

**2014 Amendment of  
Financial Instruments and Exchange Act, etc.  
(Act No.44 of 2014)**

[Briefing Materials]

May 2014  
Financial Services Agency, Japan

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# **I . Outline of 2014 Amendment of Financial Instruments and Exchange Act, etc.**

# Outline of 2014 Amendment of the Financial Instruments and Exchange Act, etc.

Promulgated on  
May 23, 2014

Establish “measures to enhance the overall attractiveness of Japan’s financial and capital markets,” particularly measures to turn household financial assets into investment for growth



Accelerate and reinforce the growth strategy from the financial side

Revitalization of markets  
(Promoting the provision of risk money to emerging and growing companies, etc.)

## Promoting the Use of Equity Crowdfunding (see Note)

- ◆ Relax entry requirements of Financial Instruments Business Operators which handle equity crowdfunding under a certain amount (the total amount offered is less than 100 million yen and the amount of investment per investor is 500,000 yen or less)
- ◆ Introduce new regulations to prevent fraudulent solicitation of investment via the Internet, etc.

Note: A scheme in which emerging and growing companies and investors are connected via the Internet so that funds are collected from a large number of fund providers who each contribute a small amount.

## New Trading System for Non-listed Shares

- ◆ Unlike the current Green Sheet system (see Note), apply the same rules as ordinary non-listed shares to the new trading system which would be established to meet needs for trading and cashing of non-listed shares, as distribution would be restricted to a limited investment group.

Note: The current system for trading of non-listed shares. Regulations similar to those for listed shares apply.

## Amendments to Rules on the Business Years of Financial Instruments Business Operators

- ◆ Financial Instruments Business Operators would be allowed to choose their own business years, which currently have to be from April 1 to March 31.

Note: This measure would ease the burden on foreign financial institutions, etc. with different business years and should encourage them to enter the Japanese market.

Revitalization of markets  
(Promoting new listings and facilitating financing by listed companies)

## Reduction of the Burden Following New Listings

- ◆ For a limited period after listing, companies would be able to choose whether or not to have their internal control report audited by a Certified Public Accountant.

Note: Newly-listed companies that are deemed to exert a strong influence over the market or over society and the economy would not be subject to the exemption.

## Facilitation of Financing by Listed Companies, etc.

- ◆ When acquiring or disposing of treasury stock, listed companies would not need to submit a “Large Shareholding Report” (treasury stock would be exempted from large shareholding report rules).
- ◆ Reformation of the compensation liabilities of listed companies to secondary-market investors in connection with false disclosures (strict liability would be changed to fault liability)

Note: For investor protection, the listed company is liable unless the company itself proves that it was not at fault.

Ensuring reliability in markets

## Amendments to Regulations Concerning Sale of Partnership Rights

- ◆ Prohibit Type II Financial Instruments Business Operators from soliciting investment in a partnership right while knowing that the money invested in the partnership is used for other purposes.
- ◆ Obligate Type II Financial Instruments Business Operators to establish a domestic office, etc.

## Introduction of Regulation of Financial Benchmarks

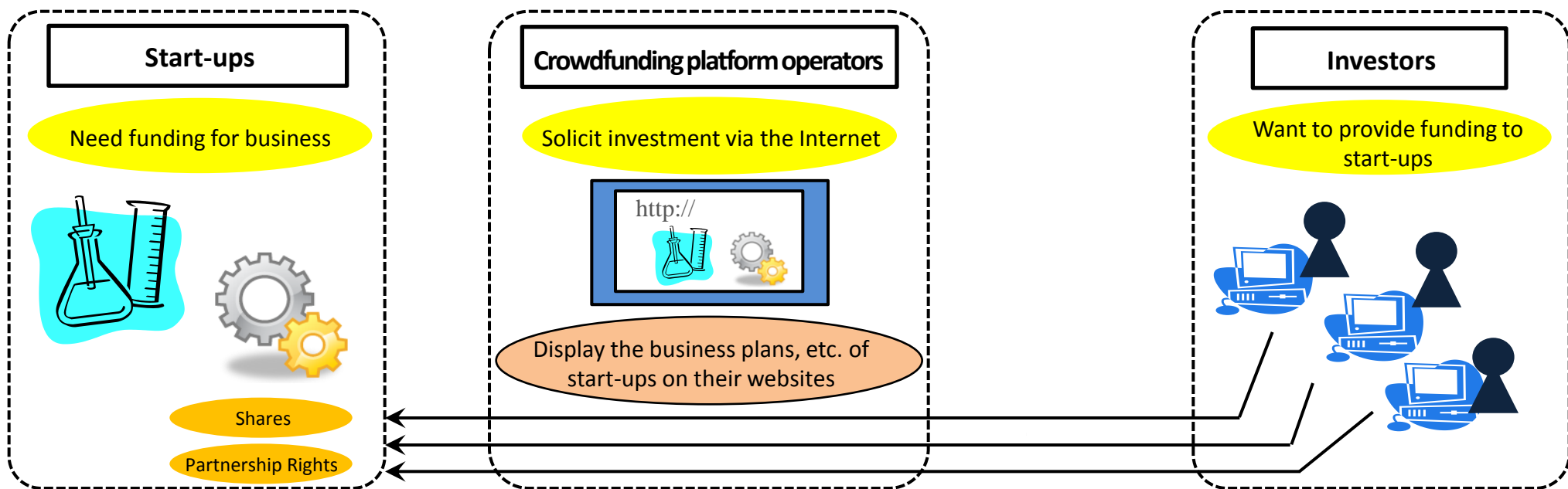
- ◆ Introduction of regulation on administrators of specified financial benchmarks.

