

### FSA Newsletter January 2009

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Minister Nakagawa inspecting the Tokyo Stock Exchange (December 8)



Senior Vice Minister Tanimoto delivering a speech at an extraordinary meeting of Local Finance Bureau Directors-General (December 15)

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The Minister in His Own Words	
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### **Photograph Gallery**

In this corner, we post photographs of the Minister, the Senior Vice Minister, the Parliamentary Secretary and FSA officials at work in meetings, conferences and other events.



At the Tokyo Stock Exchange (December 8)



Parliamentary Secretary Uno delivering a speech at an extraordinary meeting of Local Finance Bureau Directors-General (December 15)



Minister Nakagawa delivering a speech at a forum for exchanges of opinions regarding the facilitation of year-end financing (December 17)

### [Featured]

Publication of the Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Toward Building Reliable and Vibrant Markets"

On December 17, 2008, the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council (chaired by Kazuhito Ikeo, Professor, Faculty of Economics, Keio University) adopted the "Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Toward Building Reliable and Vibrant Markets."

Beginning in October 2008, the First Subcommittee held five sessions of deliberations on ways to build market infrastructures that are fair and transparent and provide a high level of diversity and convenience. In the deliberations, the Subcommittee focused on the following issues from the standpoint of strengthening the competitiveness of Japan's financial and capital markets, while giving due consideration to the global market turmoil caused by the U.S. subprime mortgage problem:

- (i) A framework for regulation of credit rating agencies;
- (ii) Alliances among financial instruments and commodity exchanges; and
- (iii) Review of the disclosure systems.

As for the review of the disclosure systems, the Disclosure Working Group set up under the Subcommittee held deliberations from the experts' viewpoints.

This report summarizes the outcome of the deliberations held by the First Subcommittee.

In light of the contents of this report, the Financial Services Agency (FSA) will quickly start establishing and improving related frameworks and systems.

#### <Outline of Report>

### (1) Framework of regulation of credit rating agencies

In light of the importance of credit rating agencies as elements of the information infrastructure of the financial and capital markets as well as responses to the various problems pointed out regarding them and international developments toward introducing and strengthening regulation of them, it is necessary to introduce regulation on credit rating agencies.

oFrom the viewpoint of ensuring the independence of credit rating, the prevention of conflicts of interest, the quality of, and fairness in, the rating process and transparency for market participants, such as investors, it will be appropriate to introduce a new framework of regulation as follows:

- \*To require registered credit rating agencies to (i) perform the duty of good faith, (ii) disclose information regarding their rating policies and (iii) establish control systems regarding the prevention of conflicts of interest and to (iv) prohibit them from assigning ratings in cases where they own securities issued by the rated entity.
- \*To impose restrictions on the solicitation of customers by financial instruments business operators using credit ratings assigned by unregistered rating agencies.
- \*To empower supervisors to require credit rating agencies to submit reports, conduct onsite inspections on their offices and order them to improve their business operations.

### (2) Alliances among Financial Instruments Exchanges and Commodity Exchanges

oIn order to enable the mutual trading of products between financial instruments and commodity exchanges under the current framework of regulation which subjects financial products and transactions to the Financial Instruments and Exchange Act and commodity derivative transactions to the Commodity Exchange Act, the government must quickly work out specific plans.

• The plans should reflect the following basic concepts:

\*To allow flexible options for alliances, such as forming alliances directly between exchanges themselves or through a subsidiary or a holding company.

- \*To streamline regulation and supervision by eliminating overlapping regulatory and supervisory processes while properly ensuring that the purposes of both acts are observed.
- \*To strengthen cooperation between the regulators of financial instruments and commodity products in dealing with inappropriate transactions that concern both financial instruments and commodity product markets.

### (3) Review of disclosure system

In light of practical processes of securities transactions as well as the needs of investors and issuers, it will be appropriate to implement the following measures in order to ensure that investment information is made easily available to investors when they need it:

- \*To revise the credit rating requirements, which constitute the eligibility requirements for the use of the shelf registration system, and reform the shelf registration system so as to improve convenience for users.
- \*To improve the mandatory prospectus regarding investment trust securities so as to provide investors with easy-to-understand, concise information important for investment decisions and simplify the procedures for the electronic provision of the prospectus.
- \*Regarding the concept of the secondary distribution, to remove the requirement for the "uniform conditions" in light of the increasingly cross-border, complex and diverse nature of securities transactions and make regulation of the provision of information more flexible in light of the practical work processes involved in such transactions.

### (4) Other issues

With respect to the procedures for changing from the status of professional investor to the status of non-professional investor under the Financial Instruments and Exchange Act, it is appropriate to consider reforming the current rules so as to keep a change of status in effect indefinitely once the change is made unless the customer applies for a change of status again.

For further details, please access <u>"Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council: Toward Building Reliable and Vibrant Markets"</u> (December 17, 2008) in the "Press Releases" section on the FSA's web site.



Minister Nakagawa receiving the First Subcommittee's report from Subcommittee Chairman Ikeo (December 17)

-Toward Building Reliable and Vibrant Markets-

December 17, 2008

#### I. Introduction of regulation on credit rating agencies

[Background and perspectives on problems and issues in introducing regulations]

- (1) Importance of role as an element of information infrastructure in the financial/capital markets
- (2) Responses to various problems that have been pointed out
- (3) International moves toward introducing and strengthening regulations

[Problems pointed out ]

Credit Rating Agencies: Conflicts of interest, lack of quality control in credit rating process, and insufficient disclosure of information

Investors: Excessive reliance on credit ratings

#### 1. Development of internationally consistent regulations

#### [Basic concepts]

- (1) Ensuring credit rating agencies are independent from issuers of rated products and preventing conflicts of interest
- (2) Ensuring high quality and fairness of the rating process
- (3) Ensuring transparency of rating process for investors and other market participants
- · Based on ensured compliance with IOSCO Code of Conduct
- Specific requirements for credit rating agencies including (1) duty of good faith, (2) disclosure of information on rating policy, etc., (3) development of control environment by preventing conflicts of interest, etc., and (4) prohibition of assigning credit ratings when analysts own the securities to be rated.

#### 2. Registration, inspection and oversight for ensuring effectiveness of regulations

### ORegistering credit rating agencies with improved control systems

• Restricting financial instruments business operators from using credit ratings assigned by unregistered entities when soliciting business. (Obligation of disclosing unregistered status, assumptions and limits of credit ratings, etc.)

OCooperation with overseas authorities regarding inspection and oversight

#### II. Alliances among financial instruments exchanges and commodity exchanges

Enabling alliances through the overall framework whereby financial instruments and financial transactions are regulated under the Financial Instruments and Exchange Act while commodity derivative transactions are regulated under the Commodity Exchange Act.

- (1) Authorizing formation of alliances through a parent-subsidiary structure or holding company structure
- (2) Streamlining regulation and oversight of exchanges through eliminating dual oversight without undermining the purposes of both laws
- (3) Enhancing cooperation between financial and commodity market regulators against

#### III. Review of disclosure system

Providing investors easy-to-understand and useful investment information in an easily accessible way whenever needed

- Review of public awareness requirements under the shelf registration system (Considering an alternative to the rating standard)
- Stating necessary and concise investment information on mandatory prospectuses regarding investment trusts
- Review of concept of secondary offerings of securities
   (Abolishing universal sales terms and making related regulations more flexible)

Review of procedures for changing the investor status between professional and non-professional status to protect investors

• Giving consideration to allowing customers who have changed from the professional investor status to the non-professional investor status to remain in such a status indefinitely unless they apply for a change of status again (currently, annual application required)

### Publication of the Report by the Joint Group of the First and Second Subcommittees on Financial System of the Financial System Council

The joint group of the First Subcommittee (chaired by Kazuhito Ikeo, Professor, Faculty of Economics, Keio University) and Second Subcommittee (chaired by Shinsaku Iwahara, Professor, University of Tokyo Graduate Schools for Law and Politics) on Financial System of the Financial System Council have held three sessions of deliberations on the alternative dispute resolution system in the financial sector (financial ADR) since November 2008.

