the FPTA has made matters any better in this regard remains to be seen; there have been very few actions since the Act came into force in 2001.

Like in the FIEA, the material scope is determined by a list of all financial products covered (Article 2 (1) FPTA). During the preparatory legislative work, there was some consideration given as to whether the scope might not be determined instead by a general definition of the term financial products in order to be more flexible when it came to responding to future developments. This was ultimately overridden by the concern of defining the material scope as precisely as possible.[79] The central provision of the Act is Article 3 FPTA, which sets out the content of the information obligations of the seller towards the investor by means of three rule examples and a catch-all-element. Articles 4 ff. of the FPTA regulate the payment of compensation in the event that these obligations are infringed. Liability occurs regardless of fault, which means that unlike in civil law the seller cannot be exonerated (Article 4 FPTA). The failure to adhere to the obligations as set out in Article 3 of the FPTA regarding the risk of investment must be the cause of the damage or loss (Article 5 (1) FPTA).

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77 For the protection of investors under the Commodity Futures Trading Act (formerly called the Commodity Exchange Act: *Shōhin torihiki-jo-hō*, Act No. 239/1950 as amended) see M. SUMIDA, Anlegerschutz bei Warentermingeschäften in Japan, ZJapanR/J.Japan.L. 12 (2001) 129 ff.

78 SCHULTE, *supra* note 75, 134.

79 *Ibid.*

b) *Set-off and Netting*

When it comes to swap agreements and other over-the-counter derivatives transactions, it is internationally common for financial institutions to reach bilateral set-off agreements in cases of bankruptcy (*close-out netting*). The validity of such agreements has long been acknowledged under Japanese law and has been strengthened in recent years by means of special statutory regulations. Particularly worthy of mention here is the Act on Close-out Netting,[80] which came into force in 1998, and which in the case of insolvency proceedings (both for liquidation or reorganization proceedings) and in certain transactions between financial institutions, allows for a set-off through the assets of one of the involved institutions, this Act taking precedence over the general regulations pertaining to insolvency law. The Act encompasses various types of over-the-counter derivatives transactions, particularly swap agreements.

In order to dispel any remaining confusion, in 2004 generally worded regulations that were not restricted to agreements between financial institutions were incorporated into the different Japanese insolvency acts (Article 58 Bankruptcy Act,[81] Article 51 Civil Rehabilitation Act,[82] Article 63 Company Reorganization Act[83]). In Article 156-11-2 of the FIEA, there is a corresponding regulation concerning the validity of such agreements if a central counterparty is brought in, as it is the rule with various securities transactions.

c) *Securities Depository and Book-entry*

As is the practice internationally, in Japan securities investments in shares, bonds, etc. are safeguarded and administered for investors by one or more intermediaries. The intermediaries are thus positioned between the issuers and the investors a and exercise against the issuers those rights held by the investors as arising from the securities. Intermediaries are typically banks or securities companies (investment firms). A central collective depository normally sits at the head of this chain of intermediaries. In Japan, the *Japanese Securities Depository Center* (JASDEC) fulfils this obligation for shares and corporate bonds whereas the central bank, the Bank of Japan, performs this task for government bonds.

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80 *Kin'yū kikan-to ga okonau tokutei kin'yū torihiki no ikkatsu ni kansuru hōritsu,* Act No. 108 of 15.6.1998, as amended; English translation and a detailed analysis in S. STEELE, Japan's Bankruptcy Safe Harbour Provisions and Repurchase Agreements, ZJapanR/ J.Japan.L. 30 (2010) 175 ff.

81 *Hasan-hō*, Act No. 75/2004, as amended.

82 *Minji saisei-hō,* Act No. 225/1999, as amended.

83 *Kaisha kōsei-hō,* Act No. 154/2002, as amended.

aa) The Securities-based 'Old' System

Clearing, collective depository and book-entry through JASDEC were established in Japan on the basis of the Depository and Book Entry Act[84] of 1984.[85] With that Japan decided on an operating method that, at that time, had long been practiced in Germany. The system – parts of which are still in operation today[86] – is orientated to a large extent on the regime under the German Depository Act. A comprehensive trustee status of the collective depository is not established, JASDEC is merely a custodian, like the former German Securities Settlement Organization.[87]

The securities passed on to intermediaries by depositing investors are first credited by the relevant securities account of the investor. The intermediaries then submit the securities to JASDEC, where they are credited to a securities account set up for intermediaries. Upon delivery and book-entry with JASDEC, the depositors lose ownership of the securities certificates delivered but acquire fractional co-ownership of all securities of the same type safeguarded by JASDEC. As the depositors are co-owners, creditors of the intermediaries are denied access to the intermediaries' securities accounts lodged with JASDEC. In the event of insolvency on the part of an intermediary or that of the collective depository (unlikely as that is), shareholders enjoy segregation rights with respect to the insolvency estate. In cases of collective deposit, this corresponds to the extent of their fractional ownership of deposited securities of the same type. At no point do the securities and the rights embodied in them become part of the insolvency estate.

The Act proceeds on the rebuttable presumption that a depositing investor really does own as many securities as are recorded in his securities account. The transfer of securities to another investor occurs by means of transfer to their securities account by the same or a different intermediary. It is assumed, as a legal fiction, that any transfer of securities certificates actually does take place so as to enable a bona fide purchase, which is a pre-requisite for an unproblematic book-entry. If the number of recorded securities does not tally with the number of certificates that are actually

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84 *Kabuken-tō no hokan oyobi furikae ni kansuru hōritsu*, Act No. 30/1984; repealed in 2009.

