The International Capital Markets Review

Third Edition

Editor
Jeffrey Golden

Law Business Research

The International Capital Markets Review

Reproduced with permission from Law Business Research Ltd.

This article was first published in
The International Capital Markets Review, 3rd edition
(published in November 2013 – editor Jeffrey Golden).

For further information please email
Adam.Sargent@lbresearch.com

The International Capital Markets Review

Third Edition

Editor
Jeffrey Golden

Law Business Research Ltd

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND
INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGERS
Adam Sargent, Nick Barette

MARKETING MANAGERS
Katherine Jablonowska, Thomas Lee, James Spearing, Felicity Bown

PUBLISHING ASSISTANT
Lucy Brewer

MARKETING ASSISTANT
Chloe Mclauchlan

PRODUCTION COORDINATOR
Lydia Gerges

HEAD OF EDITORIAL PRODUCTION
Adam Myers

PRODUCTION EDITOR
Robbie Kelly

SUBEDITOR
Caroline Rawson

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-907606-88-5

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

AFRIDI & ANGELL LEGAL CONSULTANTS

ALLEN & OVERY

ATTORNEYS AT LAW BORENIUS LTD

BBH, ADVOKÁTNÍ KANCELÁŘ, V.O.S.

DAVIS POLK & WARDWELL LONDON LLP

DE PARDIEU BROCAS MAFFEI

ENS (EDWARD NATHAN SONNENBERGS)

FENXUN PARTNERS

GAIKOKUHO KYODO-JIGYO HORITSU JIMUSHO LINKLATERS

JURIS CORP

KELLERHALS ATTORNEYS AT LAW

KIM & CHANG

KING & WOOD MALLESONS

LOYENS & LOEFF NV

MAKES & PARTNERS LAW FIRM

MAPLES AND CALDER

MKONO & CO ADVOCATES

MONASTYRSKY, ZYUBA, STEPANOV & PARTNERS

OPPENHOFF & PARTNER

PAKSOY

PLESNER

RUSSELL McVEAGH

SIDLEY AUSTIN LLP

SYCIP SALAZAR HERNANDEZ & GATMAITAN

UGHI E NUNZIANTE STUDIO LEGALE

ULHÔA CANTO, REZENDE E GUERRA ADVOGADOS

URÍA MENÉNDEZ ABOGADOS, SLP

CONTENTS

EDITOR'S PREFACE TO THE THIRD EDITION

As I write the preface to this third edition of *The International Capital Markets Review*, my morning newspaper reports that one of the major global banks, having shrunk its workforce by more than 40,000 employees over the past two years, will now embark on a hiring spree to add at least 3,000 additional compliance officers.

It would be nice if the creation of these new jobs evidenced new confidence that capital markets activity is on the rise in a way that will justify more hands on deck. In other words, capital markets lawyers will have something to celebrate if this bolstering of the ranks was thought necessary to ensure that requisite regulatory approvals and transactional paperwork would be in place for a projected expansion in deal flow.

And, indeed, my morning newspaper also reports a new transaction of some significance, namely, Twitter's filing for a multi-billion dollar international public offering, accompanied by a tweet, of course – but with a true sign-of-the-times disclosure: 'This Tweet does not constitute an offer of any securities for sale'!

Yes, confirmation of an uptick in deal flow – especially 'big deals' flow – would be nice. In the preface to the last edition of this work, I speculated that there were 'signs that any 'big freeze' on post-crisis capital markets transactional work may be thawing'. All the better if the current newspaper reports provide continued and further support for that inference. After all, when our first edition appeared a little over two years ago, the newspapers were saying terrible things about the capital markets.

What is more likely, however, is that this increased staffing aims to cope with regulatory complexity that will now impact the financial markets regardless of any growth and perhaps may even have been designed to slow down the business being done there. That complexity, but also just the scale of recently promulgated new regulation and the practitioner's resulting challenge in 'keeping up' have all encouraged this new third edition. The 8,843 pages of Dodd-Frank rule-making that I reported in my preface to the last edition have now grown to more than 14,000 pages at this time of writing – and approximately 60 per cent of the job remains unfinished. Other key jurisdictions have been catching up. Plus the rules are purposive and aim to change the way things have been done. If compliance and even ethics in the capital markets were ever instinctual, rather than matters to be taught and studied, that is probably a thing of the past.

The thickness of this volume has grown as well because of the increased number of pages and coverage in it. Nine new contributors (Finland, Indonesia, Italy, the Netherlands, the Philippines, Spain, Switzerland, Tanzania and the UAE) and an overview of EU Directives have been added. Banks are lending less to corporates, which in turn are having to issue more to meet liquidity needs. Moreover, with the low interest rate environment of quantitative easing, central banks are encouraging risk-taking rather than hoarding. For investors, risk-free assets have become very expensive. So we see a growing willingness to get off the traditional highway in search of yield. Investment banks are, as a result, often taking their clients (and their clients' regular outside counsel) to difficult, or at least less well-known, geographies.

Having a pool of country experts and jurisdictional surveys that facilitate comparative law analysis can be very helpful in this instance. That is exactly what this volume aims to provide: a 'virtual' legal network and global road map to help the reader navigate varying, and increasingly difficult, terrain to arrive at right places.

