The International Capital Markets Review

Seventh Edition

Editor
Jeffrey Golden

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THE INTERNATIONAL CAPITAL MARKETS REVIEW

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PREFACE

This book serves two purposes, one obvious, but the other possibly less so.

Quite obviously, and one reason for its continuing popularity, *The International Capital Markets Review* addresses the comparative law aspect of our readers' international capital markets (ICM) workload and equips them with a comparative law reference source. Globalisation and technological change mean that the transactional practice of a capital markets lawyer, wherever based, no longer enjoys the luxury, if ever it did, of focusing solely at home within the confines of a single jurisdiction. Globalisation means that fewer and fewer opportunities or challenges are truly local, and technology more and more permits a practitioner to tackle international issues.

Moreover, the client certainly may have multijurisdictional ambitions or, even if unintended, its activities often may risk multijurisdictional impact. In such cases, it would be a brave but possibly foolish counsel who assumed: 'The only law, regulation and jurisdiction that matter are my own!'

But actually the second purpose that this book aims to serve is, ironically, to equip its readers to do a better job as practitioners at home. In other words, reading the summaries of foreign lawyers, who can describe relevant foreign laws and practices, is perfectly consistent with and helpful when interpreting and giving advice about one's own law and practice.

As well as giving guidance for navigating a particular local, but, from the standpoint of the reader, foreign scene, the comparative perspectives presented by our authors present an agenda for thought, analysis and response about home jurisdiction laws and regulatory framework, thereby giving lawyers, in-house compliance officers, regulators, law students and law teachers also an opportunity to create a checklist of relevant considerations both in light of what is or may currently be required in their own jurisdiction but also as to where things there could or should best be headed (based on best practices of another jurisdiction) for the future.

Thus, an unfamiliar and still-changing legal jurisdiction abroad may raise awareness and stimulate discussion, which in turn may assist practitioners to revise concepts, practices and advice in our domestic as well as international work. Why is this so important? The simple answer is that it cannot be avoided in today's ICM practice. Just as importantly, an ICM practitioner's clients would not wish us to have a more blinkered perspective.

A week before writing this Preface, I had the honour of sharing the platform with a United Kingdom Supreme Court Justice, a distinguished Queen's Counsel and three American academics. Our topic was 'Comparative Law as an Appropriate Topic for Courts'. The others concentrated their remarks, as might have been expected, in the context of matters of constitutional law, and that gave rise to a spirited debate. I attempted to take some of the

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more theoretical aspects of our discussion and ground them in the specific example of the capital markets, and particularly the over-the-counter derivatives market.

Activity in that market, I said, could be characterised as truly global. More to the point, I posited that, whereas you might get varied answers if you asked a country's citizens whether they considered it appropriate for a court to take account of the experiences of other jurisdictions when considering issues of constitutional law, in my view derivatives market participants would uniformly wish courts to at least be aware of and consider relevant financial market practice beyond their jurisdictional borders and comparative jurisprudence (especially from English and New York courts, which are most often called upon to adjudicate disputes about derivatives), even when traditional approaches to contract construction as between courts in different jurisdictions may have differed.

In such cases, with so much at stake given the volumes of financial market trading on standard terms and given the complexity and technicality of many of the products and the way in which they are traded and valued, there appears to me to be a growing interest in comparative law analysis and an almost insatiable appetite among judges to know at least how experienced courts have answered similar questions.

There is no reason to think that ICM practitioners are any differently situated in this regard or less in need of or less benefited by a comparative view when facing up to the often technical and complex problems confronting them than are judges. After all, it is only human nature to wish not to be embarrassed or disadvantaged by what you do not know.

Of course, it must be recognised that there is no substitute for actual exchanges of information between lawyers from different jurisdictions directly. Ours should be an interdependent professional world. A world of shared issues and challenges, such as those posed by market regulation. A world of instant communication. A world of legal practices less constrained by jurisdictional borders. In that sense and to that end, the directory of experts and their law firms in the Appendices to this book may help identify local counterparts in potentially relevant jurisdictions (one new jurisdiction, Thailand, having been added this year). And, in that case, hopefully a pre-read of this book's content may facilitate discussions with a relevant author.

In conclusion, let me add that our authors are indeed the heroes of the stories told in the pages that follow. My admiration of our contributing experts, as I wrote in the preface to the last edition, continues. It remains too a distinct privilege to serve as their editor, and once again I shall be glad if their collective effort proves helpful to our readers when facing the challenges of their ICM practices amidst the growing interdependence of our professional world.