Based on the deliberations, the joint group adopted and published "How the Alternative Dispute Resolution System in the Financial Sector Should Be Operated" on December 17, 2008.

This report suggests that it is desirable to establish a legal framework for the financial ADR that is fair, neutral and effective from the viewpoint of enhancing users' trust in and satisfaction with the settlement of complaints and disputes and increasing their confidence in financial products and services.

Based on this report, the Financial Services Agency (FSA) will consider necessary measures to establish a desirable financial ADR system.

### Key points of the report

- \*The establishment of a cross-sectoral, comprehensive financial ADR body should be considered as a long-term task. For the time being, voluntary efforts of industry organizations, self-regulatory bodies and other relevant entities toward the settlement of complaints and disputes should be utilized.
- \*It is appropriate to ensure the neutrality and fairness of financial ADR bodies through the confirmation (designation) by a administrative agency of the framework for the implementation of the financial ADR and persons capable of implementing it.
- \*It is necessary to consider the practicalities of establishing a common contact point that refers complaints and disputes to relevant financial ADR bodies, in addition to strengthening cooperation between the bodies.
- \*In the case that a financial ADR body already exists for a financial industry segment, it would be appropriate to obligate financial institutions in that segment to accept procedures regarding the financial ADR body, provide relevant explanations and documents to the body and respect its findings.
- \*In the case that a financial industry segment lacks a financial ADR body, it would be appropriate to impose some obligations on financial institutions in that segment regarding the settlement of complaints and disputes.
- \*In order to ensure the neutrality, fairness and effectiveness of the financial ADR, it is necessary that a administrative agency is given some authority over financial institutions and financial ADR bodies with regard to the settlement of complaints and disputes.
- \*In order to establish an effective financial ADR system, it is necessary to fully take into consideration the contents of financial products and services, the characteristics of

inquiries and complaints, the circumstances of users, the number of financial institutions in each financial industry segment and the state of efforts toward the settlement of complaints and disputes in each segment.

\*It is necessary for the Financial Service Dispute Resolution Liaison Group to continue to play an important role as the leader of efforts to promote the improvement and development of the financial ADR.

### [Topics]

### Financial results of major banks as of end-September 2008

Following the announcements by major banks, etc. of their financial results as of end-September 2008, the FSA aggregated the figures announced by these banks and released them on January 9, 2009.

Below is a summary of the financial results of the major banks, etc. as of end-September 2008.

#### 1. Profit status

The net core business profits of major banks, etc. (profits from core banking operations) totaled 1.4 trillion yen in the first half of FY2008 that ended on September 30, 2008, down 0.2 trillion yen compared with September 30, 2007. Although the profit margins and the balance of outstanding loans increased, the increases were limited. Meanwhile, fee revenues declined due to the deterioration of market conditions and expenses grew, including due to a reinforcement of human resources and system investment. A combination of these factors apparently reduced their net core business profits.

The banks' net profits in the first half of FY2008 that ended on September 2008, totaled 0.3 trillion yen, down 0.5 trillion yen compared with September 30, 2007. In addition to the factors above, the write-downs of stock holdings and credit-related expenses grew, apparently leading to a decrease in net profits.

### 2. Status of non-performing loans

The non-performing loan ratio of major banks, etc. remained low at 1.5% in the first half of FY 2008 that ended on September 30, 2008, a slight increase of 0.1 percentage points compared with the level at the end FY2007 that ended on March 31, 2008.

Their capital adequacy ratio stood at 12.3% in the first half of FY2008 that ended on September 30, 2008, down 0.6 percentage points compared with the level at the end of FY2007 that ended on March 31, 2008.

### Major banks' non-consolidated financial results for the year ended in September 2008

(Unit: 100 million yen, %)

	Net core	Total Losses on	Stock rel	ated loss an	d gain				n loss on s holdings	The capital	(loans disclo	Balance of Nosed under the construction L	ne Financial	*Percentag
	business profits	Disposal of NPLs		Loss/gain on sale	Write-off	Current Profit	Net Profits		Attributable to shares	adequacy ratio		Loans requiring special attention	Loans in danger of bankruptcy or lower	(vs. total credit)
Mizuho Bank, Ltd.	1,398	-1,158	-381	292	-673	-443	800	-965	484	11.48%	7,928	2,953	4,975	2.15%
Mizuho Corporate Bank, L	1,452	-57	131	363	-232	500	857	1,821	5,614	12.62% *	2,908	2,014	894	0.81%
Mizuho Trust & Banking C	241	-90	-43	8	-51	41	37	372	842	12.86% *	623	92	531	1.73%
The Bank of Tokyo-Mitsub	3,603	-2,384	-623	583	-1,207	389	264	-2,309	3,999	10.69% *	11,464	3,193	8,271	1.36%
Mitsubishi UFJ Trust and I	786	-36	-165	32	-197	535	319	93	1,725	12.56% *	763	290	474	0.76%
Sumitomo Mitsui Banking	3,785	-2,241	-172	48	-220	1,221	804	6,298	7,825	12.50% *	10,769	2,820	7,948	1.62%
Resona Bank, Ltd	1,022	-1,157	-29	55	-84	-67	509	744	1,269	10.47%	5,365	1,646	3,719	3.00%
The Chuo Mitsui Trust and	520	-3	-128	42	-170	181	130	61	1,277	11.14%	1,383	217	1,166	1.53%
The Sumitomo Trust & Ba	728	-41	-93	24	-118	475	304	384	1,740	12.17% *	700	221	479	0.60%
Shinsei Bank, Ltd.	-82	-229	3	25	-22	-361	-364	-584	-46	13.70%	525	178	346	0.90%
Aozora Bank, Ltd.	342	-402	-290	9	-298	-397	-316	-421	-7	13.81%	987	132	855	2.47%
Total	13,794	-7,798	-1,791	1,481	-3,272	2,074	3,345	5,495	24,721	11.73%	43,414	13,755	29,659	1.52%

(Source) Securities Report, etc.

(Note) Changes in the results of major banks, etc.

tne year ended in September 2006(total of	15,818	1,872	1,437	1,917	-480	15,499	16,830	66,095	70,804	12.63%	39,504	19,020	20,484	1.46%
September 2007 (total of 11	16,103	-4,042	20	2,058	-2,038	10,559	8,306	68,811	75,665	13.04%	40,777	14,904	25,873	1.47%
the year ended in March 2008 (total of 11 banks)	32,774	-4,110	-413	4,773	-5,186	22,521	14,527	23,039	33,940	12.30%	38,589	16,971	21,618	1.38%

#### Note

- 1. Figures less than a unit have been rounded up to the nearest whole number.
- 2. The asterisks refer to those of internationally active banks.
- 3. Figures of real operating profits, total losses on disposal of NPLs, stock related loss and gain, current profits, net profits, valuation loss on securities holdings for The Bank of Tokyo-Mitsubishi UFJ, Ltd. include those which are transferred to subsidiary companies, the figures of Chuo Mitsui Trust and Banking Company, Limited include those of its subsidiary
- 4. Figures of the balance of NPLs and the percentage of NPLs for the Bank of Tokyo-Mitsubishi UFJ, Ltd. include those which are transferred to subsidiary companies for corporate
- 5. Positive figures in the total losses on disposal of NPLs and in the write-off of stock related loss and gain indicate gains, while negative figures in these refer to losses.
- 6. The capital adequacy ratio is calculated based on Basel II since the financial year ended on March 31, 2007.
- 7. Figures of the periods that ended on September 31, 2006 and 2007 differ from the previous financial results, announced by the FSA due to a bank revised earnings estimate.

### Financial results of regional Banks as of end-September 2008

Following the announcement by regional banks of the financial results as of end-September 2008, the FSA aggregated the figures announced by these banks and released the results on December 8, 2008.

The following is a summary of the financial results of the regional banks as of end-September 2008.

#### 1. Profit Status

The regional banks' net core business profits (profits from core banking operations) in the first half of FY2008 that ended on September 30, 2008, declined 24.0% compared with the same period of last year due to an increase in the write-offs of losses on securities holdings and a decrease in fee revenues.