There has been much relevant change in the legal landscape surveyed in the pages that follow. However, what has not changed is our criteria for authors. The invitation to contribute continues to go to 'first in class' capital market specialists from leading law firms. I shall be glad if, as a result, the biographical notes and contact details of the contributing firms prove a useful resource as well.

The International Capital Markets Review is not a novel. Impressed I might be, but I would certainly also be surprised by anyone picking up and reading this volume from cover to cover. What I expect instead, and what is certainly the publisher's intention, is that this work will prove a valuable resource on your shelf. And I hope that you will have plenty of opportunities to take it off the shelf and lots of excuses to draw on the comparative jurisdictional wisdom it offers.

Let me again express my sincere gratitude to our authors for their commitment to the task and their contributions. It remains a privilege to serve as their editor and a source of great pride to keep their company in the pages of this book.

Jeffrey Golden
P.R.I.M.E. Finance Foundation
The Hague
October 2013

EDITOR'S PREFACE TO THE SECOND EDITION

It was my thought that we should also include in this second edition of *The International Capital Markets Review* my preface to the first edition. Written less than a year ago, it captures relevant background and sets out the rationale for this volume in the series. The contemporary importance of the global capital marketplace (and indeed you must again admire its resilience), the staggering volume of trading and the complexity of the products offered in it, and the increased scrutiny being given to such activity by the courts all continue. And, of course, so does the role of the individual – the difference that an informed practitioner can make in the mix, and the risk that follows from not staying up to date.

However, I was delighted, following the interest generated by our first edition, by the publisher's decision to bring out a second edition so quickly and to expand it. There were several reasons for this. The picture on the regulatory front is much clearer for practitioners than it was a year ago – but no less daunting. According to one recent commentary, in the United States alone, rule-making under the Dodd-Frank report has seen 848 pages of statutory text (which we had before us when the first edition appeared) expand to 8,843 pages of regulation, with only 30 per cent of the required regulation thus far achieved. Incomplete though the picture may look, the timing seems right to take a gulp of what we have got rather than wait for what may be a very long time and perhaps then only to choke on what may be more than any one person can swallow in one go! Regulatory debate and reform in Europe and affecting other key financial centres has been similarly dramatic. Moreover, these are no longer matters of interest to local law practitioners only. Indeed, the extraterritorial reach of the new financial rules in the United States has risen to a global level of attention and has been the stuff of newspaper headlines at the time of writing.

There are also signs that any 'big freeze' on post-crisis capital markets transactional work may be thawing. In the debt markets, the search for yield continues. Equities are seen as a potential form of protection in the face of growing concerns about inflation. Participants are coming off the sidelines. Parties can be found to be taking risks. They are not oblivious to risk. They are taking risks grudgingly. But they are taking them. And derivatives (also covered in this volume) are seen as a relevant tool for managing that risk.

Most importantly, it is a big world, and international capital markets work hugs a bigger chunk of it than do most practice areas. By expanding our coverage in this second edition to include six new jurisdictions, we also, by virtue of three of them, complete our coverage of the important BRIC countries with the addition of reporting from Brazil, Russia and China. Three other important pieces to the international capital markets puzzle – Belgium, the Czech Republic and New Zealand – also fall into place.

The picture now on offer in these pages is therefore more complete. None of the 24 jurisdictions now surveyed has a monopoly on market innovation, the risks associated with it or the attempts to regulate it. In light of this, international practitioners benefit from this access to a comparative view of relevant law and practice. Providing that benefit – offering sophisticated business-focused analysis of key legal issues in the most significant jurisdictions – remains the inspiration for this volume.

As part of the wider regulatory debate, there have been calls to curtail risk-taking and even innovation itself. This wishful thinking seems to miss the point that, if they are not human rights, risk-taking and innovation are hardwired into human nature. More logical would be to keep up, think laterally from the collective experience of others, learn from the attention given to key issues by the courts (and from our mistakes) and 'cherry-pick' best practices wherever these can be identified and demonstrated to be effective.

Once again, I want to thank sincerely and congratulate our authors. They have been selected to contribute to this work based on their professional standing and peer approvals. Their willingness to share with us the benefits of their knowledge and experience is a true professional courtesy. Of course, it is an honour and a privilege to continue to serve as their editor in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2012

EDITOR'S PREFACE TO THE FIRST EDITION

Since the recent financial markets crisis (or crises, depending on your point of view), international capital markets (ICM) law and practice are no longer the esoteric topics that arguably they once were.

It used to be that there was no greater 'show-stopper' to a cocktail party or dinner conversation than to announce oneself to be an ICM lawyer. Nowadays, however, it is not unusual for such conversations to focus – at the initiation of others and in an animated way – on matters such as derivatives or sovereign debt. Indeed, even taxi drivers seem to have a strong view on the way the global capital markets function (or at least on the compensation of investment bankers). ICM lawyers, as a result, can stand tall in more social settings. Their views are thought to be particularly relevant, and so we should not be surprised if they are suddenly seen as the centre of attention – 'holding court', so to speak. This edition is designed to help ICM lawyers speak authoritatively on such occasions.

In part, the interest in what ICM lawyers have to say stems from the fact that the amounts represented by current ICM activities are staggering. The volume of outstanding over-the-counter derivatives contracts alone was last reported by the Bank for International Settlements (BIS) as exceeding $700 trillion. Add to this the fact that the BIS reported combined notional outstandings of more than $180 trillion for derivative financial instruments (futures and options) traded on organised exchanges. Crisis or crises notwithstanding, ICM transactions continue apace: one has to admire the resilience. At the time of writing, it is reported that the 'IPO machine is set to roar back into life', with 11 flotations due in the United States in the space of a single week. As Gandhi said: 'Capital in some form or another will always be needed.'