Jeffrey Golden
P.R.I.M.E. Finance Foundation
The Hague
October 2017

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Chapter 12

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] The FIEA is still important, however, even for financial institutions that are regulated by laws other than the FIEA because such laws may refer to provisions of the FIEA that are then applied to such institutions *mutatis mutandis.* As a result, such institutions are in effect also regulated by the principles of the FIEA in many respects, for example, when conducting securities and derivatives transactions.

Additionally, 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, including the Commodity Derivatives Act (CDA),[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]

1 Akihiro Wani is a senior counsellor at Morrison & Foerster LLP/Ito & Mitomi. Reiko Omachi is an of counsel at Morrison & Foerster LLP/Ito & Mitomi and currently seconded to Morrison & Foerster (UK) LLP.
2 Act No. 25 of 1948, as amended.
3 Act No. 59 of 1981, as amended.
4 Act No. 105 of 1995, as amended.
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.

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

The Financial Services Agency (FSA) is responsible for, *inter alia*, ensuring the stability of the Japanese financial system, protecting investors and carrying out surveillance over securities transactions. The FSA delegates powers relating to securities registration to local finance bureaus (LFBs), and powers relating to daily market surveillance, inspections of financial instruments firms, inspections of disclosure documents and related activities to the Securities and Exchange Surveillance Commission (SESC).

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

The Bank of Japan (BOJ), which is Japan's central bank, is independent of the Japanese government, including the FSA, similar to many other central banks in other jurisdictions. Its mission mainly focuses on the implementation of monetary policy, treasury and government securities-related operations.

Additionally, there are several self-regulatory organisations (SROs) whose membership consists of financial institutions. Among them, the Japan Securities Dealers Association (JSDA) is the most representative and important organisation in the Japanese capital markets. The JSDA promotes sound business development and protects investors by ensuring that securities transactions by its members are conducted fairly and smoothly.

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 is chosen, the parties will be entitled to a decision by a district court and two instances of appeal to the High Court and the Supreme Court.

Alternatively, a party may elect arbitral institutions including the Japan Commercial Arbitration Association or the International Chamber of Commerce (ICC) for 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 Act[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

In general, it is believed that Japanese laws and regulations do not apply to activities by foreign companies outside Japan as the scope of jurisdiction should be limited to Japanese

11 Act No. 138 of 2003, as amended.

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territory. With respect to cross-border cases, there is no general provision that specifies the extent of the application of financial laws and regulations, and the scope of the powers of regulatory authorities is still open to interpretation. Even so, there are several provisions that regulate activities targeting Japanese residents conducted by foreign financial institutions, and, considering from these provisions, it is almost certain that Japanese laws and regulations apply when a foreign company solicits an investor who resides in Japan, even from outside Japan (see Section II.v).

In 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 as well.

II THE YEAR IN REVIEW

i Developments affecting debt and equity offerings

Framework for legislation or regulation on debt and equity offerings

In order to conduct a debt or equity offering (whether primary or secondary), a securities registration statement (SRS), mainly consisting of information about the securities being offered and about the issuer, must be filed with the director general of the LFB, unless such offering constitutes a 'private placement' that is exempt from disclosure obligations (private placement exemption). Two major private placement exemptions are the small-number exemption (which may be available when solicitations are made to no more than 49 investors in Japan) and the professional investors exemption (which may be available when solicitations are made only to qualified institutional investors (QIIs) or specified investors defined in the FIEA). 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 described above, it becomes subject to ongoing disclosure obligations, and must file annual securities reports, semi-annual or quarterly reports and extraordinary reports with the LFB, as all listed companies in Japan must do.

Recent developments in regulations

Fair disclosure rule

In May 2017, the amendment to the FIEA was enacted in order to introduce the 'Fair Disclosure Rule' in Japan. The Fair Disclosure Rule means that if a listed company, etc. (information provider) discloses non-public material information to any investor or broker-dealer (information recipient), such information shall be publicly announced so that it can be accessed by other investors as well. More specifically, if the disclosure to information recipients is to be made intentionally, the information shall be publicly disclosed simultaneously. If the disclosure to information recipients has been made unintentionally, the information shall be publicly disclosed promptly after the disclosure. Details on the scope of information providers, material information, information receipts and methods of announcement, etc. are described in the amended FIEA and the Cabinet Office Ordinance that will implement the amendments. The amendment is scheduled to come into effect on 1 April 2018.