## Establishment of Procedures for Confiscating Electronic Share Certificates, etc.

- ◆ Regarding procedures for the confiscation of assets acquired through fraudulent transactions, etc. a procedural provision would be introduced to allow for the confiscation of electronic share certificates and other intangible property.

**II. Revitalization of markets  
(Promoting the provision of risk money  
to emerging and growing companies, etc.)**

# Promoting the Use of Equity Crowdfunding



## (Current Regulations)

- Registration as a Financial Instruments Business Operator is required to solicit investment in securities.  
(Solicitation of investment in shares: Type I Financial Instruments Business Operators, restrictions on the conduct of other businesses, minimum capital of 50 million yen)  
(Solicitation of investment in partnership rights: Type II Financial Instruments Business Operators, no restrictions on the conduct of other businesses, minimum capital of 10 million yen)
- Solicitation of investment in non-listed shares is, in principle, prohibited under the self-regulatory rules of the Japan Securities Dealers Association.

## (Revised Regulations)

Relaxation of entry requirements, etc.

- Restrictions on the conduct of other businesses would not be imposed on crowdfunding-platform operators that handle only small amounts (see Note 1) and the minimum capital required for registration would be reduced (see Note 2)
- Solicitation of investment in non-listed shares would be permitted only through crowdfunding of small amounts (see Note 1) (self-regulatory rules)

Establishment of rules to protect investors

- To prevent fraudulent behavior, crowdfunding platform operators would be obligated to conduct checks on the businesses of the start-ups and to provide information of issuers, etc. appropriately through the Internet.

Note 1: The total amount offered is less than 100 million yen and the amount of investment per person is 500,000 yen or less

Note 2: Type I Financial Instruments Business Operators: 50 million yen (current) → 10 million yen, Type II Financial Instruments Business Operators: 10 million yen (current) → 5 million yen

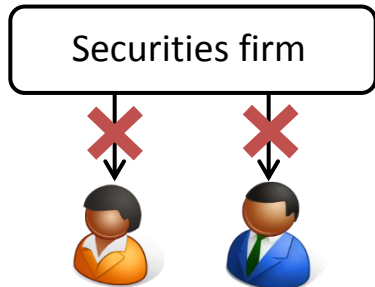
# New Trading System for Non-Listed Shares

Needs for trading and cashing of shares in non-listed companies (locally-rooted companies, emerging companies, etc.)

## Current system

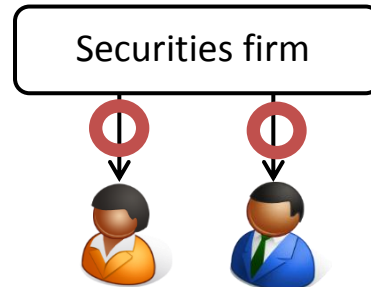
(Based on Japan Securities Dealers Association's self-regulatory rules)

(Ordinary non-listed shares)



- **Solicitation of investment prohibited in principle**
- Given that non-listed shares are illiquid, they are **exempt from**:
  - Insider trading regulations
  - Disclosure obligations

(Green Sheet shares)

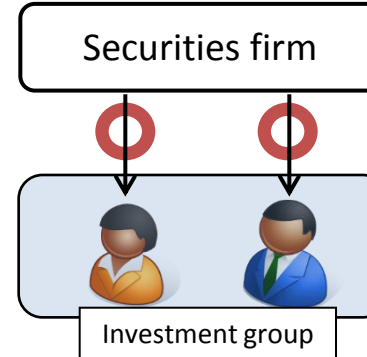


- **Solicitation of investment permitted**
  - Given that Green Sheet shares are highly liquid, they are **subject to**:
    - Insider trading regulations
    - Disclosure obligations (self-regulatory rules)
- ⇒ **A major burden for non-listed companies**

The Green Sheet system is barely used.