Their net profit dropped 62.8% due to increases in the cost of the disposal of nonperforming loans and the cost of writing off losses on shareholdings, in addition to the decline in the net core business profits.

### 2. Status of Non-Performing Loans

The amount of non-performing loans held by the regional banks increased compared with the level at the end of the fiscal year that ended on March 31, 2008, with the non-performing loan ratio rising slightly.

### 3. Capital Adequacy Ratio

The average capital adequacy ratio of the regional banks (excluding Ashikaga Bank) declined slightly compared with the level at the end of the fiscal year that ended on March 31, 2008.

### Key Points of Regional Banks' FY2008 Interim Financial Results

### 1. Profit Status

- Regional banks' net core business profits (profits from core banking operations) in the first half that ended on September 30, 2008 (FY 2008 midterm) declined 24.0% compared with the same period of the previous year due to an increase in the cost of writing off losses on bond holdings and a decrease in fee revenues.
- oTheir net profits dropped 62.8% due to increases in the cost of the disposal of nonperforming loans (NPL) and the cost of impairment losses on shareholdings, in addition to the decline in net core business profits.

(unit: ¥billion)

	FY2006 interim	FY2007 interim	FY2008 interim	Year-on-year change
Gross business profit	2,523.1	2,595.3	2,385.0	- 210.2
Interest income	2,234.5	2,262.3	2,252.7	- 9.6
Fee income	316.7	330.2	272.9	- 57.2
Bond-related profits/losses	- 43.5	- 15.2	- 184.3	- 169.1
Net core business profit	954.6	990.3	752.2	- 238.0
NPL disposal cost (-)	- 347.9	- 377.2	- 537.3	- 160.1
Profits/losses related to stocks, etc.	93.5	77.8	16.3	- 61.4
Disposal of stocks, etc. (-)	- 22.7	- 33.7	- 99.1	- 65.4
Net profit	402.8	374.7	139.4	- 235.3

<sup>(\*)</sup> The amount of net profits in the FY2008 interim term excludes the monetary grant of ¥256.6 billion that was provided by Deposit Insurance Corporation to Ashikaga Bank.

#### (Reference)

	FY2006 interim	FY2007 interim	FY2008 interim
Loan amount	¥189.0 trillion	¥193.7trillion	¥199.trillion

### 2. Status of Non-Performing Loans

oThe amount of non-performing loans (NPLs) held by regional banks increased compared with the level at the end of the fiscal year that ended on March 31, 2008 (FY2007), with the non-performing loan ratio rising slightly.

	FY2006	FY2007	FY2008 interim
NPL amount	¥7.8 trillion	¥7.5 trillion	¥7.9 trillion
NPL ratio	4.0 %	3.7 %	3.9 %

<sup>(</sup>Note) The NPL amount peaked at ¥15 trillion in the FY2002 midterm, with the NPL ratio peaking at 8.3% in the same term.

### 3. Capital Adequacy Ratio

The average capital adequacy ratio of regional banks (excluding Ashikaga Bank) declined slightly compared with the level at the end of the fiscal year that ended on March 31, 2008 (FY2007).

		FY2006	FY2007	FY2008 interim
Average	Capital	10.4 %	10.3 %	10.4 %
adequacy ratio	•	(10.8 %)	(10.7 %)	(10.4 %)

<sup>(\*)</sup> The figures in the parentheses exclude those for Ashikaga Bank, which was under special public

#### management.

(Note 1) The number of banks covered by the figures for the FY2007 midterm, the FY 2007 full term and the FY2008 midterm stood at 110 (including 64 regional banks, 45 second-tier regional banks and Saitama Resona Bank).

The number of banks covered by the figures for the FY2006 full term stood at 111 (including 64 regional banks, 46 second-tier regional banks and Saitama Resona Bank)

The number of banks covered by the figures for the FY2005 full term and the FY2006 midterm stood at 112 (including 64 regional banks, 47 second-tier regional banks and Saitama Resona Bank).

(Note 2) The above figures were calculated on a non-consolidated basis. However, the figures for non-performing loans include those of subsidiaries specialized in business rehabilitation.

(Note 3) The figures for the FY2007 midterm and the 2006 midterm are different from those published by the Financial Services Agency in the past because some banks revised their financial results.

### Exposures of Japanese deposit-taking institutions to subprime-related products and securitized products

On November 28, 2008, the Financial Services Agency (FSA) published the exposures of Japanese deposit-taking financial institutions to subprime-related products and securitized products based on the leading practices summarized in the FSF report as of the end of September 2008.

Subprime-related products held by Japanese deposit-taking financial institutions as of the end of September 2008 totaled ¥797.0 billion (down ¥161.0 billion compared with the end of June 2008), while the total of their valuation and realized losses on such products amounted to ¥950.0 billion (¥896.0 billion as of the end of June 2008).

Meanwhile, securitized products held by Japanese deposit-taking financial institutions totaled \$22,271.0 billion (down \$1,232.0 billion compared with the end of June 2008), while the total of their valuation and realized losses on such products increased sharply, to \$3,273.0 billion (\$2,574.0 billion as of the end of June 2008).

One probable reason for this is that after the summer of 2007 an increase in losses was mainly on subprime-related products, afterwards the impact of the subprime mortgage problem spread to the entire market for securitized products, leading to an increase in losses on securitized products not related to subprime mortgages, such as collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS).

Since September 2008, the FSA has published the exposures of Japanese deposit-taking financial institutions to subprime-related products and securitized products(\*) under unified standards.

We believe that efforts like this help promote a precise understanding of the impact of the turmoil in the global financial markets on Japan's financial system.

The FSA will promote the dissemination of information and continue to improve the public access to the current state of the Japanese financial system and the concept of our financial regulation.

(\*) As for exposures to securitization products based on the leading practices summarized in the FSF report, the FSA started data compilation and publication with the exposures as of the end of March 2008.

\*For further details, please access <u>"Exposures of Japanese deposit-taking institutions to subprime-related products and securitized products based on the leading practices summarized in the FSF report"</u> (November 28, 2008) in the "Press Releases" section of the FSA's web site.

### Exposures of Japanese deposit-taking institutions to subprime-related products

Figures in brackets are as of the end-June 2008 (Billion Yen)

		Oper	Valu (e	Expos	ures to subpri	me-related	Subp	orime-related b	ousinesses	Subprime-related ABCP programs
	Tier1 capital (end-March 2008)	Operating profits from core businesses (end-March 2008)	Valuation profits/losses for equity holdings (end-September 2008)	Book value (end-September 2008)	Valuation profits/losses	Realized p rofits/losses (profits/losses on sales, impairment, etc; from April 1,2007 to Se ptember 30, 2008)	Book value (end-September 2008)	Valuation profits/losses	Realized pro fits/losses (profits/losses on sales, impairment, etc; from April 1,2007 to Se ptember 30, 2008)	Exposures
Major Banks, etc.	25,987	3,499	2,201 (4,962)	719 (876)	-140 (-138)	-727 (-679)	26 (64)	0 (0)	-316 (-305)	_
Regional Banks	12,862	1,799	1,620 (2,782)	<b>46</b> (50)	-3 (-2)	-47 (-46)	_	_	_	_
Cooperative Financial Institutions	11,222	795	-132 (78)	31 (32)	-4 (-2)	- <b>29</b> (- <b>29</b> )	_	_	_	
Total	50,071	6,093	3,690 (7,823)	797 (958)	-147 (-142)	-803 (-754)	26 (64)	0 (0)	-316 (-305)	_

Apart from the above figures, there are valuation/realized losses at some Japanese financial institutions for securitized products not directly related to subprime loans, as global market turmoil has been broadly affecting financial markets, especially in the U.S. and Europe.

