

# **Financial Instruments and Exchange Law (“FIEL”) (Amendment in 2007)**

— **“Securities Exchange Law” ⇒ “FIFL” —**

**Financial Services Agency  
Hidenori MITSUI**

# 1. Purport and Objective of the “FIEL”

Sectional laws and application for specified securities



Regulatory structure of the Securities and Exchange Law



- Fraudulent cases among the loopholes between regulations
- Different rules for financial instruments whose economic functions are identical
- Interruption of financial innovation and development of new financial instruments beyond existing business lines
- Full set of rules are uniformly applied once regarded as “securities”

## “Users”

Enhancement of user protection  
Enhancement of users’ convenience  
( Promotion of financial innovation )

## “Markets”

Enhancement of fairness and transparency  
Facilitation of  
“from savings to investments”

## “Internationalization”

Development of market infrastructure in consistent with major jurisdictions

Comprehensive and Cross-sectional

= Establishing a comprehensive and cross-sectional framework of a wide range of financial instruments and services

Flexibility

= Introducing different rules on the characteristics of financial instruments, or knowledge and experience of investors

Fairness and Transparency

= Enhancing disclosure requirements and the exchange system

Strictness

= Increase in maximum criminal penalties, etc.

## 2. Basic Framework of the “FIEL”

The law for amending Securities and Exchange Law and other financial laws  
(Cross-sectional legal framework for investor protection)

Securities and Exchange Law (“SEL”)

Financial Instruments and Exchange Law (“FIEL”)

So-called “Investment Services Law”

Establishing a comprehensive and cross-sectional framework

- Cross-sectional legal framework for the financial instruments and services with strong investment characteristics



Establishing a comprehensive definition of collective investment scheme

Flexible regulatory structure

- Introducing different rules on the characteristics of financial instruments, or knowledge and experience of investors

Exchange system

- Strengthening independence of self-regulatory functions of exchanges (Independence of self-regulatory organization)

Criminal penalties and civil money penalty

- Increase in criminal penalty (Inprisonment 5 years ⇒ 10 years maximum)
- Expansion of the scope of penalties against “misegyoku”

Disclosure requirements

- Introducing the statutory quarterly reporting system
- Enhancing internal control over financial reporting
- ※ Certification for financial statements by management
- Reviewing regulations on tender offer
- Reviewing regulations on large shareholdings reports
- ※ Special reporting system for professional investors (current) once in three months and within 15 days → twice a month or more and within five business days

The law for abolishing and amending the related laws to implement the law for amending the Securities and Exchange Law and other financial laws

1. Abolish following 4 laws:

- Financial Futures Trading Law
- Law Concerning the Regulation of Investment Advisory Service Relating to Securities
- Law Concerning the Regulation of Mortgage Business
- Law Concerning Foreign Securities Firms

2. Amend other financial laws :

- Commodity Fund Law
- Financial Products Sales Law
- Others

(note) Firms and Exchanges may continue to use 「Securities firms」 「Stock Exchange」 as their names.

- Banking Law, Long-term Credit Banking Law, Shinkin Bank Law
- Insurance Business Law
- Commodity Exchange Law
- Real Estate Syndication Business Law

etc.

Application of the same rules of conduct

### 3. Effective date of the “FIEL”

Measures	Effective date
<ul style="list-style-type: none"> <li>• Increase in maximum criminal penalty</li> <li>• Countermeasures against trading orders with intention of canceling immediately (“misegyoku”)</li> </ul>	<ul style="list-style-type: none"> <li>• Twenty days after the promulgation of the legislations (= July 4, 2006)</li> </ul>
<ul style="list-style-type: none"> <li>• Review of regulations on tender offers and large shareholding reports</li> </ul>	<ul style="list-style-type: none"> <li>• December 13, 2006</li> <li>※ January 1, 2007 for the shortening of reporting deadline of special large shareholding reports</li> <li>※ April 1, 2007 for the mandatory electronic filing of large shareholding reports</li> </ul>
<ul style="list-style-type: none"> <li>• Introduction of statutory quarterly reporting requirement</li> <li>• Enhancement of internal control over financial reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Date to be designated by cabinet order not exceeding 1 year and 6 months after the promulgation</li> <li>• Applied to business year starting on and after April 1, 2008</li> </ul>
<ul style="list-style-type: none"> <li>• Establishment of cross-sectional framework of a wide range of financial instruments and services</li> <li>• Enhancement of independence of self regulatory functions of exchanges</li> <li>• Others</li> </ul>	<ul style="list-style-type: none"> <li>• Date to be designated by cabinet order not exceeding 1 year and 6 months after the promulgation</li> </ul>

(Note) The related legislations were promulgated on June 14, 2006.