## New system

(Based on Japan Securities Dealers Association's self-regulatory rules)



The securities firm puts together an “investment group”.

Envisaged members of the investment group:

- ✓ Directors and employees of the company
- ✓ Stockholders and business partners of the company
- ✓ Customers of the company, etc.

- **Solicitation of investment would be permitted only to the members of the investment group.**
  - Given that the shares covered by the new system would not be highly liquid, regulations would be similar to those for ordinary non-listed shares:
    - **Exempt** from insider trading regulations
    - Reduced burden of disclosure (self-regulatory rules)
- ⇒ **The burden on non-listed companies would be significantly reduced.**

The new system is expected to meet needs for trading and cashing of non-listed shares.

# Amendments to Rules on the Business Years of Financial Instruments Business Operators

## Background

- At present, because securities firms need to be subject to “unified supervision,” their business years are determined by law (they must end in March).
- This means, for example, that foreign securities firms whose business years end in December and who establish a local Japanese unit or branch therefore must prepare financial statements and other documents for the Japanese authority separately from those prepared for their company, which imposes a considerable administrative burden.
- Meanwhile, with developments such as the introduction of quarterly financial reporting, there is less of a supervisory need to have a fixed, legally-determined business year.

## Current and revision rules on business years

(Current)		(Revision)
Type I Financial Instruments Business Operators	Restricted (Must end in March (from April to the following March))	Unrestricted
Type II Financial Instruments Business Operators	Unrestricted	
Investment managers		
Investment advisors and agents		



**III. Revitalization of markets  
(Promoting new listings and  
facilitating financing by listed companies)**

# Reduction of the Burden Following New Listings

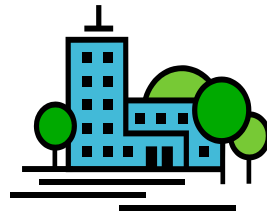
- The obligation to file an internal control report audited by a Certified Public Accountant has been cited as a factor deterring companies from listing.
- In addition, newly-listed companies are subject to a strict examination by the Financial Instrument Exchanges prior to listing.

(Before listing)

(After listing)



Listing examination  
(Confirmation of internal control structure, etc.)



Newly-listed company



(Prepared after the end of the fiscal year)



(Revision)

Companies would be able to choose whether or not to have their internal control report audited by a CPA for three years after listing\*.

\* However, newly-listed-companies that are deemed to exert a strong influence over the market or over society or over the economy (such as those with capital amounts of 10 million yen or more, or total liabilities of 100 billion yen or more) would not be subject to the exemption.

# Amendments to Treatment of Treasury Stock under Large Shareholding Report Rules

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## (Current)

- Large shareholders of listed companies must
  - submit a large shareholding report within five business days from the date on which their “Holding Ratio of Share Certificates, etc.” exceeds 5% (Large Shareholding Report Rules).

- The purpose of this rule is to disclose information concerning large shareholding, as this is important information for investors.
- However, because treasury stock does not carry a voting right, the necessity of submitting a large shareholding report for treasury stock is limited compared with normal shares.

## (Revision)

- Treasury stock would be exempted from application of large shareholding report rules.

# Compensation Liability of Company Disclosing a False Statement in the Secondary Market

- Liability when a company submits documents containing false statements

	Primary market	Secondary market
Liability	Strict liability	<b><u>Strict liability → fault liability (Revision)</u></b> (However, the burden of proof of no fault would be on the submitting companies)

⇒ **Strict liability for submitting companies in the secondary market would be reformed to fault liability** for the following reasons:

- ✓ Culpability is generally required for compensation liability.
- ✓ In the primary market, the submitting company receives capital from investors, therefore it would be fair for the company to return the capital to investors even if it was not at fault. In the secondary market, however, the submitting company does not benefit, so ultimately other shareholders, etc. bear the burden of returning capital.
- ✓ In recent years, other systems for preventing unlawful conduct have been improved. For example, the administrative monetary penalty system has been developed and a system of “Internal Control Report” has been introduced.

⇒ In addition, parties who are able to claim damages would be amended as follows:

**(Current) acquirers → (Revision) acquirers and disposers** (similar to the systems used in other major countries)

Note: This is because not only acquirers, but also disposers, can suffer losses from false statements.