85 See H. BAUM, The Present Has Finally Arrived, Settlement by Book-Entry in Japan, Butterworths Journal of International Banking and Financial Law 1991, 542 ff.; ID., Die Neugestaltung von Wertpapiersammelverwahrung und Effektengiroverkehr in Japan, Wertpapier-Mitteilungen 1988, 357 ff.

86 See hereafter bb).

87 The *Kassenverein*, dissolved into Clearstream International S.A., a subsidiary of the German Stock Exchange.

safeguarded, then JASDEC and all involved intermediaries are liable jointly and severally for compensation due to investors.

The company law problems that emerge from the tension between the collective deposit of shares on the one hand and the need to update the shareholder register on account of the increased issuing of registered securities in Japan, on the other, are solved by the fact that, with regard to the deposited securities, JASDEC alone can be entered into the shareholder register as "nominal" shareholder. It is, however, simply a question of a partial transfer of rights to JASDEC, since it is the depositing shareholder who remains materially entitled. The latter retains all "material" shareholders rights with regard to the company, such as the claim to dividend payments and participation at the general meeting of shareholders. The issuer is obliged to draw up a second register of "materially entitled" shareholders for this meeting. As a result, this means that when it comes to deposited shares, the "nominal" shareholder (JASDEC) and the "materially entitled" shareholder (the depositor) can exercise different rights. In this way, both the requisite practicability and sufficient transparency are achieved, despite the conveyance of shares to JASDEC.

bb) The Intermediated "New" System

The "old" system of collective deposits and book entry described above was used for shares until 4 January 2009. However, since the beginning of 2003 a new system, one adapted to intermediated securities (book-entry securities), has been in place for both corporate and government bonds as well as for other types of bonds. The system was established on the basis of the Act for Book Transfers of Bonds, Shares and other Securities,[88] which was passed in 2001 (and amended both in 2002 and 2004) and further amended to incorporate shares on 5 January 2009.[89] JASDEC continues to function as a central collective depository. The "new" system is characterized by a complete dematerialization. There are no more securities certificates in the system; correspondingly the concept of co-ownership is no longer applicable. Deposited shares that are already in circulation are to be integrated into the new system.

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88 *Shasai, kabushiki-to no furikae ni kansuru hōritsu*, Act No. 75/2001, as amended.

89 For a detailed analysis of the new regulatory regime, see H. KANDA, Intermediated Holding of Investment Securities in Japan, in: Grundmann et al. (eds.), Unternehmen, Markt und Verantwortung. Festschrift für Klaus J. Hopt (Berlin 2010) Volume 2, 3105, 3107 ff.; C. CHUN, The New Dematerialised Book-Entry Transfer System in Japan, ZJapanR/J.Japan.L. 31 (2011) 117 ff.; for a comparative overview ID, Cross-border Transactions of Intermediated Securities (Berlin 2012).

In the dematerialized system, every participating investor remains the immediate beneficiary with regard to the book-entry securities or securities credited on their securities accounts. Neither the intermediaries involved nor JASDEC are entitled to any proprietary rights as regards the book-entry securities or securities in question. They are merely responsible for the entries and continue to maintain the securities accounts. With that, the new system is in marked contrast with its older counterpart, and it is also significantly different from the practices of collective depositing and book entry in other countries, particularly the system of indirect possession found in the USA under the *Uniform Commercial Code.*

The number of book-entry securities or securities legally belonging to the investor is determined by the entry in his securities account, which rests with the intermediary. In relation to the issuer and third parties, the investor is the actual owner of the book-entry securities or securities in question. A transfer between different securities accounts takes place via cross-entry and only becomes legally effective upon being credited to the recipient's account – and *not* following the debiting of the transferring party's account. Securities transfers by means of clearing transactions can occur only in this way; further actions relating to a transfer of property are not necessary. Under the new dematerialized system in Japan, making a book entry on a securities account is thus the only, but nevertheless sufficient, precondition for a transfer of securities. The same goes for their pledging.

Bona fide purchases are also protected in the new system; correspondingly, a bona fide purchaser also becomes the absolute owner if the person affecting the transfer was not the entitled party. In such a case, the number of book-entry securities or securities can be inflated. Nevertheless, the issuer is not responsible for the inflated part but is obliged to treat all securities owners in the same way on a prorated basis. In the event of insolvency on the part of an intermediary (or collective depository), shareholders retain segregation rights with regard to their property. Under the new system, neither book-entry securities nor securities are at any stage part of the insolvency estate.

d) Banks as Administrators of Bonds

In Japan, banks and certain other financial institutions ("banks") are active as "administrators" of publicly issued bonds. The Companies Act makes it mandatory for banks to be involved if bonds are issued to the general public by commercial companies. Securities firms, on the other hand, are prohibited from administering bonds, even if it is true that they normally engage in the "underwriting" of issued bonds. Under company law, banks are subject to a duty of loyalty vis-a-vis bondholders and are liable for damages should they infringe this duty.

