

# **ANDERSON MORI**

## *Financial Services & Capital Markets Group*

### **RECENT AMENDMENTS TO THE SECURITIES AND EXCHANGE LAW AND RELATED LAWS**

We wish to take this opportunity to provide you with a brief update concerning recent amendments to the Securities and Exchange Law (“SEL”) and other laws that relate to the conduct of the securities business in Japan (collectively, the “Amendments”). The Amendments were promulgated on May 30, 2003 and will become effective (subject to certain minor exceptions) on April 1, 2004.

#### **Background**

Recently, companies in Japan have begun to shift their preferred method of financing from indirect financing, through banks and financial institutions, to direct financing via the capital markets. Furthermore, as part of the attempt to revitalize the Japanese capital markets, the securities industry has demanded regulatory incentives in order to facilitate investors’ – particularly retail investors’ – participation in such markets. At the same time, the development of sophisticated financing methods and the spread of information technologies have made financial transactions more global than ever, intensifying international interactions among capital markets. In light of these circumstances, the Japanese government has introduced several measures designed to make the Japanese market more attractive to investors, both domestic and foreign.

#### **Amendments to the Securities and Exchange Law**

##### 1. Introduction of “Securities Intermediary Business”.

Prior to the Amendments becoming effective, only registered securities firms (including registered branches of foreign securities firms)<sup>1</sup> are able to conduct “Securities Business,” defined in the SEL to encompass the sale and purchase of securities, as well as certain brokerage, agency and intermediary activities for securities transactions. Given the limited branch network of most securities firms, however, such regulatory restrictions have led to a distinct lack of opportunities and locations at which investors can engage in securities transactions.

To remedy this situation, the Amendments allow for the establishment of a “Securities Intermediary Business.” A Securities Intermediary Business is effectively a stockbroker agent, and is defined in the Amendments as a business that acts, on a commission basis and on behalf of a securities firm, as a securities business intermediary,

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<sup>1</sup> Please note that financial institutions, including bank or insurance companies, are able to conduct a “Securities Business” only to the limited extent set out in the SEL.

undertaking such activities as the mediation of securities sales and purchases. Any person or corporate entity, other than a banking or similar institution, may conduct Securities Intermediary Business upon registration with a competent Local Finance Bureau.

## 2. Increased Scrutiny of Securities Firm Principal Shareholders.

To promote investor confidence in securities firms, the SEL has long specified detailed qualification requirements for securities firm directors. The Amendments supplement this policy by extending these qualification requirements to principal shareholders of securities firms (*i.e.* those shareholders who hold 20% or more of a securities firm's voting rights), as well as to parent or holding companies of securities firms.

Specifically, the Amendments require that the FSA examine the "qualifications" (including history of insolvency, criminal history and record of administrative punishments) of all principal shareholders (and, when such shareholders are corporations, also the qualifications of directors, statutory auditors and officers thereof) of securities firms. While this change will increase the regulatory burden for principal shareholders, it is anticipated that it will also enhance investors' confidence in utilizing the services of securities firms and thereby play some role in revitalizing Japanese stock markets.

For your reference, please note that equivalent regulations have also been introduced into the Investment Trusts and Investment Companies Law with respect to investment trust management companies, and in the Investment Advisory Law with regard to discretionary investment management companies. In addition, based on the policy mentioned above, such examination of the qualifications of principal shareholders has introduced, in the more relaxed manner, into the Foreign Securities Firm Law with regard to foreign securities firm.

## 3. New Provision Concerning Stock Exchange Holding Companies.

The international competitiveness of Japanese stock exchanges and opportunities for formal alliances with overseas stock exchanges have to date been limited, due principally to a prohibition on the holding by any person or entity, including an overseas stock exchange, of more than 5% of the voting rights of a stock exchange in Japan. Under the Amendments, this 5% limitation is abolished, and as a general rule a single shareholder will now be able to hold up to 50% of the voting rights in a stock exchange.