- Note 1: "Subprime-related products" are asset-backed securities (ABSs) backed by subprime loans or collateralized debt obligations (CDOs) and other fina ncial products referencing these ABSs. "Subprime-related businesses" are the businesses in which firms produce subprime-related products. The above figures do not include the exposures to subprime-related products through investment trusts.
- Note 2: "Major Banks, etc" includ e major banks (Mizuho Bank, Mizuho Corporate Bank, Mizuho Trust Bank, Bank of Tokyo-Mitsubishi UFJ, Mitsubishi UFJ Trust Bank, Sumito mo Mitsui Banking Corporation, Resona Bank, Chuo-Mitsui Trust Bank, and Sumitomo Trust Bank), Norinchukin Bank, Shinsei Bank, Aozora Bank, Citibank Japan, banks of new type, foreign trust banks and others.
- Note 3: "Cooperative Financial Institutions" include Shinkin Banks including Shinkin Central Bank, Credit Cooperatives including The Shinkumi Federation Bank, Labour Banks including The Rokinren Bank, Prefectural Banking Federations of Agricultural Cooperatives, and Prefectural Banking Federations of Fishery Cooperatives. This does not include Japan Agricultural Cooperatives, etc.
- Note 4: The above figures are based on interviews with individual institutions, etc., and thus can be further revised in the process of examination by each institution.
- Note 5: Subprime-related exposures at some securities firms are included in the figures for "Major Banks, etc." as those figures are on a consolidated basis.

### Exposures of Japanese deposit-taking institutions to securitized products based on the leading practices summarized in the FSF report

																As of the	e end-Sep	otember 2	008 (Figu	ıres in bra	ickets are	as of the	e end-Jui	ne 2008)	(Billi	ion Yen)
		Exposures to subprime-related products										CL	CLOs,CDOs <sup>*</sup>			RMBS*			CMBS			raged ans	Total			
		CDOs			RMBS			Others			Subtota	ıl		Valuation	Realized		Valuation	Realized		Valuation	Realized		Realized		Valuation	Realized
	Book value	Valuation profits/ losses	Realized profits/ losses	Book value	Valuation profits/ losses	Realized profits/ losses	Book value	Valuation profits/ losses	Realized profits/ losses	Book value	Valuation profits/ losses	Realized profits/ losses	Book value	profits/ losses	profits/ losses	Book value	profits/ losses	profits/ losses	Book value	profits/ losses	profits/ losses	Book value	profits/ losses	Book value	profits/ losses	profits/ losses
Major	170	-27	-567	438	-108	-98	112	-4	-62	719	-140	-727	6,140 (6,411)	-886 (- 572)	-431 (- 349)	3,707 (3,888)	-129 (- 89)	-229 (-203)	2,246 (2,323)	-110 (- 76)	-17 (- 9)	5,599 (5,911)	-108 (- 96)	18,412 (19,410)	-1,264 (- 875)	-1,512 (- 1,337)
Banks, etc.	(209)	(-27)	(- 548)		(-112)	(-74)	(163)	(-1)	(- 57)	(876)		(- 679)	5,661 (5,901)	-865 (- 559)	-408 (- 319)	879 (962)	-122 (- 86)	-230 (- 202)	603 (625)	-92 (- 65)	-14 (- 9)	4,245 (4,488)	-87 (- 81)	12,107 (12,851)	-1,219 (- 848)	-1,466 (- 1,289)
Regional	8	-1	-47	0	0	0	38	-2	0	46	-3	-47	263 (320)	-33 (- 30)	-130 (- 87)	932 (971)	-3 (- 4)	21 (17)	417 (432)	-4 (- 3)	7 (6)	15 (15)	0 (0)	1,672 (1,788)	-43 (- 38)	-149 (- 110)
Banks	(10)	(-1)	(-46)	(0)	(0)	(0)	(39)	(- 1)	(0)	(50)		195 (246)	-31 (- 28)	-128 (- 86)	1 (1)	0 (0)	0 (0)	- (-)	- (-)	0 (0)	5 (5)	0 (0)	247 (302)	-34 (- 30)	-175 (- 131)	
Cooperative Financial	3	-1	-30	0	0	0	28	-3	1	31	-4	-29	1,113 (1,205)	-196 (- 114)	-82 (- 73)	807 (830)	-2 (- 2)	6 (4)	210 (213)	-2 (- 2)	4 (3)	26 (26)	1 (1)	2,187 (2,305)	-203 (- 119)	-101 (- 94)
Institutions	(4)	(-1)	(-30)	(0)	(0)	(0)	(28)	(-1)	(- 1)	(32)	(-2)	(-29)	878 (965)	-185 (- 106)	-82 (-73)	0 (-)	0 (-)	0 (0)	0 (-)	0 (-)	0 (-)	11 (12)	0 (0)	920 (1,009)	-188 (- 108)	-111 (- 102)
Total	181	-29	-644	438	-108	-98	178	-9	-61	797	-147	-803	7,515 (7,936)	-1,114 (- 715)	-643 (- 509)	5,447 (5,689)	-134 (- 95)	-202 (- 182)	2,873 (2,968)	-116 (-80)	-7 (- 0)	5,639 (5,953)	-107 (- 95)	22,271 (23,503)	-1,511 (- 1033)	-1,762 (- 1541)
Total	(223)	(-29)	(-625)	(504)	(-112)	(-74)	(230)	(-1)	(-55)	(958)	(-142)		6,733 (7,112)	-1,081 (- 693)	-618 (- 478)	880 (963)	-122 (- 86)	-230 (- 202)	603 (625)	-92 (- 65)	-14 (- 9)	4,261 (4,505)	-86 (- 80)	13,274 (14,161)	-1,441 (- 986)	-1,752 (- 1523)
														- 21.07%			- 5.89%			- 4.60%			.74%		- 13.07%	
(Reference)		- 79.78%			- 35.63%			- 25.02%			- 56.41%			- 21.07% (- 14.14%)		,	- 5.69% (- 4.55%)			(-3.00%)		(- 1.			(- 9.94%)	
Loss Ratio		(- 75.32%	o)		(- 31.25%	)	l '	(- 25.48%	)	(	<u>- 52.10</u> %	b)		- 22	.60%		- 29	9.36%		- 17	7.16%	- 1	1.80%		- 20	.25%

Figures in inner columns represent the underlying assets of which were originated abroad.

XExcluding subprime-related products

- Note 1: The above figures are based on interviews with individual institutions, and thus can be further revised in the process of examination by each institution.
- Note 2: "Depreciation Ratio" is the percentage of sum of valuation profits/losses (as of the end-September), additional provisions and impairment (from April 1, 2007 to September 30, 2008) to the book value as of the beginning of the period.

(-15.02%)

(-22.45%)

(-11.60%)

(-1.60%)

(- 15.34%)

- Note 3: CDOs include the exposures to SIVs.
- Note 4: RMBS does not include GSE MBS.
- Note 5: While the definition of leveraged loans can vary depending on each financial institutions, it generally refers to loans to low-rated companies, including loans made for mergers and aquisitions.
- Note 6: Apart from above figures, losses on CDS transactions with monoline insurers (about 31.7 billion yen) have been reported.

### Distribution of Rating Grades Assigned under the Financial Inspection Rating System

The Financial Services Agency (FSA) published data on the distribution of rating grades assigned under the Financial Inspection Rating System on December 16, 2008.

- 1. The FSA started applying the Financial Inspection Rating System on a trial basis in January 2006 and put it into force in April 2007 (The application to financial institutions other than major banks started in January 2008).
- 2. The purpose of the Financial Inspection Rating System is to assign grades (Note 1) to the results of inspections, thereby motivating financial institutions to make management improvement on a voluntary basis and increasing the efficiency and effectiveness of inspections at the same time.
- 3. In light of this purpose, we believe that it is sufficient that each of the inspected financial institutions are aware of specific rating grades assigned to itself and that it would not be appropriate to publicly disclose the specific rating grades assigned to individual financial institutions because such disclosure could cause reputational risk for them.
- 4. However, in response to requests for the disclosure of the distribution of rating grades assigned under this system, the FSA disclosed twice in the past the distribution of Grades "C" and "D" ("A" is the highest grade and "D" is the lowest) by type of financial institution.
- 5. This time, regarding inspections notified and conducted between April 2007, the first month after the period covered by the previous disclosure (Note 2), and the end of June 2008, which marked the end of Program Year 2007, we disclosed the distribution of Grades "A" and "B" in addition to Grades "C" and "D" (the number of financial institutions covered by this disclosure totaled 314).
- 6. The FSA will continue to accumulate data on the distribution of rating grades assigned under the Financial Inspection System and consider disclosing the data when it has accumulated a certain volume.