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Mandatory disclosure system

In April 2016, the Working Group on Corporate Disclosure of the Financial System Council, established by the FSA, published a document entitled 'Report – Promoting Constructive Dialogue', which proposes a review of the current disclosure system requiring mandatory disclosure of earnings releases, business reports and annual securities reports. The report recommends that the stock exchange rule relating to earnings releases, which are filings made by listed companies at the time of announcement of their financial statements, be revised to reduce the number of required disclosure items in order to allow companies to conduct flexible disclosure depending on each company's situation. In response to this report, in February 2017, the TSE revised its rule regarding earning releases, which obliged listed companies to submit at least once a quarter. Also, the new rule has abolished the predetermined formats and allowed flexible contents and styles depending on companies' situations.

The report also has proposed that current duplicative disclosure requirements be eliminated by unifying the requirement under the Companies Act to disclose business reports with the requirement under the FIEA to disclose annual securities reports. On the other hand, the report recommends enhanced disclosure of non-financial information such as business policies, strategies and MD&A (management's discussion and analysis) of financial condition. Given this report, on 20 October 2017, the FSA proposed an amendment to the Cabinet Office Ordinance on Disclosure of Corporate Information, etc. and the other relevant disclosure rules for the purpose of improving the current mandatory disclosure system. The FSA is soliciting public comments for a month aiming that the revised rule would apply to disclosure documents for business years ending on or after 31 March 2018.

High-frequency trading

The amended FIEA of 2017 will also introduce new regulations on high-frequency trading in response to rising concerns over the impact of high-frequency algorithmic trading (HFT) on market stability, efficiency, fairness and system vulnerabilities. The new regulation will require high-frequency traders, including institutional investors and HFT firms, to register with the prime minister. A financial instruments business operator (FIO) that is already registered with the prime minister is not required to apply for the registration, but it will be required to file a notification concerning its engagement in high-frequency trading. Such high-frequency traders will be required to establish an internal operational control system so that they could engage in high-frequency trading in an appropriate manner. They will be prohibited from having another person engage in high-frequency trading under the name of the high-frequency trader. They will need to maintain legal ledgers and submit an annual business report. FIOs will be allowed to accept an order that involves high-frequency trading only from high-frequency traders having registered with or notified to the prime minister. A financial instruments exchange will be able to conduct investigations to look into high-frequency traders' compliance with applicable laws, regulations and administrative orders. These amendments are scheduled to come into effect on 1 April 2018. Some transitional measures will be taken for traders who have already been conducting high-frequency trading when the amendment come into effect. More details will be provided by anticipated amendments to the Enforcement Order, Cabinet Office Ordinance and the FSA's Supervisory Guidelines that will implement the amendments to the FIEA. The amendment draft of the Enforcement Order, etc., was published by the FSA on 24 October 2017. As well as Japanese traders, non-resident traders should note the update on these regulations and guidelines, because non-resident traders will be also required to make a registration.

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Curtailing settlement risks

For some years, the JSDA has been actively advancing efforts for shortening settlement cycles for Japanese government bonds (JGBs) and stock trades in order to facilitate and strengthen the functioning of the capital markets. For example, the settlement cycle of JGBs is scheduled to be shortened from T+2 to T+1 for 1 May 2018. If they can confirm stable operation of JGB T+1 settlement system, new stock settlement cycle T+2 will be implemented in late April or May 2019.

Financial benchmarks

In order to implement recommendations by the Financial Stability Board, the FIEA was amended in May 2015 to introduce a new regulatory framework for organisations that set financial benchmarks such as the Tokyo Interbank Offered Rate (TIBOR) (financial benchmark administrators). Under this amended FIEA, the FSA may designate entities as financial benchmark administrators that are then required to establish and observe operational rules consistent with the principles for financial benchmarks of the International Organization of Securities Commissions (IOSCO) regarding their systems of governance, the quality of their benchmarks, the quality of their methodology and accountability. Financial benchmark administrators are subject to supervision by the FSA (not the SESC), including on-site inspection. Each reference bank or financial institution that submits rate data is subject to and monitored for compliance with the code of conduct agreed upon with the financial benchmark administrator. Manipulative activities by FIOs or registered financial institutions (RFIs) are sanctioned. The FSA has designated the JBA TIBOR Administration (JBATA) as a financial benchmark administrator. The JBATA engages in the calculation, publication and administration of JBA TIBOR.