## 4. Clarification and Easing of Rules Regarding Offshore Trading Terminals.

It has historically been difficult for foreign stock exchanges to establish offshore trading terminals in Japan, in large part because the rules regulating the establishment of such terminals are not clear. In particular, such rules have never specified with sufficient clarity whether the establishment of an offshore trading terminal in Japan is tantamount to the establishment of a Japanese securities exchange, an act that would trigger significant and burdensome authorization procedures.

The Amendments define the term “establishment of a securities exchange” to include establishment of an offshore trading terminal, thus requiring a full license from the Japanese authorities in order to establish an offshore trading terminal in Japan. If, however, (i) the offshore trading terminal is regulated and supervised by the laws of its home jurisdiction and (ii) the relevant overseas stock exchange operates under rules ensuring appropriate methods to protect investors, an exemption from such licensing requirement (or in the alternative, an easing of the licensing approval requirements) is available. This represents a significantly lower regulatory burden than the full licensing procedure, and is therefore expected to encourage the establishment of offshore trading terminals in Japan.

### **Amendments to the Foreign Securities Firms Law**

In the past, foreign securities firms have generally been able to enter into securities transactions with financial institutions in Japan from outside of Japan, or with other parties in Japan only through their branch offices in Japan (if any), which are duly registered and (if appropriate) licensed under the Foreign Securities Firms Law. The Amendments have established an exemption from these restrictions, thereby permitting foreign securities firms without a branch office in Japan to directly place orders for securities transactions with stock exchanges in Japan as direct participants thereof.

Along with the introduction of an exemption from the branch office requirements, the Amendments provide for alternative systems by which the FSA may effectively control foreign securities firms without branch offices in Japan, so as to prevent them from engaging in unfair securities transactions. Among such alternative systems are license requirements from the FSA for such direct participation from foreign securities firms. Through licensing procedures, the FSA will examine whether there are arrangements between the FSA and the relevant overseas regulatory authorities, pursuant to which the FSA may receive the necessary information on the foreign securities firms. The FSA will also examine whether there exists any framework through which relevant overseas stock exchanges will be able to help stock exchanges in Japan effectively supervise foreign securities firms.

### **Amendments to the Investment Advisory Law**

#### **1. Elimination of FSA Prior Approval for Ancillary Businesses.**

In order to engage in a business other than the securities and investment advisory businesses (an “ancillary business”), securities firms that are licensed to concurrently engage in the discretionary investment management business are under the Investment Advisory Law required to obtain prior FSA approval. This prior approval is required even if under the SEL a securities firm would be permitted to undertake the ancillary business as a matter of course, or would be expected to be permitted to undertake such business upon notification to or by approval from the regulatory authorities governing such ancillary business, were it not licensed to engage in the discretionary management business. Pursuant to the Amendments, the FSA approval requirement will be eliminated, and under

the amended Investment Advisory Law such securities firms will only need to notify the FSA in advance of their intention to engage in such ancillary business (though the Amendments will not affect SEL procedural requirements).

Furthermore, under the Amendments, securities firms that engage in a discretionary investment management business will no longer need to provide clients with detailed records of their proprietary trading, thereby significantly simplifying their reporting and compliance obligations.

2. Allowance for Trust Banks to Provide Discretionary Investment Advice.

Prior to the Amendments, notwithstanding the fact that they may have obtained a license under the Investment Advisory Law, it was, in practice, impossible for a trust bank to concurrently conduct discretionary investment management business because of the restrictions on the conduct of discretionary investment managers imposed by the Investment Advisory Law (including those on any side business). This anomaly has been corrected by the Amendments, and now, with approval from the FSA, it will be possible for a trust bank to concurrently conduct a discretionary investment management business. The Amendments thus enables a trust bank to specialize in *asset management*, entrusting *asset maintenance* to trust banks that solely conduct the trust business.

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This memorandum is intended solely to provide general guidance concerning the Amendments and not to provide detailed analysis or advice regarding any particular legal issues. If you have any further questions or require specific advice in regard to such matters, please get in touch with your usual contact at Anderson Mori or with any of the partners of the firm's Financial Services & Capital Markets Group.

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