## **IV. Ensuring reliability of markets**

# Amendments to Regulations Concerning Sale of Partnership Rights

Given the occurrence of problematic incidents by vendors of partnership rights, regulations on Type II Financial Instruments Business Operators (FIBOs) engaged in the sale of partnership rights would be strengthened as follows in order to ensure reliability of the market.

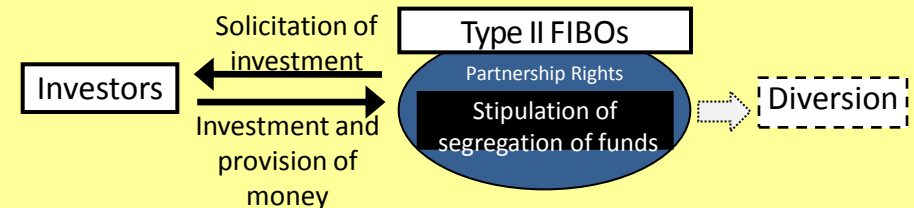
## Amendments to rules concerning the segregation of funds

- It is prohibited for Type II FIBOs to solicit investment in partnership rights if the partnership agreements do not stipulate segregation of funds.

However, there have been cases where even though segregation of funds was stipulated, funds were not actually segregated and were used for other purposes.

### (Proposed Amendment)

- In addition, Type II FIBOs would be newly prohibited from soliciting investment in partnership rights while knowing that the money invested in the partnership is used for other purposes.



## Obligation to establish a domestic office, etc.

- If the Type II FIBO does not have a domestic office, it is very difficult to assess damages when an incident of wrongdoing involving overseas transactions occurs.

### (Proposed Amendment)

- Like securities firms, Type II FIBOs, who conduct sale of partnership rights, would be obligated to establish a domestic office and to have a domestic representative.

\* The same obligation would apply to investment managers.

## Encouragement to join a self-regulatory organization (SRO)

- Self-regulatory rules do not apply to Type II FIBOs that are not members of a SRO.

### (Proposed Amendment)

- Type II FIBOs that are not members of a SRO would be encouraged to join one as they would be obligated to establish internal rules based on the relevant SRO's rules and a structure for ensuring compliance with these internal rules.
- The above obligation would be included in the criteria for refusing registration, ensuring application of internal rules from the time of registration.

\* The same obligation would apply to securities firms and investment managers.

# Introduction of Regulation of Financial Benchmarks

## Regulation on Designated Financial Benchmark Administrators

### Purpose of Regulation

Ensuring credibility of Specified Financial Benchmarks that are widely used as the basis of financial transactions

### Outline of Regulation

#### [Regulatory Framework]

Designate Administrators\* of Specified Financial Benchmarks (tentatively assumed to be an administrator of TIBOR (Tokyo Interbank Offered Rate))

\* Exempt Foreign Administrators of Specified Financial Benchmarks from Japanese regulation if they are adequately supervised by home-country regulators.

#### [Formulation and Compliance with Operational Rules]

Require Designated Financial Benchmark Administrators to formulate and comply with "Operational Rules," containing items in line with requirements of IOSCO Principles for Financial Benchmarks.

#### [Inspection/Supervision Framework]

Establish a framework for inspection/supervision, such as requiring production of reports and conducting on-site inspection.

Consistency

## IOSCO Principles for Financial Benchmarks

### 1. Governance of Administrators

- Primary responsibility for all aspects of the benchmark determination process
- Identify, disclose, manage and avoid conflicts of interest

### 2. Quality of Benchmarks

- Establish and publish the hierarchy of data inputs and guidelines on expert judgment

### 3. Quality of Benchmark Methodology

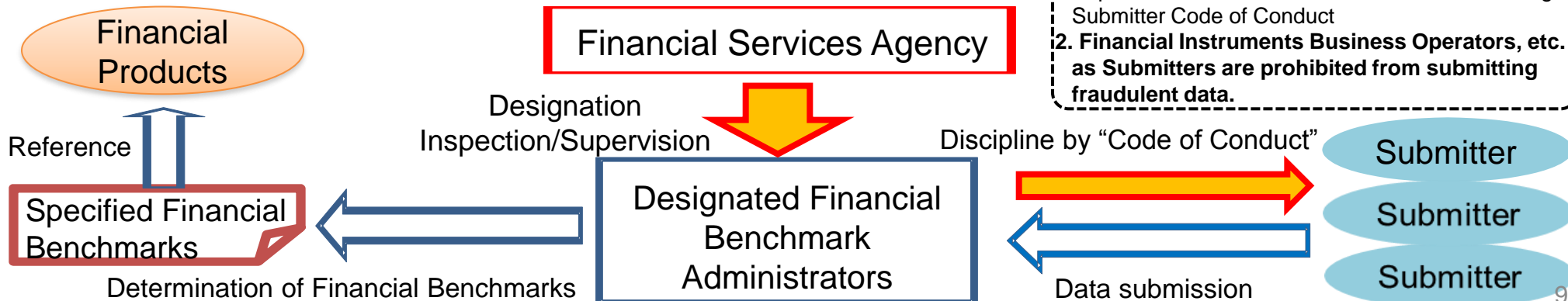
- Document and publish methodology
- Develop and publish Submitter Code of Conduct