(Note 1)

Grade A: A strong management system has been established by the management

Grade B: A sufficient management system has been established by the management

Grade C: The management system is insufficient and needs to be improved.

Grade D: The management system is defective or seriously defective.

(Note 2) The previous disclosure was made on December 11, 2007 (covering the results of inspections conducted during the trial application period of this system, which started in January 2006 and expired at the end of March 2007, when the Financial Inspection Manual was revised).

### 1. Financial institutions subjected to the Financial Inspection Rating System

Under the Financial Inspection Rating System, 314 financial institutions were subject to inspections which started between April 2007 and the end of June 2008 (Note 1). (The number of rated items totaled 2,901.)

(Note 1) Prior notice for these inspections was made between April 2007 and June 2008. (Unannounced inspections were conducted during this period.)

# 2. Distribution of grades by sector (number of rated items/total number of rated items for each sector)

Sector		Grade A	Grade B	Grades C & D
4 institutions in all sector ,901 rated items)	'S	1.6%	72.2%	26.2%
Major banks, etc.	17	2.7%	62.7%	34.5%
Foreign bank branches	24	4.8%	81.0%	14.3%
Regional banks	54	2.5%	68.5%	29.0%
Cooperative-structure Financial institutions	219	1.1%	73.2%	25.7%

(Note 2) The total of the percentage figures for "Grade A", "Grade B" and Grades C & D may not necessarily add up to 100% due to rounding. The same shall apply to "3. Distribution of grades by rated item."

# 3. Distribution of grades by rated item(number of rated items/total number of rated items for each system)

Rated item (Note 3)	Grade A	Grade B	Grades C & D
A total of 2,901 rated items	1.6%	72.2%	26.2%
Business Management (Governance) system	1.0%	80.3%	18.7%
Legal Compliance system	0.3%	50.2%	49.5%

Rated item (Note 3)	Grade A	Grade B	Grades C & D
Customer protection management system	0.3%	64.2%	35.5%
Comprehensive risk management system	1.4%	78.8%	19.8%
Capital Management system	4.0%	86.7%	9.4%
Credit risk management system	1.0%	68.6%	30.3%
Asset assessment management system	0.7%	76.0%	23.3%
Market risk management	2.1%	74.4%	23.5%
Liquidity risk management system	5.1%	92.4%	2.5%
Operational risk management system	_	55.2%	44.8%

(Note 3) Following the revision of the Financial Inspection Manual, the number and composition of rated items was changed. (The number was changed from 9 to 10.)

Cabinet Orders and Cabinet Office Ordinances Concerning the 2008 Amendment of the Financial Instruments and Exchange Act

### 1. Introduction

Following the enactment and promulgation on June 6 and on June 13 of 2008, respectively, of the Act for the Amendment of the Financial Instruments and Exchange Act (hereinafter referred to as the "Amendment Act"), which includes provisions for institutional improvements necessary for strengthening Japan's financial and capital markets, the government decided, at a cabinet meeting on December 2, 2008, the Cabinet Order Concerning the Establishment and Revision of Relevant Cabinet Orders Related to the Enforcement of the Act for the Amendment of the Financial Instruments and Exchange Act and promulgated it on December 5.

It was stipulated that the Amendment Act must enter into force on a date within six months from the date of its promulgation (June 13, 2008) that is prescribed by a relevant Cabinet Order, and December 12, 2008 was determined as the date of its entry into force. (The Cabinet Order that prescribes the date of the entry into force was also decided at the cabinet meeting held on December 2, 2008 and promulgated on December 5.)

Cabinet Office Ordinances and other regulations concerning the Amendment Act also entered into force on December 12, 2008.

It should be noted that the portions of the Amendment Act that concern the reform of the firewall regulations and the establishment of control systems for preventing the conflicts of interest must enter into force within one year from the promulgation of this act (by June 12, 2009).

The key points of the revisions of the Cabinet Orders and Cabinet Office Ordinances that entered into force at this time are as follows:

### 2. Establishment of new markets intended for professional investors

The Amendment Act puts in place an institutional framework for new markets intended for professional investors (specified investors), and instead of imposing the current disclosure rules requiring the availability of information for public view as a prerequisite on issuers which are to be listed on such new markets, it allows such issuers to use simplified procedures for the provision and publication of information.

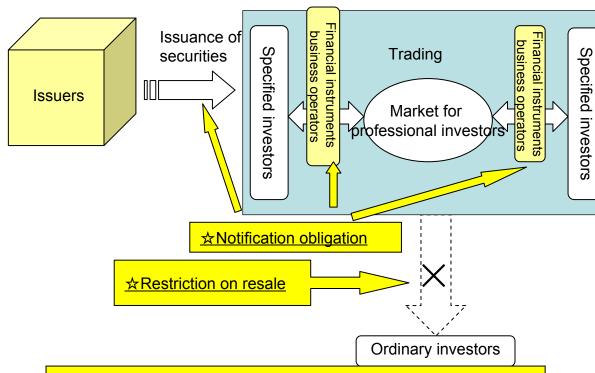
The Cabinet Orders and Cabinet Office Ordinances that entered into force at this time include the following provisions for institutional improvements:

- (i) specifying the details of the obligation for the notification of solicitation activities and transactions related to financial instruments intended for professional investors as well as the details of the restriction on the resale of such financial instruments that is aimed at preventing resale to ordinary investors
- (ii) specifying that the contents of information regarding securities and issuers and the method of information provision should be based on rules set by exchanges.

- (iii) specifying that preliminary investigations regarding the conformance with the criteria for listing or delisting of stocks should be included in the scope of the self-regulatory activities that exchanges may consign to entities other than self-regulatory organizations
- (iv) establishing rules regarding the joint establishment of an exchange by a Japanese exchange and a foreign exchange (the scope of entities that can hold a stake of between 20% and 50% in an exchange that is a subsidiary of a Japanese exchange in terms of voting rights has been expanded to include foreign exchanges)

### Creation of market for professional investors(1)

Key points of cabinet orders, cabinet office ordinances



★ Simplified procedures for information provision, publication

[At the time of issuance]

<u>Provision, publication of information on details of securities/</u> issuers

[After recognition as issues for professional investors]
Provision, publication of information on details of issuers at least once a year

\*Exempted from the current requirement for disclosure for public viewing

→Applicable formats, languages, accounting standards, etc. may be determined flexibly by exchange-set rules.

### **★Notification obligations**

OSpecifying contents of notification

- Absence of disclosure for public viewing
- ·Existence of restriction on resale
- Existence of ban on financial instruments business operators acting as brokers for ordinary investors Etc.

### **☆Restrictions on resale**

OSpecifying the requirement for a contract including restriction on resale to ordinary investors at the time of issuance

Exceptional cases in which resale is allowed

•Transfer to the issuer, owner shareholder, etc.

### ★ Simplified procedures for information provision, publication

Specifying that info rmation on sec urities/issuers should be provided, disclosed according to exchange-set rules

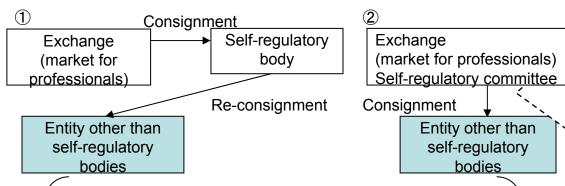
### **★Relaxation of pro forma criteria**

The pro forma criteri a for the re quirement of submission of financial statements was relaxed from 500 or more sharehol ders to 1,000 or more shareholders excluding specified investors.

### Creation of markets for professional investors 2

Key points of cabinet orders, cabinet office ordinances

### Consignment of self-regulatory processes to entity other than self-regulatory body



[Reference] Screening by AIM of U.K. of companies traded on the exchange

- Screening for registration by exchange-designated advisors (Nomads)
- •Registration, trading not all owed without Nomads. Trading to be suspended in the absence of Nomads and registration to be abolished if the absence of Nomads continues for a month

### Self-regulatory processes allowed to be consigned

- •Preliminary check on conformance with listing, delisting standards
- Preliminary check on conformance of the issuer's disclosure with disclosure screening standards Etc.