7. *Securitization*

Before 1998 there were four obstacles standing in the way of securitization:[90]

- the lack of a simple procedure for the safe transfer of assets,
- high costs in adhering to the requirements of company law,
- the lack of a practicable legal basis for an originator to end his involvement in a special-purpose company, and
- the lack of a secondary market for institutional investors (alongside the burden of complex capital market regulations).

a) *1998 Reforms*

The reforms of 1998 made it possible to negotiate – to a greater or lesser extent – the first two obstacles named above; the fourth obstacle was at least addressed. The third problem remained, however. Initially, the Japanese legislature, which was interested during the banking crisis in easing the burden of debt-ridden credit institutions through a simplification of the process of securitization, created special legislative provisions for the legally enforceable transfer of loans, demands and other claims. Since then a ceding can be legally enforced by being entered into the register. When making claims for money, this possibility is open to all incorporated companies that have legal capacity.

Secondly the Ministry of Finance drafted the "Act for the Securitization of Certain Assets through Special Purpose Companies", which was passed and later renamed the "Securitization Act".[91] The Act operates on the "carrot and stick" principle. Its goal was to lower the cost of establishing a special-purpose company *(tokutei mokuteki kaisha).* After its inception, a special-purpose company could be established with a minimum capital of 3 million yen (c. € 23,000) and was able to issue bonds (including unsecured short-term debt notes, *commercial papers*) as well as preference shares. Here securities are understood within the meaning of Article 2 (1) of the FIEA.[92] Under certain conditions, dividends paid on preference shares are exempt from dual taxation. The organizational structure of a special-purpose company is more straightforward than a normal joint stock company. For example, only one director must be appointed *(torishimari-yaku);* nevertheless, as was previously the case it is necessary to engage the services of an internal auditor *(kansa-yaku)* and an auditor *(kaikei kansa-nin).*

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90 On the development and functioning of the market for securitization in Japan, see H. KANDA, Securitization in Japan, Duke Journal of Comparative & International Law 8 (1998) 359 ff.; JSRI, *supra* note 8, 141 ff.

91 *Shisan no ryūdō-ka ni kansuru hōritsu*, Act No. 105/1998, as amended.

92 See *supra* 1.b).

A special-purpose company must be registered with the appropriate market supervisory body and is subject to its scrutiny, above all to ensure that the company has only been brought into being for the purpose of securitization. Unlike in previous legislation pertaining to securitization, no objective examination takes place; the Act does, however, provide for various restrictions. The system is applicable for the securitization of all kinds of money claims (including loans and other demands) as well as for real estate.

Finally, the problem that there was no secondary market for institutional investors (such as the *Rule 144A*-market in the USA) was solved in June 1998 by abolishing the management arrangements that had limited the transfer of securities issued by a private placement. Since then, under the FIEA, unregistered securities of this kind are freely transferable amongst qualified institutional investors.

b) 2000 Reforms

Further legislative reforms followed in 2000. The Securitization Act in particular was comprehensively amended and acquired its current name. Three fundamental reforms were carried out. First, there was a decisive liberalization of the securitization business. In the course of the amendments, the minimum capital required for the establishment of a special-purpose company was lowered to 100,000 yen (in 2005 the minimum capital requirement was completely abandoned alongside the corresponding deregulation for joint-stock companies in company law). Further, mandatory registration was replaced by a simple duty to provide notification that a special-purpose company was being set up within the context of securitization.

The requirement of incorporating the concept of the securitization in the special-purpose company's regulations was also waived; the concept no longer needs to exist in its final form upon the establishment of a company but must be finalized upon completion of the transaction. Any changes to the concept, which once required the prior agreement of all shareholders, are now possible with a simple majority. Since the reforms, the issuing of corporate bonds and retractable shares is also permitted. Further, under certain conditions, a special-purpose company is now allowed to take out credit. Finally, the restriction dictating that only money claims and real estate could be objects of securitization was lifted. Now any asset can be the object of securitization.

Alongside the necessary steps towards liberalization mentioned above, the central problem – namely the lack of a practicable legal basis for an originator to end his involvement in a special-purpose company – was solved by the introduction of a Japanese version of what is known internationally as a "charitable trust". Lastly, the ability to adopt the structure of a trust was introduced as an additional option for special-purpose vehicles.

In addition, the year 2000 saw the comprehensive amendments to the Investment Trust and Investment Corporation Act (ITICA) (a name which it also acquired).[93] As mentioned above, the ITICA regulates the establishment and activities of investment funds.[94] With the reform the limits on investing in securities were relaxed; since then funds are free to choose how they invest their liquid assets. For funds established on a contractual basis with a fiduciary character, an organizational separation between the investment fund manager and the company charged with safeguarding the fund assets is normally stipulated. The reform introduced a special kind of fund, which allows a single person to exercise the functions named above. With that it became possible in Japan to establish REITs *(real estate investment trusts).*[95] These are widely used in the USA and allow the administrator power of discretion with regard to the investment of fund assets in a real estate pool.

c) Continuing Obstacles

As regards the securitization business in Japan, there are continuing legal obstacles concerning, among other things, the validity of a contract clause which prohibits a special-purpose company from making an application to undergo a restructuring process. Clauses of this kind are particularly valued by rating agencies but ought now to be invalid under Japanese law. Further, the fiscal requirements for funds that are organized in the form of companies are unfavorable, at least outside the scope of the Securitization Act. All in all, however, compared to the progress engendered by these reforms, such remaining obstacles should be of relatively little consequence. Correspondingly, two Japanese REITs were established as far back as 2001 and listed on the Tōkyō Stock Exchange.