## 4. Cross-sectional coverage of the “FIEL”

### Current coverage under the SEL

- Government bonds
  - Local bonds
  - Corporate bonds
  - Stocks
  - Interests in investment trusts and investment corporations
  - Securities derivative transactions, etc.
- (Limited list)



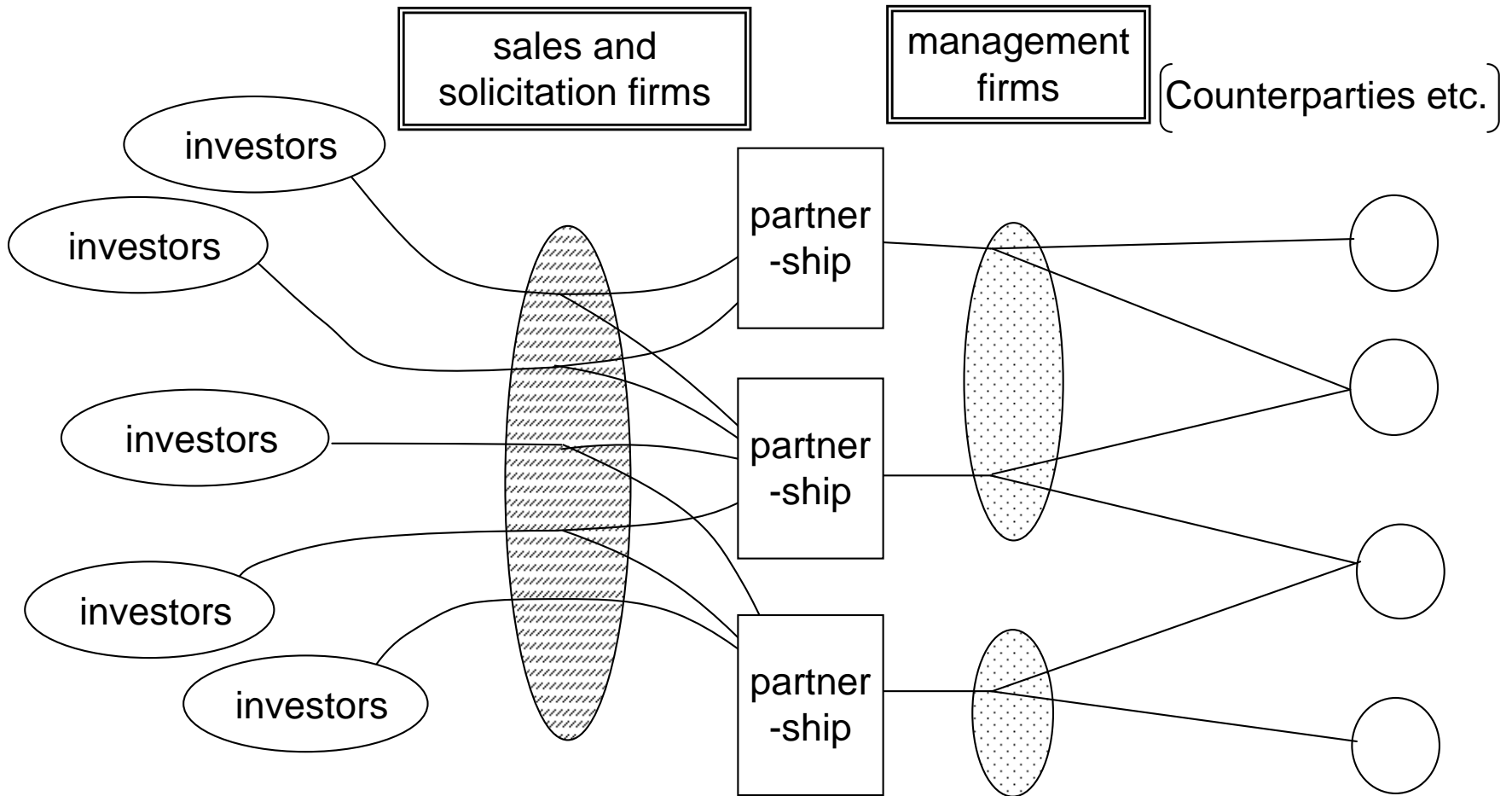
### Coverage under the “FIEL”

- Government bonds
- Local bonds
- Corporate bonds
- Stocks
- Interests in investment trusts and investment corporations
- Interests in trust
- Interests in collective investment schemes (fund)  
(basket clause)
  - ※ Including foreign funds
- Derivative transactions, etc.