### Consignment-related measures to be taken by an exchange

- Measures to ensure consignment to a person capable of implementing self-regulatory processes in an appropriate and fair manner
- Measures to ensure independence from the issuer
- Measures to examine implementation of the processes, conduct appropriate supervision and, when necessary, levy a penalty and terminate the consignment

### Joint establishment of an exchange by Japanese and foreign exchanges

large shareholdings in exchanges

Restriction on

	Framework of Financial Instruments and Exchange Act
50%~	Acquisition, ownership not allowed
20%~50%	Acquisition, ownership allowed (requiring authorization) (Eligible persons designated by a cabinet order)
~20%	Acquisition, ownership allowed for anyone

Key points of cabinet orders. cabinet office ordinances

### Additional designation of foreign exchanges meeting certain requirements as eligible shareholders in exchanges

Etc.

Requirements

- The exchange targeted for ac guisition, ownership of voting rights must be subsidiary of a Japanese exchange.
- •The foreign exchange must have a license as an exchange in the country of origin.
- •A memorandum of understand ing (MOU) must exist betw een the authorities of the foreign exchange's country of origin and those of Japan.

### 3. Diversification of exchange-traded funds (ETFs)

From the viewpoint of improving convenience for users, the Amendment Act expands the scope of products exchangeable with ETFs to include assets convertible into cash, in addition to securities, as a measure to diversify ETFs.

The Cabinet Orders and Cabinet Office Ordinances that entered into force at this time have added commodities spots and commodity futures, including gold, to the scope of the products in which ETFs may invest mainly, and added commodities listed on commodity exchanges to the scope of products exchangeable with ETFs.

### Diversification of ETFs (exchange-traded funds)

Investment trust business operators approved for investment in investment trusts investing in physical commodities and commodity Financial instruments futures are exempted from restrictions regarding business operator commodity investment advisory business. (legal amendment, June 2008) Investment instructions Specified assets **ETF** Investment Commodity Purchase of ETF Scope of products exchangeable with ETFs expanded to include assets convertible into cash. in addition to securities (legal amendment, June 2008) Investor

Key points of cabinet orders, cabinet office ordinances

# Cooperation with relevant administrative agencies

Hearings to be held with the Minister of Agriculture, Forestry and Fisheries and the Minister of Economy, Trade and Industry when approval is granted for investment by investment trusts and when an administrative action is taken, etc.

### Expansion of scope of specified assets

Addition of physical commodities, commodity futures including gold as major investment targets of investment trusts

### **Expansion of scope of products** exchangeable with ETFs

Addition of commodities traded on commodity exchanges

### 4. Expansion of scope of businesses permitted to Banking and Insurance Groups

From the viewpoint of further promoting corporate rehabilitation (regional rehabilitation), the Amendment Act has expanded the scope of exemptions to the restriction on the ownership of shareholder voting rights by banking and insurance groups (the scope of exemption, which was previously limited to venture businesses, has been expanded to include companies engaging in business rehabilitation efforts) and removed the ban that prohibits banks and insurance companies from directly engaging in the investment advisory business and conducting emissions trading.

The Cabinet Orders and Cabinet Office Ordinances that entered into force at this time provide for the following measures:

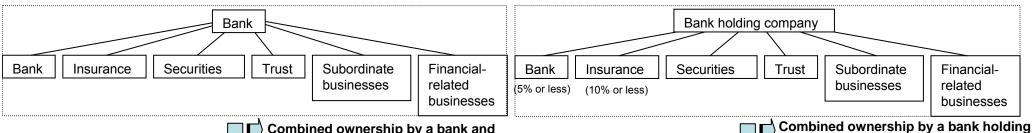
- (1) Specifying the scope of companies exempted from the restriction on the ownership of shareholder voting rights by banking and insurance groups
  - (i) Companies that have received approval for the management reform plan under the Law concerning to the Promotion of New Business Activities by Small and Medium Enterprises are specified as companies engaging in business rehabilitation efforts.
- (ii) The upper limit on the corporate age of venture businesses exempted from the restriction has been raised from less than five years from their establishment to less than 10 years.
- (2) Allowing subsidiaries and sister companies of banks and insurance companies to engage in the Islamic finance business, which should be deemed to be effectively equivalent to the provision of credit
- (3) Allowing banks and insurance companies to directly conduct emissions trading.

### Expansion of scope of business Permitted to banking and insurance groups ①

### Expansion of scope of exemptions from restriction on banking groups' ownership of voting rights

Before amendment

Restriction was imposed on ownership of voting rights of ordinary business corporations from the viewpoint of prohibiting engagement in other businesses and preventing violation of restrictions on the scope of business for subsidiaries. However, ownership of voting rights of a venture business company by a bank through a specialist investment subsidiary was exempted from this restriction (ownership was limited to 10 years or less).



Combined ownership by a bank and subsidiaries of more than 5% of voting rights banned in principle

Combined ownership by a bank holding company and subsidiaries of more than 15% of voting rights banned in principle

Japanese companies

(Companies other than those that may become bank subsidiaries)

Japanese companies

(Companies other than those that may become bank subsidiaries)

After amendment

Scope of companies exempted from the ristriction on the ownership of the voting rights by banks expanded to include companies engaging in business rehabilitation efforts, in addition to venture business companies.

A banking group will be able to make increa sed contributions to business rehabilitation as well as business start-up through a comprehensive range of corporate financing instruments, including equity as well as debts.

- O Unlisted companies meeting the following criteria are specified as companies engaging in business rehabilitation efforts.
- 1. A company that has received approval for the "management reform plan" under the Law concerning to Promotion of New Business Activities by Small and Medium Enterprises
- 2. A company that has received approval for the "business restructuring plan" under the Law on Special Measures for Industrial Revitalization
- 3. A company that has received approval for the "revival plan" or the "rehabilitation plan" under the Civil Rehabilitation Law or the Corporate Rehabilitation Law.
- 4. A company implementing a reasonable management improvement plan including any of loan forgiveness, a debt-for-equity swap, a debt-for-debt swap (a switch to a subordinated loan) by banks.
- O In addition, the upper limit on the corporate age of venture businesses exempted from the voting rights ownership restriction on banks has been raised from less than five years from the establishment to less than 10 years.
- ※ Similar measures have been introduced for insurance companies.

Key points of cabinet office ordinances

### Expansion of scope of business Permitted to banking and insurance groups 2

### Lifting of ban on Islamic finance

Under Shariah (Islamic law), riba (interest) is banned.

- → In place of loans, Murabaha (a type of transaction)\*1 and ljarah (a type of leasing)\*2 have been developed.
- \*1 A bank pu rchases equipment needed by a company and then sells it back to the company. An amount corresponding to interest is added to the purchase price, which is to be paid later.
- \*2 A bank purchases equipment nee ded by a company and levies an amount corresponding to the price and interest as a fee for its use.

Inflated by high oil prices

Payment for oil

Inflow of funds

Islamic World

Recycling of oil money=Islamic finance

Oil money

Scale: Approx. \$700 billi on per year =

approx. ¥78.4 trillion

(Estimate by Islamic Development Bank)

Key points of cabinet office ordinances

Islamic finance, which is deemed to be effectively equiralent to the provision of credit, was added to the scope of business allowed for subsidiaries and sister companies of banks and insurance companies.

### Lifting of ban on emissions trading

**UN Framework Convention on Climate Change** (UNFCCC)

Adopted in June 1992, put into effect in 1994

Kyoto Protocol

Adopted in December 1997, put into effect in February 2005

- O Set binding reduction targets for greenhouse gas emissions for developed countries (39 countries, including EU)
- The countries must reduce their overall emissions of greenhouse gases between 2008 and 2012 by the prescribed percentages. Japan must reduce its emissions by 6%.
- O Laws the use of "Kyoto Mechanism" for achievement of the targets

### **Kyoto Mechanism**

### 1. Joint implementation (JI)

Developed countries join tly implement a project for reduction of greenhouse gas emis sions, and the emissions credits (ERU\*1)in the host country (developed country where the JI project is implemented) is to be transferred to the investing country (developed country).