8. Derivatives

a) Basic Regulation

The tradition of financial futures in Japan dates back to the Rice Exchange in seventeenth century Osaka.[96] It was, however, interrupted for a long period as the Allied Forces made the re-opening of the Japanese stock ex-

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93 See *supra note* 72.

94 See *supra* 5.d).

95 For these see K. SUZUKA/J. MIKAMI, Real Property and Securitization, in: McAlinn (ed.), Japanese Business Law (Alphen aan den Rijn 2007) 263, 316 ff.

96 See U. SCHAEDE, Der neue japanische Kapitalmarkt (Wiesbaden 1990) 37 ff.

changes in 1949 dependent on the ban of financial futures transactions. It was only in the 1980s that option and futures trading were allowed once more, and since then they have steadily gained importance.[97]

The Japanese regulatory infrastructure for trading with derivative financial instruments is complex. At this point, only a brief overview can be provided. In principle, the legal regulations differ according to the kind of assets that are ascribed to the derivatives. Thus, for commodity futures, the Commodity Futures Trading Act[98] applies, and these are traded on the commodity exchange. Until the FIEA came into force in 2007, securities derivatives were subject to the Securities and Exchange Act and traded on the securities exchange, while financial derivatives (interest rate futures and currency futures) that were traded on the financial futures exchange, established in Tōkyō in 1989, were subject to the Financial Futures Trading Act,[99] created in 1988.

The FIEA brought together the last two regulations named above. Since its inception both securities derivatives and financial derivatives fall within the scope of the FIEA, and it is permitted to trade in both kinds of derivatives on financial instruments exchanges (including stock exchanges). In the future, it is expected that securities exchanges will be granted the right to trade commodity futures and that commodity exchanges will be allowed to trade securities and financial derivatives. With regard to OTC trading of securities and financial derivatives, the FIEA sets out behavioral obligations for the marketing of such products.

b) OTC Derivatives

The amendments in 2010 introduced new regulations requiring certain over-the-counter (OTC) derivatives transactions to be cleared through a centralized clearing house (Article 156-2 FIEA). Investment firms also are required to keep records of derivatives trades and provide them to the FSA (Article 156-3 FIEA). Further, the amendments in 2012 introduced a new regulation requiring OTC derivatives transactions to use electronic trading platforms (Article 40-7 FIEA). From 2016 until 2020, margin requirements for OTC derivatives transactions that are not cleared through a centralized clearing house are gradually tightened.

9. Comprehensive Exchanges

The amendments in 2010 introduced a basic framework for a comprehensive exchange, which means permitting a financial exchange to list com-

97 For an overview see JSRI , *supra* note 8, 120 ff.

98 *Shōhin torihiki-hō,* Act No. 239/1950, as amended.

99 *Kinyū sakimono torihiki-jo hō,* Act No. 77/1988; repealed in 2007.

modity-related instruments and permitting a commodity exchange to list financial instruments. The 2012 amendments also introduced a more specific regulatory framework under which a financial exchange may deal with commodity-related futures and options. Such a comprehensive exchange has, however, not yet been put into place.

III. REGULATION OF BANKING SERVICES

1. The Japanese Banking World

Like Germany, Japan is also home to a variety of institutions that are active in "banking operations" in the non-technical sense.[100] Legal distinctions are made between the Bank of Japan, the National Savings Bank – which operates as a (still) government owned financial institution – and, finally, private credit institutions and finance companies.

The basis for the activities of the Bank of Japan (*Nippon Ginkō)*, established in 1882, is a special act from 1942,[101] the same year the bank was also extensively reorganized. The bank, which is in the form of a joint stock company and whose shares are held by the government, discharges the duties of a central bank and, alongside the FSA, is also involved in supervising banks.[102] With branches in some 20,000 post offices throughout the country, the Japanese National Savings Bank (*Yūbin Chokkin*, recently renamed *Yūcho Ginkō*) is by some distance the largest savings bank in the world; first established in 1875, it provides a wide range of financial services which are orientated towards the needs of private clients. Its privatization, initiated incrementally after the millennium, has been politically controversial and is still not settled, but today it is subject to FSA supervision.

For a long time the Japanese financial system was characterized by a strict segmentation. Alongside the main categories of insurance, securities

100 For an overview see FEDERATION OF BANKERS ASSOCIATIONS OF JAPAN (ed.), The Banking System in Japan (Tōkyō 2010); M. MISAWA, Current Business and Legal Issues in Japan's Banking and Finance Industry (Hackensack, NJ, 2nd ed., 2011); H. KANDA, Legal Explanations on Bank Behavior, in: K. Hopt et al. (eds.), Corporate Governance in Context: Corporations, State and Markets in Europe, Japan, and the US (Oxford 2005) 567; S. KOZUKA, Reform of Banking Regulation in Japan in the 1990s: Has the Market Become Competitive?, The Japanese Economy 33 (2005) 50; S. KONOE, Policy Shifts and the Changing Role of Banks: A Comparison between Japan and Germany, ZJapanR/J.Japan.L. 29 (2010) 81; T. KUBOTA, Regulation of Banking Services: The Japanese Perspective, in: J. BASEDOW et al. (eds.), Economic Regulation and Competition. Regulation of Services in the EU, Germany and Japan (The Hague 2002) 253.