The current interest in the subject also stems from the fact that our newspapers are full of the stuff too. No longer confined to the back pages of pink-sheet issues, stories from the ICM vie for our attention on the front pages of our most widely read editions. Much attention of late has been given to regulation, and much of the coverage in the pages of this book will also report on relevant regulation and regulatory developments; but regulation is merely 'preventive medicine'. To continue the analogy, the courts are our 'hospitals'. Accordingly, we have also asked our contributors to comment on any lessons to be learned from the courts in their home jurisdictions. Have the judges got it right? Judges who understand finance can, by fleshing out laws and regulations and applying them to facts perhaps unforeseen, help in the battle to mitigate systemic risk. Judges who do not understand finance – given the increase in financial regulation, the amounts involved, and the considerable reliance on standard contracts and terms (and the need therefore for a uniform reading of these) – may themselves be a source of systemic risk.

ICM lawyers are receiving greater attention because there is no denying that many capital market products that are being offered are complex, and some would argue that the trend is towards increasing complexity. These changing financing practices, combined with technological, regulatory and political changes, account for the considerable challenge that the ICM lawyer faces.

ICM activity by definition shows little respect for national or jurisdictional boundaries. The complete ICM lawyer needs familiarity with comparative law and practice. It would not be surprising if many ICM practitioners felt a measure of insecurity given the pace of change; things are complex and the rules of the game are changing fast – and the transactions can be highly technical. This volume aims to assuage that concern by gathering in one place the insights of leading practitioners on relevant capital market developments in the jurisdictions in which they practise.

The book's scope on capital markets takes in debt and equity, derivatives, high-yield products, structured finance, repackaging and securitisation. There is a particular focus on international capital markets, with coverage of topics of particular relevance to those carrying out cross-border transactions and practising in global financial markets.

Of course, ICM transactions, technical though they may be, do not take place in a purely mechanical fashion – a human element is involved: someone makes the decision to structure and market the product and someone makes the decision to invest. The thought leadership and experience of individuals makes a difference; this is why we selected the leading practitioners from the jurisdictions surveyed in this volume and gave them this platform to share their insights. The collective experience and reputation of our authors is the hallmark of this work.

The International Capital Markets Review is a guide to current practice in the international capital markets in the most significant jurisdictions worldwide, and it attempts to put relevant law and practice into context. It is designed to help practitioners navigate the complexities of foreign or transnational capital markets matters. With all the pressure – both professional and social – to be up to date and knowledgeable about context and to get things right, we think that there is a space to be filled for an analytical review of the key issues faced by ICM lawyers in each of the important capital market jurisdictions, capturing recent developments but putting them in the context of the jurisdiction's legal and regulatory structure and selecting the most important matters for comment. This volume, to which leading capital markets practitioners around the world have made valuable contributions, seeks to fill that space.

We hope that lawyers in private practice, in-house counsel and academics will all find it helpful, and I would be remiss if I did not sincerely thank our talented group of authors for their dedicated efforts and excellent work in compiling this edition.

Jeffrey Golden
London School of Economics and Political Science
London
November 2011

Chapter 16

JAPAN

Akihiro Wani and Reiko Omachi[1]

I INTRODUCTION

i Structure of financial laws and regulations in Japan

The Financial Instruments and Exchange Act (FIEA)[2] and the Cabinet Order and Cabinet Office Ordinances thereunder are the most basic and important direct regulations on capital markets in Japan. The FIEA regulates the financial instruments business and financial transactions including securities offerings and distributions for the purpose of maintaining the fairness of capital markets, protecting investors and developing the economy. In Japan, there are no overarching laws that regulate all financial institutions, which means that each type of institution is regulated separately. For example, banks are regulated by the Banking Act;[3] securities firms are regulated by the FIEA, and insurance companies are regulated by the Insurance Business Act.[4] However, the FIEA is still important from the standpoint of these financial institutions because it applies, *mutatis mutandis*, to relevant acts and regulations and, as a result, other financial institutions are actually regulated by the principle of the FIEA in many respects, such as when conducting securities and derivatives transactions.

On top of that, there are several other laws and regulations that specifically govern certain types of financial transactions including derivatives transactions, securitisations, structured products, investment funds, trusts and partnerships, namely the Commodity

1 Akihiro Wani is a partner and Reiko Omachi is a managing associate at Gaikokuho Kyodo-Jigyo Horitsu Jimusho Linklaters. The authors express sincere thanks to their editor, Tavis Kiley.

2 Act No. 25 of 1948, as amended.

3 Act No. 59 of 1981, as amended.

4 Act No. 105 of 1995, as amended.

Derivatives Act,[5] the Act on Investment Trusts and Investment Corporations,[6] the Limited Partnership Act for Investment,[7] the Act on Securitisation of Assets,[8] the Trust Act[9] and the Companies Act.[10]

ii Roles of regulatory, supervisory agencies and the central bank in Japanese capital markets

The Financial Services Agency (FSA) is responsible for, *inter alia*, ensuring the stability of the Japanese financial system, protecting investors and conducting surveillance over securities transactions. The FSA delegates its power regarding securities registration to local finance bureaux (LFBs), and to the Securities and Exchange Surveillance Commission (SESC) in respect of daily market surveillance, inspections on financial instruments firms and inspections of disclosure documents, etc.

