



Amendment to the Financial Instruments and Exchange Law (FIEL)

Introduction

The House of Councilors is currently discussing an amendment to the Financial Instruments and Exchange Law (FIEL), a bill submitted by the FSA to the lower house on March 6, 2009. The European Business Council (EBC) supports the purpose of the amendment, to protect investors and curtail abuses of so-called “Uridashi-Kisei,” but fears that the whole Japanese financial market risks being adversely affected by the new rules if the FSA does not introduce proper exemptions for products to which the new rules cannot be applied. In the worst case, trading foreign securities in Japan could be suspended and ordinary trading of Japanese stocks could decrease substantially. The EBC understands that this amendment is not intended to impede the funding activities of European governments and companies in Japan. The EBC asks the Government of Japan to ensure that this does not happen by ensuring the following measures:

1. Exemption from the rules of securities issued by governments and government agencies of major countries, including European governments, as well as securities listed in the exchanges of European markets that have appropriate disclosure requirements, from the proposed amendment.
2. Establishment of clear criteria distinguishing block trade from underwriting and exempt such trade from the new disclosure requirements.
3. Clarification of the specific disclosure requirements that financial instrument firms are required to satisfy when conducting secondary offerings of foreign securities in Japan.
4. Establish that disclosure requirements for new securities should not be applied also to securities issued by foreign issuers weeks or months earlier.

Background

Under the current FIEL, any secondary offering of a security to 50 or more domestic investors with “equal economic terms” is automatically subjected to the “Uridashi-Kisei” requirements for primary disclosure, including the provision of the securities registration statement and a prospectus. It is said that some brokerage firms have avoided this requirement by offering securities under the same economic terms to up to 49 investors, then changing the terms slightly for another 49 investors and by so doing, avoided having to provide the additional information for any products. The EBC supports the FSA’s drive to correct this abuse and believes that this is the major reason behind the amendment of FIEL proposed to parliament.

However, by deleting the term “unified economic terms” from the definition of secondary offering, as currently proposed, risks bringing a number of unintended consequences as described below:



1. Trading of government bonds, agency bonds or any other bond with high liquidity may be subject to “Uridashi-Kisei” as such securities may be sold to 50 or more investors, even though such securities are actively traded with frequently changing terms. For foreign securities, an indemnity clause is also added on top of the disclosure requirements. It is likely that the risk of trading with foreign government bonds becomes so high that financial firms are likely to suspend or substantially reduce their trading of foreign securities, depending on the way the indemnity clause is applied. With foreign bonds exceeding several trillion yen in Japan, the Japanese market has been an important funding source for foreign governments, agencies and corporations. The EBC is concerned that a suspension of trading of these bonds following the revision of FIEL would have significant impact on the ability of many foreign governments to raise funds. The goal of the amendment should be enhanced disclosure, not restriction of trading of liquid bonds. We understand that the FSA is currently considering exempting these types of securities from the disclosure requirement and urge the government to exempt securities issued by governments and government agencies of all major countries, including those in Europe, as well as securities listed on stock exchanges in Europe which have appropriate disclosure systems.

2. Block trading, a practice in which financial firms purchase equity securities in larger number (a block) and sell them to several investors at the prevailing market price while managing the risk, may also be subject to “Uridashi-Kisei”, following the proposed amendments. If this happens, not only foreign securities but also ordinary Japanese stocks would be adversely affected as the liquidity would be considerably reduced. This would, in turn, affect the overall stock market negatively and pose another blow to an already struggling Japanese economy. The EBC believes that block trading should be differentiated from “secondary offering” and “underwriting”, and that the amended disclosure requirement should not apply to listed securities, such as liquid stocks.

3. If secondary offerings of foreign securities are not exempted under paragraph 1 above, disclosure of foreign securities information will be required and the brokerage firms will be liable for any damages caused by improper information. However, under which circumstances the brokerage will be held responsible remains obscure. If this is not clarified, financial instrument firms may have to stop selling such securities to avoid compensation risks and the costs of lawsuits and attesting. This risks, in turn, damaging the financial activities of the issuers of those securities. To maintain the international attractiveness of the Japanese market, the EBC believes that the amendment should clearly, specifically, and unambiguously state the scope and description of foreign securities information to be disclosed and under what circumstances firms may be held liable.

4. We have heard that Article 23-14 of the FIEL, which is the legal basis of the domestic trading of securities issued overseas, will be deleted. We also understand that the FSA is considering a new regulation that would treat any security issued outside of Japan as a new security for a period from several weeks to up to three



months following its issuance. Such a regulation implies that it would become necessary to meet the requirements either for issuance disclosure or exemption as a private placement when selling recently issued securities to Japanese investors, if these are not exempted under paragraph 1 above. This risk significantly reduces the liquidity of such securities, even though securities, including bonds, are the most liquid products and are normally actively traded for several months following issuance. The EBC urges the government to not introduce this regulation but keep the current practice of treating securities as issued security from the day after issuance.

Many proposals are currently being discussed on how to avoid the potentially detrimental effects on the Japanese market following the proposed amendments. One idea is to limit ordinary sales to specific investors (so-called professional investors) only and impose stronger requirements on resale to public investors (so-called amateur investors). The drawback of this idea is that it restricts the sales of liquid securities to the public forever, even if taken outside of Japan. Managing such a restriction would, furthermore, require a common international system to be developed, which would take a long time and be a very difficult task. Such a system would, moreover, create a greater demand for non-restricted securities and, indirectly, discriminate against foreign government bonds and foreign issued securities. The EBC urges the government of Japan to not introduce such a system.

About the EBC:

The European Business Council (EBC) is the trade policy arm of the 18 European national chambers of commerce and business associations in Japan. Established in 1972, the EBC works to improve the trade and investment environment for European companies in Japan. The EBC currently represents more than 3,000 local European companies and individuals who are members of their national chambers of commerce in Japan. Some 350 of these companies participate directly in the EBC's 28 sector-based committees.

For more information, please contact:

Tel: +81-3-3263-6222, E-mail: ebc@gol.com