On 24 July 2017, the JBATA implemented JBA TIBOR reform in line with the principle of IOSCO expecting that financial indices shall be based on 'actual' transactions rather than 'virtual' ones. With the implementation of this reform, new financial indices (TIBOR+) have been introduced that are defined as average of interest rates that reference banks or financial institutions deem as prevailing market rates 'assuming transactions between prime banks' on the Japan unsecured call market. All reference banks need to calculate their reference rates following the integrated and clarified calculation and determination process prescribed in the rules determined by JBATA. From these facts, new financial indices TIBOR+ can be interpreted to reflect 'actual' funding cost of the reference banks or financial institutions.

ii Developments affecting derivatives, securitisations and other structured products

Framework for legislation or regulation on derivatives, securitisations and other structured products

The FIEA is the most basic and fundamental instrument of regulation applicable across the spectrum of derivatives, securitisations and other structured products. In addition, there are other laws 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 product.

In 2006, the FIEA underwent radical amendment (it was formerly the Securities and Exchange Act), as did the CDA in 2011 (formerly the Commodity Exchange Act). The main purpose of these amendments was to provide more complete protection for investors

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and to improve and enhance the convenience of participating in the Japanese market. While these amendments introduced strict and rigid regulations for investor protection, there are exceptions for rules and regulations that are applicable to financial instruments businesses targeting only professional investors, QIIs or commodity derivatives professionals. In other words, the rules and regulations applicable to the financial instruments business can differ depending on the type of investor. The FSA has also promoted a considerable number of further amendments to the FIEA in recent years in order to implement agreements reached at the G20 summits, which aim to strengthen the global financial system by fortifying prudential oversight, improving risk management, promoting transparency and continuously reinforcing international cooperation.

Recent developments in regulations

Derivatives

In light of the statements made by leaders at the G20 summits calling for improvements in OTC derivatives markets, there have been several legislative and regulatory developments intended to implement new policies regarding central clearing, trade reporting, margin requirements and trading platforms since 2012. The following reforms on OTC derivatives market have recently been implemented (with respect to central clearing and trade reporting, see Section II.iv).

On 1 September 2015, a Japanese version of an electronic trading platform was introduced. FIOs and RFIs are required to use electronic trading platforms when engaging in OTC interest rate swap transactions denominated in Japanese yen in order to enhance the immediate disclosure of information about the derivatives trade. More details regarding the scope of transactions subject to regulation are prescribed in the FSA's public notice under the Cabinet Office Ordinance of the FIEA. The regulation also provides for a licensing system, minimum capital requirements, record-keeping and other rules for electronic trading platforms.

On 1 September 2016, non-cleared margin rules under the Cabinet Office Ordinance of the FIEA became effective by which BCBS-IOSCO's margin requirements for non-centrally cleared derivatives have been implemented. These rules require that FIOs engaged in Type I financial instruments business (Type I FIOs) and RFIs post and collect initial margin (IM) and variation margin (VM) to and from the counterparty on a bilateral basis with some exceptions. For both IM and VM, there were and have been phase-in periods during which margin obligations apply to a given entity only if certain *de minimis* thresholds are met by the average over the preceding three months of the month-end aggregate notional amounts of the entity's non-cleared OTC derivatives, OTC commodity derivatives and physically settled FX forwards and swaps (determined on a consolidated group basis). From 1 September 2017 to 31 August 2018, IM obligations are applied to entities with an initial *de minimis* threshold of ¥315 trillion. Thereafter, IM obligations will be phased in from 1 September 2018 to 1 September 2020, with an initial *de minimis* threshold of ¥210 trillion that will be lowered until it reaches ¥1.1 trillion for the last portion of the phase-in period from 1 September 2019 to 1 September 2020. After the IM phase-in period ends on 1 September 2020, IM will be required if:

a the average over the preceding year of the month-end aggregate notional amounts of the entity's OTC derivatives (on an unconsolidated basis) is ¥300 billion or more; or

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b the average over the preceding year of the month-end aggregate notional amounts of the entity's non-cleared OTC derivatives, OTC commodity derivatives and physically settled FX forwards and swaps (determined on a consolidated group basis) is ¥1.1 trillion or more.

On the other hand, the VM phase-in period ended on 1 March 2017, and, currently, VM is required if the average over the preceding year of the month-end aggregate notional amounts of the entity's OTC derivatives (on an unconsolidated basis) is ¥300 billion or more.