The commodity derivatives business is regulated by either the Ministry of Economy, Trade and Industry of Japan or the Ministry of Agriculture, Forestry and Fisheries of Japan, or both, depending on the type of the underlying commodity.

The Bank of Japan (BOJ) is the central bank in Japan and, like central banks in many other jurisdictions, it is independent of the government; the BOJ is also independent of the FSA. Its mission mainly focuses on the implementation of monetary policy, treasury and government securities-related operations.

Additionally, there are several self-regulatory organisations (SROs) consisting of financial institutions. Among them, the Japan Securities Dealers Association (JSDA) is the most representative and important organisation in the Japanese capital markets; it promotes sound business development and protects investors by ensuring the fair and smooth conduct of securities transactions by its members.

There is also an electronic system called 'Compliance WAN', which can be accessed by the SESC, LFBs, securities companies, SROs (including the JSDA) and stock exchanges. This system enables the SESC and LFBs to utilise transaction data sent, for example, from securities companies for the purpose of market surveillance.

iii Financial dispute resolution in Japan

Several options exist for resolving financial disputes in Japan: judiciary proceedings in court, arbitration procedures at an arbitral tribunal and alternative dispute resolution (Financial ADR) procedures.

Usually, a party to a financial transaction is able to sue the counterparty in court, and once a court procedure has been chosen, the parties are entitled to a decision by a district court and two instances of appeal, to the High Court and the Supreme Court.

5 Act No. 239 of 1950, as amended.

6 Act No. 198 of 1951, as amended.

7 Act No. 90 of 1998, as amended.

8 Act No. 105 of 1998, as amended.

9 Act No. 108 of 2006, as amended.

10 Act No. 86 of 2005, as amended.

Alternatively, a party may elect to use arbitral institutions, including the Japan Commercial Arbitration Association or the International Chamber of Commerce (ICC), which make arbitral awards that are deemed to be final and binding by the courts. Japan is a member of both the ICSID Convention and the New York Convention, and Japan's Arbitration Law[11] is based on the UNCITRAL Model Law.

In addition to court and arbitral procedures, an investor may seek settlement of a financial dispute by choosing the Financial ADR procedures, a simplified and expeditious resolution system.

iv Scope of jurisdiction

It is generally held that Japanese laws and regulations do not apply to activities by foreign companies outside Japan because the scope of jurisdiction is limited to Japanese territory. With respect to cross-border cases, however, there is no provision that specifies the extent of the application of financial laws and regulations, and the scope of regulatory authorities' power is still open to interpretation. Even so, it is almost certain that Japanese laws and regulations apply when a foreign company solicits an investor who resides in Japan, even when solicited from outside Japan (see Section II.vi, *infra*).

As a matter of practice, the FSA maintains close contact with the regulators of foreign countries on a daily basis. Financial institutions should pay careful attention to the relevant overseas regulations and to Japanese regulations.

II THE YEAR IN REVIEW

i Developments affecting debt and equity offerings

Framework for legislation or regulation on debt and equity offerings

To make a debt and equity offering (whether primary or secondary), a securities registration statement (SRS), mainly consisting of information on the securities being offered and on the issuer, must be filed with the director-general of the LFB, unless such offerings constitute 'private placements', which are exempt from disclosure obligations (private placement exemptions). Two major private placement exemptions are the small-number exemption (which may be available when solicitations are made to 49 or fewer investors in Japan) and the qualified institutional investors (QIIs) exemption (which may be available when solicitations are made only to QIIs). Detailed conditions for each exemption differ depending on the type of security being offered.

Once a company has filed the SRS with the LFB as stated above, it becomes subject to ongoing disclosure obligations and must file an annual securities report (ASR), a semi-annual or quarterly report, and an extraordinary report with the LFB, as must all listed companies in Japan.

11 Act No. 138 of 2003, as amended.

Recent developments in regulations

Short sales regulation

The FSA implemented new regulations on short sales in November 2013. The main purpose of this revision was to relax the regulations introduced in 2008 following Lehman's collapse. With this revision the regulations that were regarded as 'contingent regulations' changed into 'ordinary regulations'.

In summary, under the new regulations 'short sales' are permitted if the broker or dealer is able to confirm with sufficient information that (1) the short seller has entered into a securities lending transaction at the time of the agreement to sell, where the lender is obliged to deliver the borrowed securities to the short seller by the settlement date of the short sale, or (2) the short seller has taken other equivalent measures to ensure that the securities will be delivered to the seller by the settlement date of the short sale (a 'covered short sale'). Covered short sales must also comply with the 'uptick rule' that requires, in principle, the short sale to be at or above the last traded price of the security on the relevant Japanese stock exchange market unless the trade qualifies for an exemption from the rule. Although the uptick rule previously applied in all cases (except to those with exemptions), under the new regulations it only applies if the price of the security falls by more than 10 per cent from its last traded price.

Also, the temporary measure prohibiting 'naked short selling activities' (e.g., selling of securities without ensuring that such securities can be borrowed at the time of the agreement to sell), which had been extended for several years, was recently made a permanent prohibition.