101 *Nippon ginkō-hō* [Bank of Japan Act], Act No. 67/1942.

102 See I.3 above.

and banking operations, further distinctions were made within the sphere of banking operations between trustee operations, as well as short- and long-term financing. These three areas of activity were each assigned to independent institutions, which operated according to a special legal basis. The difference between long-term financing through the long-term credit banks and short-term financing through the merchant banks has since been relaxed, however, while the trust banks, which were initially established in the 1920s purely as trust companies, and whose responsibilities encompassed trustee operations alone, are no longer limited in this way.

In the sphere of short-term financing, i.e., "normal" deposit and credit transactions, there are currently over 200 active banks in Japan, which are generally categorized as ordinary banks. These include big Japanese banking houses, namely the three "mega" bank groups[103] that have arisen through mergers in recent years, having a widely dispersed network of branches both nationally and internationally; the 100 or more regional banks; and the sixty or so branches of foreign banks in Japan. The regulation of these ordinary banks under banking supervision law forms the focal point of this section.

Alongside these ordinary banks, there are numerous co-operative banks, so-called *shinkin* banks, which together with the *Shoko Chukin Bank* (Central Cooperative Bank of Commerce and Industry) focus on the financing of medium-sized enterprises. Other cooperative banks have specialized in agriculture and forestry or the fishing industry. The best-known institution of this kind is the *Norin Chukin Bank*, which is Japan's largest institutional investor as well.

Outside the banking sector, but partly linked to it through equity investment, is the network of some 30,000 financing companies. Although not having bank status, these companies nonetheless carry out financial transactions on a large scale without being subject to strict regulations. Included here are leasing companies, acceptance corporations, credit-card companies and real-estate financing companies. Entities of this nature refinance themselves through loans rather than deposits.[104] The larger companies are mostly direct subsidiaries of banks or at least indirectly linked to them.

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103 *Mitsubishi UFJ, Mizuho, Sumitomo Mitsui*.

104 The numerous money lenders active in the consumer credit market constitute a special group here. Often decried as "credit sharks", they lend money to private parties at unusually high interest rates and often make the headlines with their subsequent drastic methods of debt recovery. The legislature still seems to have difficulties in fully coming to grips with this problem although reforms in 2006 did help. For background information see A. PARDIECK, Japan and the Moneylenders: Activist Courts and Substantive Justice, Pacific Rim Law & Policy Journal 17 (2008) 529; S. KOZUKA/L. NOTTAGE, Re-regulating Unsecured Consumer Credit in Japan:

2. *Legal Framework for Banking Supervision*

a) *Granting of Banking License*

The central legal source for the field of banking is the Banking Act,[105] which together with the corresponding regulations governs the main activities and organizational requirements of credit institutions *(commercial banking).* The Banking Act is the credit law counterpart to the FIEA. Insofar as banks are active in the field of investment services (*investment banking*), which is now possible under certain conditions, then it is the FIEA that applies cumulatively. This regulatory concept is the result of the separate banking system, introduced at the end of the 1940s.[106]

In order to become active in banking operations, under Article 4 (1) of the Banking Act a company must obtain prior approval from the financial market authority.[107] The term "banking operations" is defined in Article 2 (2) of the Banking Act as (i) the receipt of deposits and the awarding of credits and (ii) the carrying out of fund transfer transactions. Whilst the above definition provides for the carrying out of deposit and credit transactions, Article 3 of the Banking Act expands it in such a way that all types of deposit transactions are to be regarded as banking operations. The result is that, within the meaning of the Banking Act, any company that receives deposits is regarded as a bank. The term "fund transfer transactions" *(kawase)* is not defined in the Act, but it is generally understood as the carrying out of fund transfers.[108] A company can only apply for a banking license if it is in the form of a joint stock company *(kabushiki kaisha)*, under the requirements set out in the Companies Act,[109] and it fulfills additional requirements such as having sufficient minimum capital.

Banks that have obtained banking licenses under the Banking Act are generally described as "normal banks" or commercial banks. As mentioned above, alongside these there exist various special banks with specific com-

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Over-indebted Borrowers, the Supreme Court and New Legislation, in: Parry et al. (eds.), The Yearbook of Consumer Law 2009 (2008) 197; ID, Reforming Consumer Credit Markets in Japan and Beyond: Empirically Informed Normativism, Sydney Law Review 34 (2012) 129; C. RAPP, Die "bubble economy" des kleines Mannes; Verbraucherkredit in Japan, ZJapanR/ J.Japan.L. 2 (1996) 42.

105 *Ginko-hō,* Act No. 59/1981 as amended; English translation from *www.japaneselaw translation.go.jp.*

106 See *infra* 3.a).

107 The legal text speaks of approval from the Prime Minister, but the latter has delegated the relevant powers to the financial market authority, see above I.3.