Parties may agree bilaterally to introduce a minimum transfer amount as long as it does not exceed ¥70 million for the sum of IM and VM. Eligible types of collateral are cash, government or local government debt securities, high-quality debt securities with specific ratings by eligible rating agencies, equities included in a major index, convertible bonds with specific ratings by eligible rating agencies and investment trusts meeting certain conditions. IM must be segregated in a trust account or through a similar method so that the IM will be returned to the posting party in the event of a counterparty default. Rehypothecation and reuse of IM are not permitted unless (1) the IM consists of cash and (2) such rehypothecation and reuse are conducted in a safe manner that bears a relation to the management of the IM. Inter-affiliate trades are exempt from the margin requirements.

Even if Type I FIOs and RFIs are below the *de minimis* threshold for VM, they are still required by the FSA's comprehensive guidelines to establish internal systems reasonably designed for the appropriate posting and collection of VM in line with BCBS-IOSCO's final report.

With respect to cross-border trades, Type I FIOs and RFIs are required to post and collect margins to or from the counterparties that (1) conduct OTC derivatives transactions in the course of trade and (2) are estimated to have a notional outstanding amount of OTC derivatives of ¥300 billion or more (to be calculated in the same way as the ¥300 billion *de minimis* threshold applicable to FIOs). Trades with counterparties that conduct OTC derivatives transactions in the course of trade in non-netting jurisdictions or trades with counterparties that are foreign sovereigns are fully exempt from both VM and IM requirements, although such trades are still subject to appropriate risk management standards under the FSA comprehensive guidelines. On 21 October 2016, the FSA issued a public notice approving compliance with non-cleared OTC derivative margin regulations of certain countries as substituted compliance, which allows Type I FIOs and RFIs to post or receive IM and VM in accordance with the regulations of the relevant country in any domestic, cross-border or offshore transactions. With respect to this, the FSA has issued equivalence determinations for margin regulations of the Commodity Futures Trading Commission (CFTC) of the US, the Office of the Superintendent of Financial Institutions (OSFI) of Canada, the Australian Prudential Regulation Authority (APRA), the Hong Kong Monetary Authority (HKMA) and the Monetary Authority of Singapore (MAS) as of 1 September 2017. Alongside the above, the FSA issued a forbearance memo for variation margin rules on non-cleared derivatives. In that forbearance letter, the FSA recognises that it might be difficult to meet the rules when trading with counterparties that are domiciled in jurisdictions where margin requirements have not been implemented yet. The forbearance letter also stated that, in those cases, as long as each financial institution takes appropriate measures to reduce counterparty risk in line with the purpose of regulations and makes continued effort to satisfy the regulatory requirements, the FSA will deem that such financial institutions have established an appropriate system under the margin requirements.

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Apart from the foregoing, the FSA has implemented the revised FSA's comprehensive guidelines to require the inclusion of stay provisions in derivatives agreements governed by non-Japanese law since 1 April 2017 (with respect to Japanese stay regulations, see Section II.iii).

Securitisations and other structured products

There have been no material amendments to the regulations regarding securitisations and other structured products since the amendment to the FIEA of 2016 regarding investment funds.

iii Relevant tax and insolvency law

Tax law

In general, all corporations in Japan are subject to treatment as taxable entities. Foreign corporations are liable to pay certain types of corporate tax and income tax on domestic-sourced income, which varies depending on whether the foreign corporation has a permanent establishment in Japan. Non-corporate forms that are sometimes used as a vehicle for financial transactions, such as general partnerships, limited liability partnerships or trusts, are, in principle, fiscally transparent for Japanese tax purposes. However, in a tax dispute over whether a limited partnership established under the laws of the state of Delaware[12] is a corporation for Japanese taxation purposes, the Supreme Court ruled on 17 July 2015 that a Delaware LP constitutes a corporation under Japanese tax law. This ruling stated that whether a foreign limited partnership is regarded as a corporation under Japanese tax law shall be determined on a case-by-case basis, and it did not refer to any other foreign limited partnership.