\*1 Emission Reduction Unit

### 2. Clean development mechanism (CDM)

A de veloping country implements a project for reduction of g reenhouse gas emissions with financial and technical support from a developed country, and the emissions credits (CER\*2) in the host country (developing country) is to be divided between the host country and the investing country (developed country).

※2 Certified Emission Reduction

3. Emissions trading allows developed countries to trade emissions credits (AAU\*3, ERU, CER) between them. \*3 Assigned Amount Unit (emission allowances assigned to individual countries based on the Kyoto Protocol)

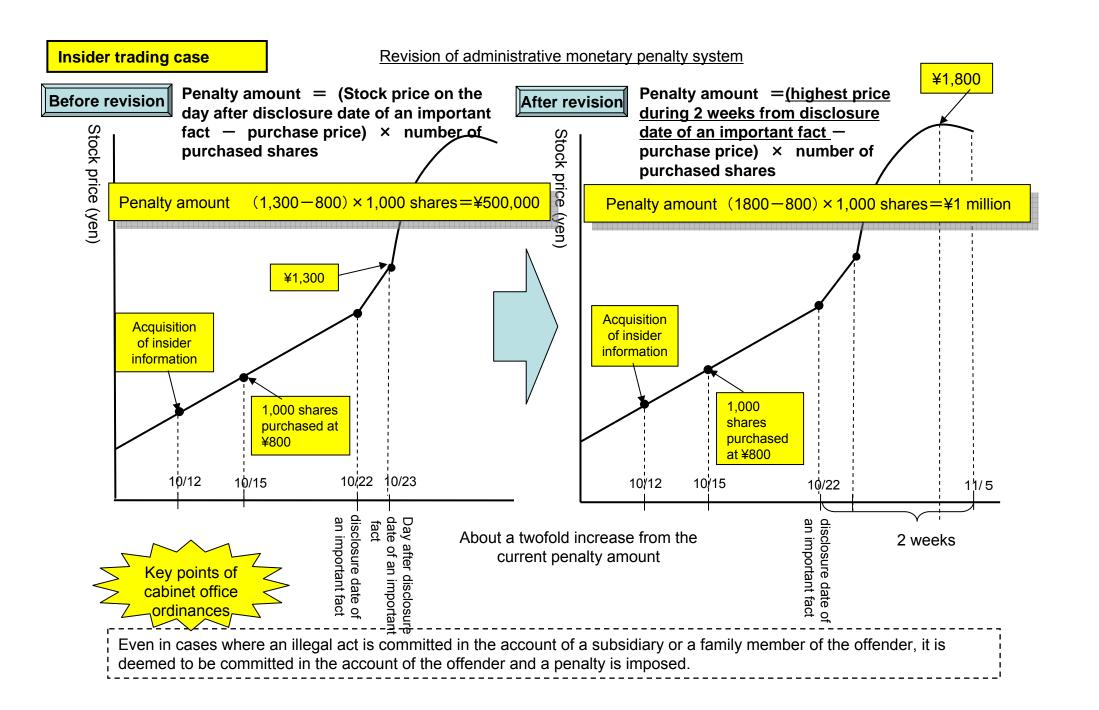
> Key points of cabinet office ordinances

Banks and insurance companies are allowed to directly conduct emissions trading, in addition to doing so through a subsidiary or a sister company.

### 5. Revision of administrative monetary penalty system

The Amendment Act has raised the amount of the administrative monetary penalties and expanded the scope of entities subject to the administrative monetary penalty system.

Regarding the provision that imposes the penalties in cases where an illegal act has been committed in the account of "persons with close relations or special relations with the offender" by regarding the act as having been committed in the offender's own account, the Cabinet Orders and Cabinet Office Ordinances that entered into force at this time have specified subsidiaries and family members as the "persons with close relations or special relations with the offender."



### 6. Other major revisions

Other major revisions include:

- (i) the establishment of the standards for the exemption of some transactions related to the dissolution of a subsidiary by a listed company (those related to the dissolution of a subsidiary that involves a decrease of less than 30% in the net asset amount and a decrease of less than 10% in sales) from the insider trading rule due to their negligible impact;
- (ii) the addition of a provision for the disclosure of evidence prior to the first sanction hearing as part of the revision of procedures for the sanction hearing regarding the imposition of administrative monetary penalties;
- (iii) relaxation of the obligation for issuers to provide documents; and
- (iv) expansion of the scope of transactions eligible for the exemption allowed for order placements by related foreign investment companies.

Key points of cabinet orders, cabinet office ordinances

# O Revision of criteria for negligible impact regarding insider trading regulation

•Introduction of criteria for negligible impact related to the dissolution of a subsidiary (the dissolution of a subsidiary involving a decrease of less than 30% in the net asset amount and a decrease of less than 10% in sales)

## O Revision of sanction hearing procedures regarding administrative monetary penalty

•Addition of a provision for the disclosure of evidence prior to the first sanction hearing (enabling the disclosure of documents used as evidence of an illegal act before the first sanction hearing)

## O Revision of registration notification procedures regarding EDINET

•Introduction of obligation for the submission of certificate of registered items every three years in order to keep track of information on persons submitting disclosure documents through EDINET

### Other major revisions

## O Revision of scope of trust beneficiary rights subject to disclosure requirement

•Exempting beneficiary rights for trusts based on the Workers Property Accumulation Promotion Act (property accumulation benefit trusts and property accumulation fund trusts) from the disclosure requirement.

### O Relaxation of obligation for provision of documents

- •Abolishing the requirement for the provision of pre-contract documents to issuers, owners, because sufficient prior consultations are held in the case of underwriting, offering, secondary sales and private placement.
- •Abolishing the requirement for the provision of pre-contract documents, at-contract documents to tender offer bidders because strict procedures are specified regarding tender offers.

# O Expansion of scope of exemptions allowed for order placements by related foreign investment management firms

•Until now, order placements to exchanges by domestic investment management firms on commission from related foreign investment management firms (foreign parent companies or subsidiaries) have been exempted from regulations on Type I Financial Instruments Business. The amendment expands the scope of exemptions to include order placements for off-exchange transactions with securities companies, over-the-counter derivatives transactions and transactions on foreign exchanges.

## O Relaxation of notification obligation on foreign investment trusts companies, foreign investment corporations

•Abolishing obligation on foreign investment trusts companies, etc. to make notification regarding trading of foreign investment trusts, etc. (including those not linked to stock price indexes) in foreign markets by specified institutional investors.

### Implementation of administrative monetary penalty system in relation to reporting of large shareholding

Following the amendment of the Financial Instruments and Exchange Act (hereinafter referred to as the FIEA), persons who fail to submit a large shareholding report and/or who make a false statement in the report have been subject to the administrative monetary penalty since December 12, 2008.

Cases subject to the penalty are:

(Case 1) Failure to submit a large shareholding report or a report on a change in a large shareholding. (Article 172-7, the amended FIEA)

(Case 2) Submitting (1) a large shareholding report, (2) a report on a change in a large shareholding, or (3) an amendment report of (1) or (2) that contains any false statement on important matters and/or lacks a statement on important matters that should be stated. (Article 172-8, the amended FIEA)

The amount of administrative monetary penalty is to be 1/100,000 of the market capitalization of the issuer of the stock that is subject to the requirement for the reporting of a large shareholding.

In Case 1 above, if the person who has failed to submit the required report notifies the Securities and Exchange Surveillance Commission (SESC) of the failure prior to either of (1) the issuance of an administrative order for the submission of a report or (2) the commencement of an inspection, he/she may be eligible for the halving of the administrative monetary penalty under a new rule for the reduction of the penalty. (Article185-7, Paragraph 12 of the amended FIEA)

\* Click <u>here</u> for a link to the format and the reporting procedures regarding the penalty reduction rule (the web site of the Securities and Exchange Surveillance Committee).

There is also a new rule under which a repeat offender may face an additional administrative monetary penalty. (Article 185-7, Paragraph 13 of the amended FIEA)

The following are examples of failure to meet the requirement for the submission of a report regarding a large shareholding.