### 4. Accountability of Administrators

- Appoint independent internal/external auditors
- Retain documents and make them available to regulatory authorities

## Discipline on Submitters

1. Indirectly impose discipline on Submitters through Designated Financial Benchmark Administrators by requiring them to conclude "Submitter Code of Conduct" with Submitters.  
\* Operational Rules shall include items concerning Submitter Code of Conduct
2. Financial Instruments Business Operators, etc. as Submitters are prohibited from submitting fraudulent data.



# Establishment of Procedures for Confiscating Electronic Share Certificates, etc.

(Current)

Under the Financial Instruments and Exchange Act, the following assets, etc. obtained by a criminal engaged in the following criminal conduct shall be confiscated:

Criminal conduct covered: unfair transactions (insider trading, etc.), compensation of loss

Assets covered: tangible objects, **intangible property (monetary claims, etc.)**

- Tangible objects can be confiscated under the Code of Criminal Procedure.
- However, **intangible property cannot be confiscated as there are no procedural provisions concerning confiscation.**
  - With the passage of the Act on Book-Entry Transfer of Corporate Bonds, Shares, etc. (passed in 2004), the issues increased, as share certificates, etc., which could traditionally be confiscated as tangible objects, were made electronic (i.e. made intangible property).

Furthermore ...

The Tokyo District Court (on November 22, 2013) pointed out the problem that “electronic share certificates acquired by a criminal through insider trading cannot be confiscated, so even if their monetary value at the time of the acquisition is collected, criminals can still benefit from increases in the prices of the shares they hold.”

**(Revision)**

**Will include procedural provisions concerning the confiscation of intangible property, such as electronic share certificates**



## **V. Other Amendments**

# Other Amendments

- **Amendment concerning the submission of amended shelf registration statements**

Companies that have submitted a “Shelf Registration Statement” must submit an “Amended Shelf Registration Statement” whenever they submit the “Annual Securities Reports, etc.”. However, because the “Annual Securities Reports, etc.” are submitted periodically, investors can easily obtain their content through EDINET.

→ In cases such as the above, submission of an amended shelf registration statement would not be required.

- **Amendment to large shareholding report rules**

To ease the burden on submitters of large shareholding reports, the following measures would be taken:

- Abolish the simultaneous submission obligation for change report
- Exclude matters relating to recipients of small numbers of share certificates, etc. from the matters that must be included in short-term large volume transfer reports
- Make the final day of the public inspection period of amendment report the same as the final day of the public inspection period of original large shareholding report, etc.
- Exempt submitters from the obligation to send a copy of a large shareholding report, etc. to the issuer (provided that the report is made publicly available through EDINET).

- **Additional reason for refusal of registration as a Financial Instruments Business Operators, etc.**

“Five years have not yet passed since the registering party gave notification of abolition, etc. of the Financial Instruments Business prior to having its registration rescinded” would be added as a reason for refusal of registration as a Financial Instruments Business Operator.

- **Expanding the business scope of financial instruments exchanges**

In order for authorities and financial institutions to monitor the financial transactions more efficiently and effectively, efforts have been made globally to introduce Legal Entity Identifiers that would be allocated to parties to financial transactions under a globally common way.

→ Given that exchanges in foreign countries allocate Legal Entity Identifiers, the business scope of Japanese financial instruments exchanges would be expanded to allow them to allocate Legal Entity Identifiers.

## **VI. Schedule for Enforcement**

## Schedule for Enforcement

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- This Act shall come into force as from the date specified by a Cabinet Order within a period not exceeding one year from the date of promulgation.
  
- Provided that:
  - Amendment to Rules on the Business Years of Financial Instruments Business Operators
  - Establishment of Procedures for Confiscating Electronic Share Certificates
    - ⇒ shall come into force as from the date specified by a Cabinet Order within a period not exceeding six months from the date of promulgation.
  - Expanding the business scope of financial instruments exchanges
    - ⇒ shall come into force from the date of promulgation.