108 This definition was provided by the Supreme Court of Justice in its decision of 13 March 2001, Keishu 55-297.

109 *Kaisha-hō,* Act No. 86/2005, as amended.

petences;[110] these are licensed in a comparable way but operate on a separate legal basis. For the commercial execution of fiduciary activities, a license is needed under the Trust Business Act.[111] In practice, however, only a few trust company *(shintaku kaisha)* are licensed under the Act. Instead, a number of Japanese and foreign commercial banks carry out trustee operations alongside their other activities with special permission from the financial market authority under a special statute titled "Act for Concurrent Operation of Trust Business by Financial Institutions."[112]

b) Permitted Activities

Alongside banking operations, banks licensed under the Banking Act are permitted to carry out additional activities. In addition to these, the Banking Act allows them to perform certain "non-banking" activities. Exactly what activities banks are allowed to carry out is regulated in Article 10 (1) of the Banking Act in accordance with the definition of banking operations provided by Article 2 (2) of the Banking Act. As mentioned previously these include the receipt of deposits, the awarding of credits and the execution of fund transfer transactions. Additional permissible activities related to banking operations are listed (in *non*-enumerative form) in Article 10 (2) of the Banking Act. Included among them are, for instance, issuing guarantees for bonds, securities lending, the issuing of government bonds and bonds of local establishments, and derivatives trading. Additional activities must be closely *(fuzui)* connected to banking operations. In addition, and to the extent that it is permitted in Article 33 of the FIEA, Article 11 of the Banking Act allows banks to be active in the field of investment banking and to perform certain kinds of investment services. Under Article 11 of the Anti-Monopoly Act,[113] banks are forbidden from holding more than five percent of voting rights as part of their involvement with other companies, although with certain important exceptions.[114]

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110 The term bank is not easy to define. For the purposes of this section, (only) institutions that receive deposits are regarded as "banks". However, the term "deposit" is also hard to define. Unfortunately, this issue cannot be further discussed within the parameters of this article.

111 *Shintaku-gyō hō,* Act No. 154/2004, as amended.

112 The basis for this is *Kin'yū kikan no shintaku gyōmu no ken'ei-tō ni kansuru hōritsu* [Act for Concurrent Operation of Trust Business by Financial Institutions], Act No. 43/1943, as amended.

113 *Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu,* [Act on Prohibition of Private Monopolization and Maintenance of Fair Trade] Act No. 54/1947, as amended.

114 Under Article 33 of the FIEA, banks are nevertheless allowed to acquire and hold securities for the purposes of investment.

c) *Regulation of Activities*

If a company has obtained a license to carry out banking operations, it must observe the numerous activity-related regulations stipulated by the Banking Act, as well as other laws connected to it. It is also subject to regulation by the FSA. For the most part, banks reach agreements with the Bank of Japan regarding banking services. To this extent, it is then incumbent upon the central bank to supervise the banks involved.

Essentially, the aim of these regulations is to guarantee the "solidity" of individual banks and the banking sector as a whole. Nevertheless, in Japan, as elsewhere, there has been some discussion as to whether banks are special and as to whether or not there should be specific legislation for them.[115] In short, in Japan and in other jurisdictions there has been a general liberalization regarding the regulation of banking services as well as a general strengthening of guarantee schemes.

The traditional method of regulating banking services was the regulation of interest rates on the one hand and the regulation of branch offices on the other. The regulation of interest rates was abolished in Japan in the 1990s, and the regulation of branch offices is no longer strictly defined. Portfolio regulation refers to both the banks' assets and their liabilities. The most important rule here is the risk-based capital requirement for banks, which applies in Japan in accordance with the rules promulgated by the Basel Committee on Banking Supervision ("Basel III").[116] Further, under the Banking Act, banks are subject to special requirements with regard to accounting and publicity. Other regulations set limits for the awarding of credit, namely with respect to the awarding of credit to a single borrower. As previously mentioned, apart from in certain circumstances involvement in other companies is limited to a five percent share in voting rights. Under the Banking Act, banks are also not permitted to hold more than five percent of shares in other companies on their own, or more than fifteen percent in conjunction with companies connected to them (for example, a bank-holding company and its subsidiary). Again, certain exceptions apply here. In addition, a special law from 2001 restricts the overall amount of a bank's permissible involvements in relation to its net equity base.[117]

The bans on insider trading are stricter for banks than for industrial companies and encompass stricter regulations pertaining to conflicts of interest on the part of the banks' managerial staff. Ultimately, the system of

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115 See for instance, D. R. FISCHEL/A. M. ROSENFIELD/R. S. STILLMAN, The Regulation of Banks and Bank Holding Companies, Virginia Law Review 73 (1987) 301 ff.

116 At the time of printing, "Basel III" is in the process of being implemented in Japan.

117 *Ginkō-tō kabushiki-tō no hoyū no seigen-tō ni kansuru horitsu*, [Act on Limitation of Shareholding by Banks], Act No. 131/2001, as amended.

deposit insurance and the role of the central bank as "lender of last resort" are decisive aspects of the safety net. Deposit insurance was introduced to Japan in 1971[118] on the basis of the Deposit Insurance Act.[119] Practically all credit institutions that receive deposits are subject to compulsory membership in the system.[120] Deposits up to a value of 10 million yen (c. €75,000) are insured per depositor against any default due to insolvency on the part of the credit institution in question. In the course of 1986 expansions made to the guarantee scheme, it became possible to support the takeover by another credit institution of a beleaguered bank through deposit insurance company payments (the so-called "first-aid mechanism"). In December 2008 Japan passed a special law in response to the worldwide financial crisis that enabled the government to provide direct financial assistance to beleaguered banks.[121] This does not apply to larger financial institutions, however. The amendments to the Deposit Insurance Act in 2013 introduced a scheme of orderly resolutions.

d) Regulation of Financial Groups

Anyone wishing to hold twenty percent or more of a bank's voting capital must seek approval from the financial market authority and is obliged to comply with certain ensuing regulations. A bank-holding company, whereby a holding company is understood within the meaning of the Anti-Monopoly Act, which owns one or more banks is also required to seek approval from the financial market authority and is subject to even stricter regulations, including minimum capital requirements. Bank-holding companies, like banks, are allowed to run investment firms as subsidiaries, but they must nevertheless ensure that a "fire-wall" is created between the banks and the investment firm. In this way, potential conflicts of interest that could harm the clients of the institutions involved are prevented.