(Example 1) A person who had acquired more than 5% of the total number of a listed company's outstanding shares failed to submit a large shareholding report by the due date and submitted it after the due date.

(Example 2) A person who had submitted a large shareholding report purchased an additional 1% or more of the total number of outstanding shares but failed to submit a report on the change in the large shareholding by the due date and submitted it after the due date.

(Example 3) A person who had submitted a large shareholding report failed to submit a report on a change in the large shareholding by the due date when the number of joint holders increased, leading to a rise of 1% or more in the share ownership ratio, and submitted the change report after the due date.

### Revision of Comprehensive Guidelines for Supervision of Financial Instruments Business Operators

The FSA invited opinions from the public regarding the revision of the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators (draft) from September 19 to October 20, 2008, following the amendment of the Financial Instruments and Exchange Act (which entered into force on December 12, 2008). On December 2, it published the results of the public comment procedure and revised the guidelines. The revised guidelines have been applicable since December 12.

The key points of the revision are as follows:

### 1. Treatment of securities intended for specified investors

- (1) In light of the introduction of the restriction on the sales and purchases of securities intended for specified investors (professional investors) under Article 40-4 of the Financial Instruments and Exchange Act, the establishment of procedures and systems for the prevention of sales and purchases of such securities by ordinary investors in cases where a financial instruments business operator handles such securities has been added as a point of attention when supervisors consider whether to authorize the business operator to engage in the PTS (proprietary trading system) business.
- (2) In light of the introduction of the obligation for notification regarding securities intended for specified investors under Article 40-5 of the Financial Instruments and Exchange Act, whether a financial institution identifies the actual state of notifications it must make when it handles such securities, and whether it implements corrective measures when necessary have been added as supervisory viewpoints regarding financial instruments business operators' systems for solicitation and explanations.

### 2. Instructions for representation of investment reports regarding investment trust assets

Following the addition of rights related to physical commodities and commodity futures transactions to the category of "specified assets" that are major investment vehicles for investment trusts under Article 3(ix) and (x) of the Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations, specific instructions for the representation of investment reports concerning investment trusts investing in such rights were added to the guidelines for supervision.

### What is a PTS (proprietary trading system)?

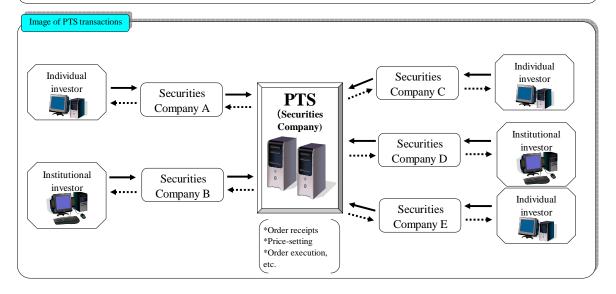
#### Background to introduction of PTS

The PTS was introduced in line with the abolition of the requirement for placing orders regarding trading of securities to exchanges under the so-called Financial System Reform Act which came into enforce in December 1998.

#### Definition of PTS

The PTS is a system for purchases and sales of securities that are made through a computer network with the simultaneous participation of a number of investors and with the use of a prescribed price-setting method.

⇒The PTS provides a place for trading of a certain volume and range of securities by a group of investors with the use of electronic technology.



### [Minister in his own words]

This section provides information regarding the hot topics of the moment, selected from questions and answers given at the Minister's press conferences, etc. If you wish to find out more, we invite you to visit the "Press Conferences" section of the FSA website.

### (Opening Remarks by Minister Nakagawa)

Regarding the financial situation, following today's enactment of the revised Act on Special Measures for Strengthening Financial Functions, we would like to put the new act into force as soon as possible. We plan to put it into force next week, although the deadline for the enforcement is two months from the enactment according to the text of the act. Furthermore, the quota for funds for capital injection will be raised by 10 trillion yen from the current 2 trillion yen in the fiscal 2008 budget to 12 trillion yen. In addition, although we have already initiated crisis management measures to facilitate fund-raising, we have concluded that the purchase of CP will be necessary, so, as the Prime Minister explained earlier, we intend to allocate 3 trillion yen for the purchase of CP in the second supplementary budget and another 3 trillion yen in the initial budget for fiscal 2009, compared with the 66 billion yen or so currently allocated for that purpose. Also, we have started procedures for the purchase of CP as a measure to secure liquidity toward the end of the year. We hope that the designated financial institutions will take appropriate action in this respect. We also hope that the Bank of Japan will take additional measures to secure sufficient liquidity amid the severe year-end fund-raising situation for companies. Next, regarding measures to facilitate fund-raising at the end of the calendar and fiscal years, as the Prime Minister said earlier, 4 trillion of the 6trillion-ven guota for credit guarantee still remains unused, so I strongly hope that these funds will be used. During the few hours when I attended today's plenary Diet session, some lawmakers came to me and talked about a credit crunch for SMEs in their constituencies. I will instruct the Financial Services Agency to invite financial industry representatives for something like a briefing session — I would like to attend the session if possible — as soon as possible to remind them of the importance of the credit guarantee scheme and of the need to provide loans properly. Also, I intend to convene a meeting with the Directors-General of Local Finance Bureaus next Monday and give them an instruction regarding measures based on the revised Act on Special Measures for Strengthening Financial Functions and year-end support measures.

[Extract from the press conference on December 12, 2008]

Meanwhile, the revised Act on Special Measures for Strengthening Financial Functions is promulgated today and will be put into force tomorrow. This act was enacted last Friday, and it was specified that the act had to be put into force within two months. However, as we implemented the necessary procedures without any delay and at an extraordinary speed, we have managed to put it into force so that the capital injection scheme can be utilized starting in mid-December. Yesterday, we took steps to ensure that the purpose of this act is fully communicated to all relevant parties across the country. According to media reports, I understand that there are some financial institutions that are eager to utilize this scheme. As the approval of capital injection into a financial institution made as a result of screening is a proof of the institution's soundness, I hope that this will be actively used so that small and medium-size enterprises (SMEs) across the country can receive necessary funds.

[Extract from the press conference on December 16, 2008]

Q: I would like to ask you about the Act on Special Measures for Strengthening Financial Functions. I hear that you plan to meet with financial industry representatives tomorrow and explain the purpose of this act directly to them. I suppose that among financial institutions, there is still a strong reluctance to receive public funds under the capital injection scheme. Could you tell me how you intend to encourage financial institutions to use this scheme so as to make effective use of the 12 trillion yen allocated for it?

A. As I said earlier, financial institutions in some regions are hoping to use this in order to provide funds to their regions, according a media report I read yesterday. While there may be some such financial institutions in some regions, a media report today said that a financial institution in Hokkaido has denied a need for capital injection. Although there may be various speculations, this scheme is intended not to support financial institutions but to ensure that they properly exercise their functions for the benefit of SMEs and local economies. So, if financial institutions that are sound enough to qualify for capital injection refuse to receive public funds, I suppose they could even be criticized. Regardless of how strongly we may urge them to do so, financial institutions that avoid applying for capital injection from the government may invite doubt about their soundness — it may be too much to say this — as capital injection will not be approved for troubled financial institutions this time, although applying for capital injection only to be rejected would also be problematic. Borrowers are complaining about the severe situation across the country while financial institutions are speaking of their own pains. In such a situation, financial institutions have a social responsibility to strengthen their capital bases and meet the fund needs of SMEs in their regions in the year-end period.

On Sunday, I talked with various SME managers in my constituency and they still have complaints about the financing situation. At a committee meeting yesterday, such complaints were also discussed. As there are still complaints about credit guarantee associations and financial institutions, I hope that by using the capital injection scheme, financial institutions will provide funds to companies that need them and that both borrower companies and financial institutions will contribute to successful business, which they need to achieve before performing social responsibility.

### [Information]

The FSA has started an E-mail Information Service. If you register your e-mail address on the Subscribe Page of the FSA website, we will notify you by e-mail once on each day when new information is posted on our website. For details, please access <u>Subscribing to E-mail Information Service</u> of the FSA website.