It should be also noted that the Japanese anti-tax haven rules were amended by the 2017 Tax Reform Act and will be implemented on or after 1 April 2018. By this amendment, the Japanese CFC (controlled foreign company) regime will shift more to an 'income approach', although it is still based on 'entity approach', which will be consistent with the final report issued by the project of the OECD and G20 aiming to tackle and prevent base erosion and profit shifting (BEPS) (i.e., tax avoidance strategies exploiting gaps and mismatches in tax rules in order to artificially shift profits to low or no-tax locations). Under the current rule, if a foreign subsidiary's tax rate is less than 20 per cent, it is treated as a tax haven subsidiary and the Japanese shareholder must include the CFC income unless the active business exception tests are satisfied. Under the new rule, however, if: (1) a foreign company does not meet the 'economic activity test' consisting of elements such as business, substance, administration and control criteria; and (2) the foreign tax rate is less than 20 per cent, income earned by such foreign subsidiary must be aggregated and included within Japanese tax income. Also, if: (1) a foreign company falls into the categories of a 'paper company' or 'cash box' or a company located in the blacklist countries defined therein; and (2) the foreign tax rate is less than 30 per cent, income earned by such foreign subsidiary must be aggregated and included within Japanese tax income. In addition, even when a foreign company satisfies the 'economic activity test' stated above, if the foreign tax rate is less than 20 per cent, certain passive income still must be aggregated under certain conditions.

12 Delaware LP.

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Apart from the above, the following reforms on domestic taxation that may affect investors have recently been implemented.

First, the combined national and local effective corporate tax rate for large corporations was reduced to 29.97 per cent from the current 32.11 per cent for taxable years beginning on or after 1 April 2016. A further rate cut is planned for 2018, which would result in a combined effective tax rate of 29.74 per cent. The reduction in the corporate tax rate is intended to strengthen Japan's attractiveness as a business location and enhance the competitiveness of Japanese companies.

Second, a Japanese version of an individual saving account (ISA) system called 'NISA' was introduced in 2014, which makes investments of up to ¥1.2 million per year tax free if the investment was made through an ISA. An investor can hold an ISA as a tax-exempt account for a maximum of five years falling within the period from 2014 to 2023. Furthermore, in January 2018, the new type ISA called 'instalment-type NISA' will be introduced for individuals who hope to build up their assets through instalment-type investment. In the case of this new ISA, an investor makes investments of up to ¥400,000 per year tax free and can hold an ISA for a maximum of 20 years falling within the period from 2018 to 2037. The government continues to proactively promote the use of the NISA because NISA steadily increases participation in the stock market by individuals and has attracted the interest of retail investors.

With respect to the consumption tax, consumption tax is scheduled to rise from 8 per cent to 10 per cent in April 2019. While the consumption tax is not directly applicable to financial transactions, the consumption tax increase may have broader implications for the Japanese economy, including the financial markets. In this regard, the 2017 Tax Reform Act has clearly stated that the consumption tax is not imposed on transfer of virtual currencies, which had not been clear before the tax reform. It became effective on 1 July 2017.

Meanwhile, in order to address tax evasion and avoidance through offshore financial accounts, the 'Common Reporting Standard' (CRS) developed by the OECD and committed to by more than 100 countries has come into force since 1 January 2017 in Japan. The CRS requires jurisdictions to obtain information about financial accounts from each financial institution located in that jurisdiction and conducts automatic exchanges of that information with other jurisdictions on an annual basis.

Insolvency law

The insolvency laws in Japan consist of the Bankruptcy Act,[13] the Civil Rehabilitation Act,[14] the Corporate Reorganisation Act[15] and the Act Concerning the Special Provisions for the Reorganisation of Financial Institutions.[16] In addition, in line with the international agreement reached at the Financial Stability Board and G20 Cannes Summit, the Deposit Insurance Act[17] was revised to provide for an orderly resolution and recovery regime covering banks, securities companies, insurance companies, financial holding companies and similar entities that are experiencing financial difficulties. This regime gives the prime minister the authority to suspend the application of any termination provisions of certain financial

13 Act No. 75 of 2004, as amended.

14 Act No. 225 of 1999, as amended.

15 Act No. 154 of 2002, as amended.

16 Act No. 95 of 1996, as amended.

17 Act No. 34 of 1971, as amended.

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agreements and to close out netting provisions for a period the prime minister designates. The prime minister, thus, in effect has the ability to implement a kind of temporary stay for a designated period to enable a troubled financial institution to transfer its assets to an acquiring financial institution or a bridge financial institution.

Since 2014, there have been no material amendments to the insolvency laws or the Companies Act.

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

In principle, the FIEA regulates financial instruments exchanges, financial instruments clearing organisations (CCPs) and rating agencies. The CDA regulates the commodity exchanges.