- Trust Business Law : Interests in trust
- Commodity Fund Law : Commodity fund
- Financial Future Trading Law :

Financial future trading  
(including foreign exchange  
margin transactions )

# 5. Regulations on Collective Investment Schemes (1)



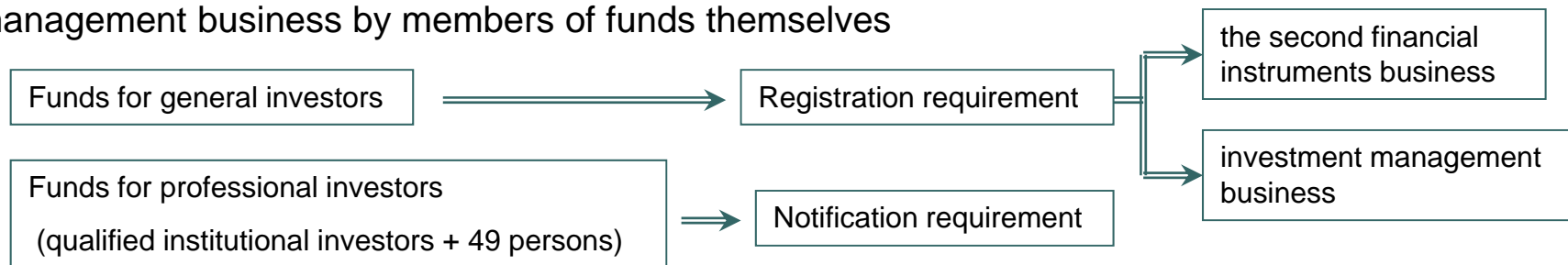
# 5. Regulations on Collective Investment Schemes (2)

## Current regulatory treatment of funds such as partnership or limited partnership

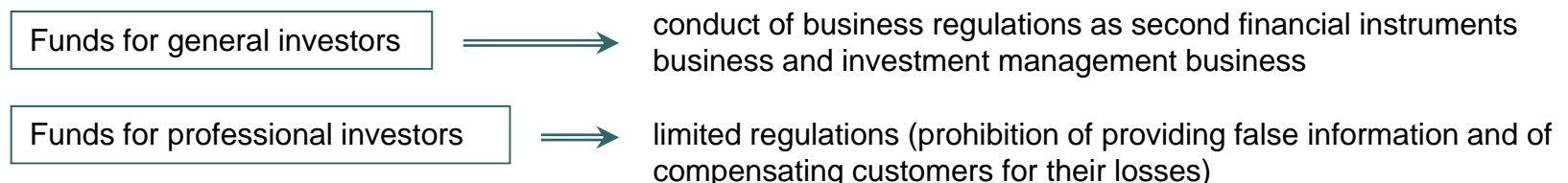
- No business regulation on sales and solicitations of interests in funds by members of funds themselves.
- No business regulation on investment management of interests in funds by members of funds themselves.

## Regulatory treatment under the Financial Instruments and Exchange Law

- Introducing business regulations on sales and solicitation business and investment management business by members of funds themselves



- Introducing conduct of business regulations on sales and solicitation business and investment management business



## 5. Regulations on Collective Investment Schemes (3)

### ● Definition of the Collective Investment Scheme (the “CIS”)

Any scheme that:

- Collects money or similar assets from other persons
- Conducts business/investments in use of the aforementioned money/assets
- Distributes profits to investors generated from the business/investments

※ Any type of funds, e.g. Partnership based on the Civil Law and Partnership based on the Commercial Law (“Tokumei-Kumiai”), is included in the CIS.

※ Any type of business or investment (securities, real estate, commodities) is engaged in/made by the CIS.

A fund which has any of the following features is EXCLUDED from the CIS

- All the investors are involved in the business of the fund,
- No distribution of profits/properties beyond the amount of original investment is made to investors by the fund etc.