Insider trading regulation

Several reforms on insider trading regulations have been implemented over the past few years. Reforms implemented in April 2012 and April 2013 have created some new exemptions to facilitate certain types of transactions in the context of corporate streamlining, such as rights offerings, block trades, tender offers and certain other merger and acquisition transactions subject to certain conditions.

Another reform will be implemented before June 2014 to tighten insider trading regulations, whereby the improper leakage of inside information or inducement of improper trading using such information, by officers or employees, etc., of listed companies or lead underwriters will now be prohibited. Under the existing law, only persons who conduct the insider trading are subject to penalties; however, this amended law for regulating the leakage of inside information and inducement of improper trading will also apply to persons who do not actually conduct the trading. This regulation further aims to eradicate insider trading conducted by the recipients of insider information provided by officers or employees of an issuing company or by underwriters in the context of public stock offerings as this type of insider trading has recently increased. When a recipient of such information has conducted improper trading, criminal charges (punishable by up to five years' imprisonment and a ¥5 million fine, and an additional fine of up to ¥500 million if it relates to a corporation) and an administrative penalty (a monetary penalty and publication of the offender's name) will be imposed on the person providing such information or person inducing someone to trade improperly by using such information.

In addition, the administrative monetary penalty will increase if an asset manager commits insider trading on a client's account. The penalty will increase to a level equivalent to three times the asset management fee paid to the asset manager by the client for the month of the relevant insider trading date.

Furthermore, investment securities issued by investment corporations will now be subject to insider trading restrictions (such restrictions do not apply to investment securities at present). This means that officers and employees, etc., of asset management companies and their parent companies will be deemed as 'insiders' and will be required to submit a report when they conduct trading as an insider to the extent permissible under certain exemptions.

Incidentally, additional amendments will be implemented for the smooth operation of business practice. For example, if a transaction is conducted between recipients possessing the same inside information, such transactions will be exempt from the insider trading restrictions. Also, a recipient of information on a tender offer will be permitted to purchase shares of the offeree company when the information has been made public by a Tender Offer Notification and six months have passed since the recipient received such information.

Transactions through proprietary trading systems (PTSs)[12]

Since October 2012, the trading of listed securities through PTSs has been exempt under certain conditions of the '5 per cent takeover bid (TOB) rule'. This rule requires investors taking an equity stake exceeding 5 per cent in any company that files an ASR to launch a tender offer unless certain exemptions can be applied. Accordingly, application of the 5 per cent TOB rule to PTS trading was said to hinder the use of PTSs. For PTS participants to be exempt from the 5 per cent TOB rule, operators of PTSs need to ensure that real-time market data is immediately disseminated and that fair and equal opportunities to dispose of securities are available to all PTS participants. Additionally, the price of securities must be determined via an auction system or order matching. It is expected that more buy-side participants will access PTS venues following the lifting of the 5 per cent TOB rule.

Ongoing disclosure obligations of foreign companies

In principle, a company owes ongoing disclosure obligations and must file an ASR with the LFB once a company has filed its SRS (see Section II.i, *supra*). However, in November 2013 a new exemption was introduced whereby a foreign company is not required to file an ASR if (1) the company has had fewer than 300 shareholders at the end of each business year over the past five business years; and (2) the company has received approval from the FSA not to file.

12 Electronic trading systems operated by brokers with a special licence.

ii Developments affecting derivatives, securitisations and other structured products

Overview of legislation or regulation on derivatives, securitisations and other structured products

The FIEA is the most basic and fundamental item of regulation applicable across the spectrum of derivatives, securitisations and other structured products. In addition, there are some other acts governing derivatives, securitisations and other structured products such as the Act on Investment Trusts and Investment Corporations, the Limited Partnership Act for Investment, the Act on Securitisation of Assets, the Trust Act and the Companies Act. Other related laws and regulations may apply depending on the type of the structure.

In 2006, the FIEA underwent radical amendment (it was formerly the Securities and Exchange Act), as did the Commodity Derivatives Act (CDA) in 2011 (formerly the Commodity Exchange Act). The main purpose of these amendments was to provide more complete protection for investors and to improve and enhance the ease of participation in the Japanese market. Accordingly, they introduced strict and rigid regulations for investor protection, but there are some exceptions to those rules and regulations applicable to the financial instruments business, offered only to professional investors, QIIs or commodity derivatives professionals. In other words, the applicable regulation depends on the type of investor. The FSA has also promoted considerable further amendments to the FIEA in recent years to implement agreements reached at the G20 summits (especially in September 2009 at Pittsburgh, in June 2010 at Toronto, and in November 2011 at Cannes), which aim to strengthen the global financial system by fortifying prudential oversight, improving risk management, promoting transparency and continuously reinforcing international cooperation.

Recent regulatory developments

Derivatives market

The FIEA will be amended by March 2014 to establish a 'unified exchange' (see Section II.v, *infra*). Further, the scope of market participants' capacity will be expanded, whereby a securities firm registered as a financial instruments business operator (FIO) engaging in Type I Financial Instruments Business under the FIEA will be able to participate in commodity derivatives transactions on the unified exchange without any further licence. Also, a commodity derivatives business operator (CDBO) licensed under the CDA will be eligible to participate in commodity derivatives transactions on the unified exchange if the operator satisfies the same requirements as those under the current CDA. Also, current regulations on unfair trading and the rules of conduct governing FIOs' responsibilities under the FIEA will also apply to the unified exchange with slight modification.