Japan Exchange Group, Inc (JPX) is the largest company operating financial instruments exchange markets to provide market users with venues for cash equity trading through its subsidiary, Tokyo Stock Exchange Inc (TSE) and for derivatives trading through Osaka Exchange, Inc (OSE). TSE also offers companies an alternative listing framework to meet the needs of professional and other investors, which consists of Mothers, JASDAQ, TOKYO PRO Market and the TOKYO PRO-BOND Market. In addition to providing market infrastructure, JPX also provides clearing and settlement services through a CCP, Japan Securities Clearing Corporation (JSCC) and conducts trading oversight to maintain the integrity of the markets. JPX has not yet, however, commenced commodity trading operations because the Tokyo Commodity Exchange Inc (TOCOM) has not decided to become a subsidiary of JPX and is still considering alternative survival strategies amid Japan's shrinking commodities market.

Exchanges

There have been no material amendments to regulations for financial instruments exchanges under the FIEA or for commodity exchanges under the CDA recently.

Apart from traditional financial instruments exchanges, for the purpose of regulating the virtual currency exchange services, the amended Payment Services Act (PSA)[18] and the relevant Cabinet Office Ordinance became effective on 1 April 2017. Under the new regulation, the term 'Virtual Currency Exchange Services' is defined as any business of: (1) sale and purchase or exchange of virtual currencies; (2) intermediary, agency or delegation for such sale and purchase or exchange; and (3) management of users' money or virtual currencies in connection with (1) or (2). For conducting virtual currency exchange services in Japan, it will be required to register as a 'Virtual Currency Exchange Service Provider' and need to be a *kabushiki kaisha* stock company or a foreign virtual currency exchange service provider having an office in Japan and a minimum capital amount of ¥10 million. A registered virtual currency exchange service provider would be under obligations, for example, to keep customer information secure, to ensure the proper implementation of services including when the services are outsourced to a third party, to provide users with sufficient explanation and certain information for the protection of user, to segregate users' assets from its own assets, to undergo an audit of such segregation, to maintain books and records and to prepare and submit an annual business report and a periodic report on the amount of users' money and virtual currencies. With respect to a service provider that has

18 Act No. 59 of 2009, as amended.

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already offered virtual currency exchange services since before the amendment to the PSA, a grace period for the registration has been given until the day of registration provided that it applied for the registration before 30 September 2017.

Central counterparties

Since November 2012, FIOs and RFIs 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 credit default swaps (CDS) on Markit iTraxx Japan referencing the credit of no more than 50 Japanese corporations, and 'plain vanilla' yen-denominated interest rate swaps (IRS) referencing three-month or six-month JPY LIBOR or Euro JPY TIBOR, which are eligible for clearing services provided by a Japanese CCP (i.e., JSCC). Certain transactions, however, such as (1) transactions with a party that is not an FIO or RFI, (2) transactions that are booked in a trust account or (3) transactions between affiliates, may be exempt from the mandatory use of the CCP.

With respect to client clearing, CDS or IRS transactions with a party that is not a clearing participant of the CCP may be exempt from mandatory clearing. However, IRS transactions are subject to mandatory clearing (through client-clearing services) when one or both parties are FIOs or RFIs that are registered with the FSA. Such registration is required when (1) the monthly average outstanding notional amount of OTC derivatives is ¥300 billion or more or (2) the monthly average outstanding notional amount of property booked in a trust account of FIOs or RFIs is ¥300 billion or more.

JSCC provides clearing services for listed products, OTC derivatives (CDS and IRS) and OTC Japanese Government Bond (JGB) transactions.

With respect to commodity derivatives transactions, Japan Commodity Clearing House Co, Ltd (JCCH) provides clearing services for transactions conducted at the TOCOM or the Osaka Dojima Commodity Exchange, and OTC commodity derivatives transactions.

Transaction information and trade repositories

Since November 2012, certain financial institutions, CCPs and trade repositories have been required to report OTC derivatives transaction information to the FSA under the FIEA. The FSA uses such data to regularly publish information on the number of transactions and total amounts. The DTCC Data Repository Japan (DDRJ) has provided trade depository services in Japan as a 'Foreign Trade Repository' under the FIEA since March 2013.

v Other strategic considerations

The FIEA, which imposes restrictions on the solicitation of certain securities transactions (including offerings, purchases and sales of securities, but excluding securities lending and repo transactions) directed at residents in Japan, applies regardless of whether the solicitation is domestic or from overseas. This means that direct solicitation for securities transactions is permitted without satisfying licensing requirements only when it is directed at QIIs such as banks, FIOs and insurance companies. All other direct solicitation for securities transactions directed at residents in Japan is strictly prohibited by the FIEA and requires agency or intermediary services by a licensed FIO. Similar but different standards apply to the solicitation of 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.