# 6. Regulations of business (1)

## (1) Registration

Current system  
(sectional regulations)

Regulatory system under the Financial  
Instruments and Exchange Law

### 【sales and solicitation】

Securities and Exchange Law = Securities business

Foreign Securities Firms Law = Securities business

Financial futures trading Law = Financial futures trading business

Commodity Fund Law = Commodity fund sales business

### 【investment management and advice】

Securities Investment Advisory Law = Discretionary investment business

Investment advisory business

Investment Trusts and Investment Corporations Law = Investment trust management business

### 【administration of money and securities】

No regulations

### 【Introducing brokerage business】

Securities and Exchange Law

(No regulations) Introducing brokerage of discretionary investment contracts and investment advisory contracts

### Financial instruments firms

- The first financial instruments business  
(Sales/solicitation of liquid securities, Underwriting, public offering etc.)
- The second financial instruments business  
(Sale/solicitation of illiquid securities e.g. partnership etc.)
- Investment management business
- Investment advisory and agency business

### Financial instruments introducing brokerage firms

# 6. Regulations of business (2)

[Basic concept]

- Coverage should be “sales and solicitation,” “investment management,” “investment advice,” and “administration of money and securities.” ⇒ Expanding core businesses ⇒ Cross-sectional regulatory structure
- Regulations are tailored to types of businesses financial instruments firms conduct. ⇒ Flexible regulatory structure

“financial instruments businesses”	Type of businesses	Entry regulation	Regulation of financial conditions	Regulation of other business
“the first financial instruments business”	• all financial instruments businesses dealing with all the securities and derivatives	Registration requirement	• minimum capital and net asset requirements • CAR regulation	notification or approval requirement
“investment management business”	• investment management including discretionary investment businesses		• minimum capital and net asset requirements	notification or approval requirement
“the second financial instruments business”	• sales and solicitation of securities with lower liquidity and market derivatives		• minimum capital requirement only	None
“investment advisory and agency business”	• Investment advice		• no minimum capital requirement • business security deposits requirement	None
“financial instruments introducing brokerage business”	• introducing brokerage of deals entrusted by other financial instruments firms	Registration requirement	None	None

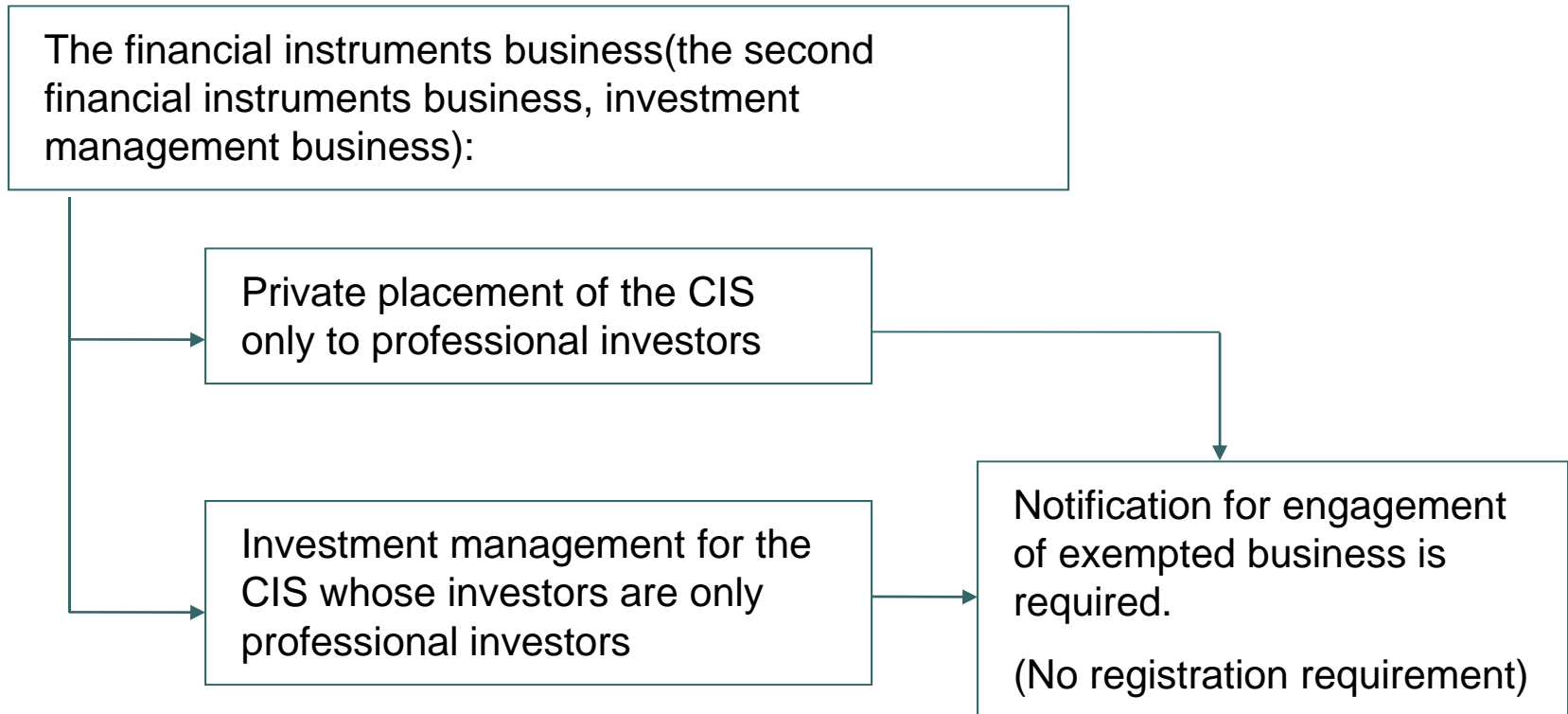
(Note 1) Entry requirement for proprietary trading system (alternative trading system) is approval.