In addition, in light of the statements made by leaders at the G20 Pittsburgh Summit of 2009 calling for an improvement in the over-the-counter derivatives (OTC derivatives) markets, the Japanese system of the swap execution facility (SEF) is scheduled to be implemented no later than September 2015. With this change, FIOs will be required to use electronic trading platforms when they trade certain types of OTC derivatives contracts to enhance the immediate disclosure of information on the derivatives trade. Also, this amendment will allow a foreign provider to supply its electronic trading platforms to Japanese customers.

See Section II.v, *infra*, regarding recent developments in the use of central counterparties and trade depositaries for derivatives transactions.

Asset management regulations

In light of the scandal in which AIJ Investment Advisors Co, Ltd had long falsified its performance and was operating a fraudulent Ponzi scheme, whereby the majority of its clients' assets (approximately ¥200 billion) had disappeared, the FIEA has been amended and will be further amended before July 2014.

With these amendments, a new monitoring requirement will be introduced for funds in cases where an investment manager invests the assets of clients who are not professional investors. Specifically, Japanese trust banks must be able to directly verify the funds and obtain the net asset value and an audit report from the reporting source (i.e., from persons or companies that calculate such value), and Japanese trust banks will be required to have an internal system in place to cross-check reported net asset values and will be required to notify clients of results. Also, trust banks will be required to issue more frequently (i.e., once every three months) investment reports on the status of assets in employee pension funds.

In addition, investment managers will be required, in view of their knowledge and experience, to provide sufficient explanation to clients on any risks and conflicts of interest, and to reveal any violations of their obligation to diversify investments, if applicable.

Criminal penalties against discretionary investment managers for making false statements in investment reports or making fraudulent statements in soliciting will be strengthened: penalties of up to three years' imprisonment and a ¥3 million fine (and an additional fine of up to ¥300 million if it relates to a corporation).

Investment trust and investment corporation (J-REIT) regulations

For the purpose of facilitating transactions using investment trusts or investment corporations including J-REITs, the regulations on investment trusts and investment corporations will be revised by December 2014.

First, an investment corporation will be permitted to repurchase its equity or undertake financing by way of a rights offering, etc. This revision is expected to provide investment corporations with more options for financing or raising capital. Second, investment corporations will be allowed to use a special purpose company (SPC) to hold overseas real estate when local regulations prohibit an investment corporation from directly holding such real estate. Third, to improve J-REIT governance, an investment corporation will be required to obtain prior approval from the board of the investment corporation when making substantial acquisitions of properties from any interested person (e.g., a sponsor company).

The asset manager of an investment trust will be required to deliver a 'summary of an investment performance report' to all investors, as current investment reports are often expansive and complicated. At the same time, the merger process for small-scale investment trusts will be simplified to improve their operational efficiency. Such trusts tend to remain small in scale and this tendency leads to the operational inefficiency of funds.

iii Cases and dispute settlement

Three years have passed since the Financial ADR[13] started its services, providing a simplified resolution system for troubles with financial institutions, and a sizable number of investors have sought consultations or settlements using the Financial ADR proceedings. In particular, disputes involving foreign exchange derivatives have increased. Such disputes involve an investor claiming a huge loss against a financial institution, alleging that the financial institution violated the principle of suitability or that the issue of accountability was not fulfilled. In practice, however, many disputes involving foreign exchange derivatives could not be settled at Financial ADR proceedings and such cases have been brought to the courts. Apart from this, many disputes dealt with by the Financial ADR or courts have ended with reconcilement or withdrawal of the claim due to Japan's economic recovery and depreciation of the Japanese yen since the beginning of 2013.

The Supreme Court of Japan issued noteworthy judgments in March 2013 in relation to disputes involving interest rate swaps between a bank and its customer (a small corporation). It stated that, even if a bank did not provide an explanation on the specific amount of termination fees for cancelling before maturity, it shall be considered that a bank fulfilled its accountability on condition that: (1) the sales person of the bank explained the basic structure of the transaction and its potential risks, (i.e., that the customer might be obliged to pay a very large amount of interest depending on the floating rate); (2) it cannot be considered that the basic structure was overly complicated for a company owner to understand; (3) it was specified in the bank's documents that the customer would not have the right to terminate the agreement before maturity and that only when the bank has agreed otherwise can the customer terminate the agreement with payment of the cancellation fee. This judgment may have an influence on similar cases in future.

iv Relevant tax and insolvency law

Tax law

Some reforms on domestic taxation have been implemented and other reforms are forthcoming, and this may affect investors in Japan.

First, in relation to reconstruction funding for the Great East Japan Earthquake that occurred in March 2011, special reconstruction income surtaxes that are calculated by multiplying 2.1 per cent against the base income tax were introduced in January 2013. For the 25-year period from 2013 to 2037, the surtaxes are imposed on permanent residents, non-permanent residents, non-residents, Japanese companies and foreign companies, as well as on the interest and dividends arising from financial products.

Second, to proceed with the government policy aimed at the convergence of financial income with respect to the Japanese tax system, income from the transfer of public bonds and corporate bonds (which are not taxed under the current law) will be subject to taxation from January 2014. The government's policy aims to enable the

13 The purpose and features of the Financial ADR are described in *The International Capital Markets Review*, First Edition (2011) p. 119.

aggregation of profit and loss from a broader range of financial products so that investors can choose financial products without being concerned about the differences in tax rates among financial products. The aggregation is expected to be introduced in January 2016.