3. Characteristics of Banking Regulations

There are several fundamental differences as well as a number of differences in detail between banking regulations in Japan and those that apply in other important financial centers. Several examples are provided in the following section.

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118 By way of comparison: This was introduced in the Federal Republic of Germany in 1976 and the United Kingdom in 1982.

119 *Yokin hoken-hō,* Act No. 34/1971, as amended.

120 For co-operative style credit institutions operating in the field of agriculture there is a special guarantee scheme.

121 Act No. 90/2008.

a) *Separation of Banking and Securities Transactions*

Under Article 33 of the FIEA, which is a continuation of Article 65 of the former Securities Exchange Act, banks (and insurance companies) are forbidden in principle from carrying out securities business. An exception is made for transactions involving government bonds and other government debentures. Although the Japanese regulation was based on the US *Glass-Steagall Act* of 1933 – which was itself largely replaced by the *Gramm-Leach-Bliley Act* of 1999 – there are still various differences between the two regulations. First, the fact that Article 33 is localized in the FIEA means that the regulation only applies to "securities" and "securities business" *(yūka shōken kanren-gyō)* within the meaning of the Act. Secondly, banks are allowed to hold shares for investment purposes. In practice – and within the limits of what is permissible in terms of antitrust law – this is a widespread strategy, even allowing for the fact that banks' share ownership of other companies has fallen in recent years.[122] Thirdly, banks are forbidden from offering brokerage services in shares as far as possible. This is in contrast to the US *Glass-Steagall Act*, under which investment firms affiliated to bank-holding companies were allowed – at least based on a liberal interpretation of the legal regulations – to engage in a wide variety of securities-based activities.

The justification for separating banking and securities transactions has long been a controversial subject in Japan. Up to now, however, the regulation has not been abolished, even if banks, as a result of an incremental modification of the separate banking system, have long since been allowed to engage in securities transactions via subsidiaries (or in the case of a bank-holding company via an affiliate). Likewise, the regulation concerning the creation of a "fire-wall" has been liberalized in recent years.

b) *Bank Insolvency*

For the liquidation and reorganization of a bank in Japan the same set of laws apply as with company insolvency, namely the Bankruptcy Act,[123] the Civil Rehabilitation Act[124] and the Company Reorganization Act.[125] This uniform regulatory approach is also well-known in Europe. In the USA, however, the *Bankruptcy Code* does not apply to bank insolvencies; further, the local banking authorities there have a far stronger influence on proceedings than is the case in Japan. The FSA and the Bank of Japan are limited to initiating

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122 See *supra* I.1.
123 See *supra* note 80.
124 See *supra* note 81.
125 See *supra* note 82.

proceedings and to a purely formal steering of such. Despite the 1990s banking crisis, there were no bank insolvencies in Japan up to the summer of 2010 (dating back to the end of the Second World War), even if the "first-aid mechanism" mentioned above[126] had to be applied on various occasions in the course of managing the crisis. The first insolvency of a Japanese credit institution in over 60 years occurred when the *Incubator Bank of Japan* applied for bankruptcy in September 2010. This was the first test case where a "pay-off" scheme applied under the deposit guarantee system.

Alongside this special first aid mechanism, there are three general possibilities which can be employed to save endangered banks. First, it should be emphasized that in the past when crises occurred, both financially interlocked banks and banks from the same sector (regional banks, cooperative banks) were often prepared to provide financial support measures. Affected institutions have also been known to merge with financially stronger banks on a partly voluntary basis. In such cases, the managerial staff of beleaguered credit institutions are often replaced as a "punishment".

Secondly, the government can use special legal provisions to supply the affected bank with capital and buy up risky credits. Two large banks that threatened to go bankrupt in 1998 were nationalized in this way. On top of this, most large banks have obtained financial support from the government in recent years. Thirdly, like in other countries, credits from the central bank can be used to bail a bank out. Indeed, this has occasionally happened in the past, even if the awarding of credit by the Bank of Japan is used primarily for the provision of liquidity.

4. *Foreign Banks*

Under the Banking Act, and with due regard to their legal obligations, foreign banks are allowed to be active in banking operations in Japan through subsidiaries and branch offices; under certain conditions they are also allowed to be active in other ways. Nevertheless, it is necessary for them to obtain the relevant authorizations from the financial market authority under Article 4 in conjunction with Article 47 of the Banking Act. Such authorizations must be obtained individually for each subsidiary or branch office. With regard to the activity-related regulations contained within the Banking Act, such as the limits imposed on the awarding of credit or the minimum capital requirements, now and again the FSA takes as its basis a consolidation treatment for every individual branch office, irrespective of the authorization requirements, which then encompasses all branch offices of the foreign bank in Japan.