(Note 2) Items on which applications for registrations are to be rejected are tailored to types of businesses.

# 6. Regulations of business (3)

## (2) Notification

The firm which engages in private placement of the CIS only to professional investors (qualified institutional investors + less than 50 investors) or engages in investment management for the CIS whose investors are professional investors



# 7. Regulations on conduct of businesses

	Regulations	General Investors	Professional Investors	Professional Investors for Funds
All businesses	<ul style="list-style-type: none"> <li>- Duty of sincerity and fairness</li> <li>- Obligation of notification of sign</li> </ul>	<p style="text-align: center;">○</p> <p style="text-align: center;">○</p>	<p style="text-align: center;">○</p> <p style="text-align: center;">○</p>	<p style="text-align: center;">—</p> <p style="text-align: center;">—</p>
Sales and solicitation	<ul style="list-style-type: none"> <li>- Regulation of advertisement</li> <li>- Obligation of delivering documents in advance</li> <li>- Prohibition of providing false statement</li> <li>- Prohibition of compensating customers for their losses</li> <li>- Requirement for suitability</li> </ul>	<p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p>	<p style="text-align: center;">—</p> <p style="text-align: center;">—</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">—</p>	<p style="text-align: center;">—</p> <p style="text-align: center;">—</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">—</p>
Investment management and investment advice	<ul style="list-style-type: none"> <li>- Duty of loyalty, fiduciary duty</li> <li>- Conflict of interest</li> <li>- Obligation of delivering investment management report</li> </ul>	<p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">○</p>	<p style="text-align: center;">○</p> <p style="text-align: center;">○</p> <p style="text-align: center;">—</p>	<p style="text-align: center;">—</p> <p style="text-align: center;">—</p> <p style="text-align: center;">—</p>
Custody business	<ul style="list-style-type: none"> <li>- Obligation of segregation of assets</li> </ul>	<p style="text-align: center;">○</p>	<p style="text-align: center;">○</p>	<p style="text-align: center;">—</p>



## 8. Enforcement

### **Financial Instruments Firm (Registered firm)**

- Collection of reports or exercise of inspections on the firm, its counterparties, specific subsidiaries, holding companies and any service vendors
- In addition to regular business reports to FSA, exercise of enforcement actions, such as business improvement order, business suspension order or revocation of registration

### **Firms notifying the engagement of exempted fund business**

- 1) Prohibition of false statement and 2) prohibition of compensating customer for their loss are applied to the firm
- Collection of reports from the firm, its counterparties, service vendors and exercise of inspection on the firm which engages in investment management business and/or service vendors

In addition to the above, regardless of registered/notification, market regulations such as report requirement for large shareholding, TOB regulations or prohibition of insider trading are applied.

Foreign securities firms, foreign investment management firms or foreign investment advisory firms which are not registered firms in Japan shall make notification to the FSA on the establishment of representative offices in Japan and be subject to reporting requirement as necessary.

# 9. Disclosure Requirements

## Securities

Securities with high liquidity (stocks, corporate bonds, etc.)

In principle

Disclosure requirements (submission of registration statement and securities report etc.)

Listed companies (introducing statutory quarterly reporting system and internal control reporting system on financial reporting)

Exception

- Private placement to qualified institutional investors
- Private placement to less than 50 investors

Securities with low liquidity (interests in trust, interests in CIS, etc.)

In principle

Exempted from disclosure to the public requirements

Exception

Investment-type fund (investing mainly in securities)

- Application of disclosure requirements
- Special definition for “offering”
  - number of owners (cf. generally number of investors solicited)
  - 500 investors or more (cf. generally 50 investors or more)