Third, from January 2014, a Japanese version of an individual saving account (ISA) system, 'NISA', will be introduced, whereby investments of up to ¥1 million per year will be tax free if the investment has been made through an ISA. An investor can hold an ISA as a tax exemption account for a maximum of 10 years. This new system is being set up to spur further participation in the stock market by individual investors.

With respect to international taxation, new earnings stripping rules for applicable parties (e.g., subsidiaries or parent companies) have been introduced and apply to fiscal years beginning in or after 1 April 2013. In addition to the past rules,[14] the new rules restrict interest payments that are excessive when compared to income. The new rules cap the interest deduction derived from net interest payments for applicable persons at ¥10 million or 50 per cent of the adjusted taxable income, and this could significantly affect the structure of financial transactions or corporate capital strategies.

See Section II.vi, *infra*, regarding the increase in the consumption tax.

Insolvency law

There have been no material amendments made to the insolvency laws (last revised between 1999 and 2004), namely the Bankruptcy Act,[15] the Civil Rehabilitation Act,[16] the Corporate Reorganisation Act,[17] the Act Concerning the Special Provisions for the Reorganisation of Financial Institutions, etc.[18] and the Companies Act.

That said, the Deposit Insurance Act[19] (DIA) will be amended by March 2014. This amendment will incorporate a new orderly resolution regime covering banks, securities companies, insurance companies and financial holding companies, etc. that are experiencing financial difficulties. The framework for the new resolution regime is in line with the international agreement made at the Financial Stability Board and G20 Cannes Summit.

According to the DIA, the Prime Minister will determine the implementation of the resolution regime following the deliberations by the Financial Crisis Response Council. Thereafter, appropriate measures such as (1) oversight by the Deposits Insurance Corporation and (2) provision of liquidity and financial assistance to financial institutions (by way of providing loans, guarantees, the subscription of shares, business transfers or sales of assets, etc.) will be enforced. The purpose of the new regime is to reduce market transactions, realise the orderly resolution of financial institutions and prevent severe market disruption (while ensuring the performance and continuation of obligations that are critical for stabilisation of the financial system). The Prime Minister will have the

14 See *The International Capital Markets Review*, Second Edition (2012) p. 154.

15 Act No. 75 of 2004, as amended.

16 Act No. 225 of 1999, as amended.

17 Act No. 154 of 2002, as amended.

18 Act No. 95 of 1996, as amended.

19 Act No. 34 of 1971, as amended.

authority to suspend the application of any termination provisions of certain financial agreements and close-out netting provisions for a period the Prime Minster so designates (Designated Period). This Designated Period is a kind of temporary stay to enable the troubled financial institution to transfer its assets to the acquiring financial institution or to a bridge financial institution, each of which shall be a solvent financial institution.

v Role of exchanges, central counterparties (CCPs) and rating agencies

In principle, the FIEA regulates financial instruments exchanges, financial instruments clearing organisations (central counterparties or CCPs) and rating agencies; the CDA regulates the commodity exchanges. The major developments in legislation or practice of the exchanges, CCPs and rating agencies are as follows:

Exchanges

The Tokyo Stock Exchange Group and the Osaka Securities Exchange merged on 1 January 2013 to form the Japan Exchange Group (JPX) to enhance their competitiveness in the global market. With the merger, the Tokyo Stock Exchange, Inc (TSE) and the Osaka Stock Exchange Co, Ltd (OSE) have become subsidiaries of JPX. The cash equity markets of both exchanges were combined on 16 July 2013 to form one cash equity market of the TSE. The derivatives markets of both exchanges will be integrated into one derivatives market of the OSE in March 2014. Mothers of the TSE, JASDAQ of the OSE and the TOKYO PRO Market will respectively continue to offer companies an alternative listing framework and to meet the needs of professional and other investors.

JPX is expected to become a 'unified exchange' (i.e., an integrated exchange for equities, derivatives, commodities and other products supervised by the FSA). At present, financial instruments exchanges are under the supervision of the FSA and commodity exchanges are under the supervision of either the Ministry of Economy, Trade and Industry or the Ministry of Agriculture, Forestry and Fisheries of Japan (or both) depending on the type of underlying commodity. With a view to becoming a unified exchange, the FIEA will be amended by March 2014 to (1) allow the financial instruments exchanges to trade commodity products and (2) establish the necessary procedures for merging financial instruments exchanges with commodity exchanges. This forthcoming amendment will provide for further types of integration between financial instruments exchanges and commodity exchanges, allowing, for example, a financial instruments exchange to become a subsidiary or parent company of a commodity exchange and vice versa.

CCPs

Since November 2012, FIOs and registered financial institutions have been required to clear certain types of OTC derivatives transactions via the mandatory use of central clearing under the FIEA.

Under the current FIEA, the types of OTC derivatives transactions that are subject to mandatory clearing are (1) credit derivatives swaps (CDS) on Markit iTraxx Japan referencing the credit of no more than 50 Japanese corporations and (2) 'plain vanilla' yen-denominated interest rate swaps (IRS) referencing three-month or six-month LIBOR, which are eligible for clearing services provided by a Japanese CCP (i.e., the Japan Securities Clearing Corporation (JSCC)); however, certain transactions, such as (1) transactions with a party that is not a registered FIO, (2) transactions with a party acting as trustee for the trust account, (3) transactions with a company in the same business group; and (4) transactions with a party that is not a clearing member of the CCP, may be exempt from the mandatory use of CCPs. Also, transactions that have been cleared through any licensed CCP in the US or the UK are also eligible for the exemption.