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126 See *supra* 2.c).

As a prerequisite, the Banking Act imposes a reciprocity requirement on any foreign bank seeking a license in Japan. Under this reciprocity requirement, the home state in question must provide Japanese banks with materially comparable treatment upon entry to the market. It is generally recognized that this is simply a question of formally assessing whether the legal rules of the state in question allow equivalent access. The idea of demanding that, from a competitive point of view, the same market access opportunities *actually* exist is *not* used as an instrument of market access control against foreign credit institutions hoping to build up a presence on the Japanese financial market.

5. FinTech

The amendments to the Banking Act and to related statutes in 2016 permit banks and similar financial institutions to set up a subsidiary whose business is beyond the limitations set up by current law, under certain conditions (Article 16-2 and 52-23 etc. Banking Act). To do so, banks must obtain authorization from the FSA, and the validity of holding such a subsidiary will be for up to five years. This reform is intended to create a regulatory sandbox by permitting banks to enter into new business by investing in and owning FinTech companies.

IV. OUTLOOK

Since the Securities and Exchange Act was transformed into the Financial Instruments and Exchange Act (FIEA) by the amendments of 2006 (effective from 30 September 2007), the FIEA has been amended every year from 2008 to 2017 (with only one exception in 2016). This frequency of amendments reflects rapid changes in the financial markets in Japan and worldwide. Indeed, the amendments in recent years can be traced to two driving forces. One is international discussion at the G20 level and the Financial Stability Board created after the global financial crisis. The other is the domestic situation calling for a change of the FIEA. The high frequency of regulatory activities can be observed in many European jurisdictions as well.[127] A significant difference, however, is the level of securities litigation. German and other European courts have been swamped with thousands of (sometimes frivolous) damages claims raised by aggrieved investors based on (perceived or real) violations of information duties in the

127 In Germany, for instance, some forty legislative measures were enacted in financial market law between 2008 and 2017; see BAUM/YAMANAKA, *supra* note 68, with further references.

primary as well as secondary capital markets over the last two decades.[128] In contrast, while Japan has seen substantial securities litigation, it has been nowhere near these levels.

Recent developments in financial services regulation in Japan manifest two characteristic aspects. First, enforcement is taken into account more seriously than before and it has become multiple by applying administrative, civil and criminal sanctions. In particular, administrative penalties have developed into an important tool for the enforcement of the FIEA today. Second, an interesting change in the style of regulation can be observed. Since 2007, the FSA has begun to use principles in addition to rules in order to regulate the financial sector. Rules provide detailed norms and principles offer best practices. The FSA seems to be trying to find the optimal mix of rules and principles, and it uses the comply-or-explain approach to implement principles. In this vein, Japanese financial regulation today is closer to the European approach than the American approach. In any event, frequent amendments over the past years made the law and regulation in this area highly complex. Yet the future path of financial regulation in Japan seems uncertain. What is certain, however, is that financial regulation in Japan will continue to be an interesting topic for academic research for years to come.

SUMMARY

This article provides an overview of the regulation of Japan's financial markets. It begins by introducing the institutional framework in a discussion considering the Japanese corporate landscape of today, the development of the regulatory architecture in the years from 1945 to the early 1990s as well as its fundamental amendment after 2000, and the structure of financial market supervision. This is followed by a comprehensive analysis of capital market regulation and of the Financial Instruments and Exchange Act as its basic law. From the perspective of public law (supervisory mandatory law), special emphasis is laid on information and transparency duties in the primary market, prohibited conduct in the secondary market such as insider trading, the regime of sanctions, and different types of investment services. From the private law perspective, the article discusses the Financial Products Trading Act, the system of close-out netting, and the securities depository and book-entry regime. Further topics are securitization and derivatives regulation. A third major part deals with the regulation of banking services. The article closes with a brief policy outlook.

128 *Ibid.*

ZUSAMMENFASSUNG

Der Beitrag gibt einen Überblick über die Regulierung der japanischen Finanzmärkte. Als erstes wird der institutionelle Rahmen beleuchtet; Schwerpunkte sind dabei die heutige Unternehmenslandschaft in Japan, Entwicklung und Änderungen der Regulierungsarchitektur seit 1945 und die Ausgestaltung der Finanzmarktaufsicht. Es folgt eine umfängliche Analyse der Kapitalmarktregulierung. Stichwörter sind aus dem Blickwinkel des öffentlichen Rechts (Aufsichtsrechts) das Finanzprodukte- und Börsengesetz als „Grundgesetz" des Kapitalmarktes, Informations- und Transparenzpflichten im Primärmarkt, verbotene Verhaltensweisen im Sekundärmarkt wie z.B. Insiderhandel, Formen der Sanktionierung von Verstößen, verschiedene Typen von Wertpapierdienstleistungen. Aus der Perspektive des Privatrechts werden das Gesetz über den Verkauf von Finanzprodukten, das "close-out netting" und der Effektengiroverkehr diskutiert. Weitere Schwerpunkte sind Verbriefungen und Finanzderivate. Ein dritter größerer Abschnitt ist der Regulierung von Bankgeschäften gewidmet. Der Beitrag schließ mit einem kurzen regulierungspolitischen Ausblick.