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Money-lending activities from overseas to residents in Japan are restricted mainly under the Money Lending Business Act[19] and the Usury Act.[20] Briefly stated, direct lending from overseas to residents in Japan is prohibited except when a foreign bank uses a branch in Japan that is licensed as the foreign bank's branch under the Banking Act or a borrower is an affiliate company of the lender. This restriction does not apply if the borrowing is made in the form of a bond issuance.

It is noteworthy that the FSA is promoting the development of fintech. To date, the FSA has made amendments to the Banking Act, the FIEA and the PSA to facilitate fintech-related business in financial sectors. The need for multiple amendments reflects that financial institutions are subject to different regulations depending on which sector the institution belongs to (see Section I.i). For example, in 2017, the Banking Act was amended to allow a bank to hold the ownership of a fintech company, and the PSA legislated for virtual currency exchange services as stated in Section II.iv. Furthermore, in order to newly regulate electronic payment intermediate services providers that display users' bank account statements and provide payment-related services from or to users' bank accounts as intermediaries between a bank and their customers through an application programming interface (API), the amendment to Banking Act will be implemented early 2018. Having said that, the FSA recognises that it is important to see the larger picture so that it can ensure proper support for fintech-related new business that transcends conventional boundaries through technological development. From this perspective, the FSA established the Working Group on the Financial System of the Financial System Council in July 2016 and the Panel of Experts on FinTech Start-ups in April 2018 in order to discuss a potential financial business environment that would allow IT financial services affected by multiple regulations to be provided more easily.

Overall, the government, together with Tokyo Metropolitan Government, holds the significance in raising the status of Tokyo as a global financial centre. Toward this goal, the FSA expresses a stance to have its financial regulations and supervisions aligned with international trends with a view to changes in the domestic and foreign market environment. Based on this policy, over the past years, the FSA has diversified primary markets and products, established markets for professional investors, strongly encouraged financial institutions to reform corporate governance and published the 'Principles for Customer-Oriented Business Conduct' to ensure that financial institutions fulfil their fiduciary duties and promulgated 'Principles for Responsible Institutional Investors', which is known as the Japan Stewardship Code. The FSA is likely to continue to develop and embed its strategic policy for the promotion of Tokyo as global financial centre.

Furthermore, it should be noted that the Civil Code[21] has been amended and will be implemented within three years of 2 June 2017. The Civil Code is the fundamental law that provides for rules regarding legal relationships between contract parties or act of torts. Also, the amendment to the Act on the Protection of Personal Information[22] came into effect on 30 May 2017, which has made clear the scope of personal information and the companies' obligations for the purpose of enhancing the protection of personal information, making

19 Act No. 32 of 1983, as amended.

20 Act No. 195 of 1954, as amended.

21 Act No. 89 of 1896, as amended.

22 Act No. 57 of 2003, as amended.

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such protections comparable to those provided by EU law and allowing companies to use personal information more effectively. Financial institutions should be more careful about these changes of basic laws.

III OUTLOOK AND CONCLUSIONS

In late August of 2017, the FSA revealed the most drastic restructuring plan of itself since it spun off from the Ministry of Finance in 1998. Currently there are three bureaus in the FSA, namely the Planning and Coordination Bureau, the Inspection Bureau and the Supervisory Bureau. Under the restructuring plan, the Inspection Bureau, which is in charge of on- and off-site inspection of the financial institutions, will be liquidated and its functions will be transferred to the existing Supervisory Bureau. The Planning and Coordination Bureau will be divided into the General Policy Bureau, which will be newly organised to be in charge of strategic planning (including 'Evidence Based Policy Making' (EBPM)) and the coordination of the implementation of the financial policies, and the Planning and Market Bureau, which will also be organised to be in charge of fintech and the enhancement of market infrastructure. On the other hand, the Supervisory Bureau will continue to focus on on/off monitoring of each financial business sector. The new regime will be operative in July 2018.

This restructuring seems to officially indicate that the crisis management in the 'lost 20 years' of Japan, which was mostly devoted to disposal of the non-performing loans and the realignment of the institutions in the financial sector, is now over. Under the strong leadership of Commissioner Nobuchika Mori, who is in his third term, the FSA is now changing its role to be the control tower of the development of the Japanese financial markets.

Now the last challenge for Japanese financial markets is how and when the Bank of Japan will cease quantitative and qualitative easing policy, including the adoption of the negative interest policy, while the economic performance of Japan is as good as that of the United States.

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Appendix 1

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