In practice, JSCC has provided clearing services for CDS transactions since 19 July 2011, working with nine major financial institutions as clearing participants, and it has been providing clearing services for IRS transactions since October 2012, working with 22 financial institutions. Some of the clearing participants plan to start providing client clearing services for several non-clearing participants in February 2014.

JSCC and its parent company, JPX, expect that many other market participants will become members of the clearing framework at JSCC in the near future, and JSCC has expressed its intention to expand its range of services. In this first stage, JSCC has been providing clearing services for IRS transactions since February 2013, referencing TIBOR, which is not subject to legally mandatory clearing. JSCC is also providing clearing services for listed derivatives and FX transactions traded on the OSE, which is in addition to the clearing services offered for equities and derivatives transactions traded on the TSE. Furthermore, with a view to enhancing the market for the convenience of participants, JSCC merged with the Japan Government Bond Clearing Corporation in October 2013 to provide clearing services for Japan government bond transactions.

Transaction information and trade repositories

Since November 2012, certain financial institutions, CCPs and trade repositories have been obliged to report OTC derivatives transaction information to the FSA under the FIEA:

a FIOs engaging in Type I Financial Instruments Business and registered financial institutions are required to store transaction information and report said information to the FSA on or before the third business day of the following week, unless the transaction was cleared by a Japanese or foreign CCP (registered in Japan) or the information has been provided to the 'trade repositories' within three business days;

b Japanese and foreign CCPs (registered in Japan) must record transaction information and report said information to the FSA within three business days; and

c trade repositories must record transaction information provided by FIOs or registered institutions and report said information to the FSA within one business day.

The FSA will use such data to publish information on the number of transactions and total amounts.

The DTCC Data Repository Japan (DDRJ), which is a subsidiary of the Depository Trust & Clearing Corporation (DTCC), was designated as a 'Foreign Trade Repository' under the FIEA by the FSA in March 2013. It has already commenced its trade depositary business in Japan with respect to OTC derivatives transactions.

Rating agencies

No material amendments have been made regarding rating agencies subsequent to the amendments made to the FIEA, effective from April 2010.[20]

vi Other strategic considerations

As stated above (see Section I.iv, *supra*), the FIEA, which provides restrictions on the solicitation of certain securities transactions (including offerings, purchases and sales of securities, but excluding securities lending and repo transactions) to residents in Japan, applies regardless of whether the solicitation is domestic or from overseas. This means that the direct solicitation for securities transactions can be made free from licensing requirements only when it is made to QIIs such as banks, FIOs and insurance companies. All other direct solicitations for securities transactions to residents in Japan are strictly prohibited by the FIEA and require agency or intermediary services by a licensed FIO. Similar but different standards apply to solicitations for derivatives transactions from overseas (which are also controlled by the FIEA). In any event, careful legal due diligence is highly recommended before entering into securities transactions with residents in Japan.

Also, money lending activities from overseas to residents in Japan are restricted mainly by the Money Lending Business Act[21] and the Usury Act.[22] Briefly stated, direct lending from overseas to residents in Japan cannot be conducted unless a foreign bank uses its branch in Japan licensed as the foreign bank's branch under the Banking Act. This restriction does not apply when borrowing takes the form of bond issuance.

Several basic laws (the Civil Code, the Companies Act and the Commercial Code) are being reviewed for future amendments and these changes are likely to affect the capital markets in Japan. Also, consumption tax is scheduled to be increased from the current 5 per cent to 8 per cent in April 2014, and to 10 per cent in October 2015. The relevant bill has been passed, but discussions still continue about its implementation (i.e., timing, scope, special measures and exemptions, etc). While consumption tax is not directly applicable to financial transactions, the increase may have broad implications for the Japanese economy, including the financial markets.

III OUTLOOK AND CONCLUSIONS

Since the return to power of the Liberal Democratic Party led by Prime Minister Shinzo Abe, in December 2012, the Japanese government, and the BOJ headed by new governor Haruhiko Kuroda, are both aggressively promoting 'a bold monetary relaxation policy', 'an agile public finance policy' and 'a growth strategy aimed at spurring investment in the private sector', the 'three arrows' of 'Abenomics'. Thanks to these market changes, the Tokyo capital markets have sprung back to life. Meanwhile, the Japanese yen has slightly weakened again compared with the level seen at the beginning of the year.

---

20 See *The International Capital Markets Review,* First Edition (2011), p. 122.

21 Act No. 32 of 1983, as amended.

22 Act No. 195 of 1954, as amended.

The BOJ subscribes to a large portion of Japanese government bonds (JGBs), and recently the BOJ has been pushing Japanese financial institutions to shift their investments from JGB purchases to other types of investments, such as extending loans to regional small and medium-sized companies. Although it is still too early to make a judgement on the success of Japan's revitalisation, it is clear that Japan is moving to a new phase and away from deflation. Meanwhile, the global harmonisation of the extraterritorial application of national securities and derivatives regulations is becoming a big issue.