Provisional and unofficial translation

Report by the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council

~ Towards Strengthening the Competitiveness of Japan's Financial and Capital Markets ~

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Introduction

In order to sustain the growth of Japanese economy as the population is aging, it is essential that the functions of the Japan's financial and capital markets be enhanced and provide good investment opportunities to the financial assets held by Japanese household sector that amount to more than 1,500 trillion yen (about 14 trillion US dollars) and to supply domestic and foreign companies with adequate amounts of capital for growth. Further, financial institutions and groups should provide diverse and high-quality financial services for domestic and foreign users.

Given the intensifying global competition among markets, strengthening the competitiveness of Japan's financial and capital markets has become a pressing policy issue requiring work in a timely manner.

The Sectional Committee on Financial System of the Financial System Council established the Study Group on the Internationalization of Japanese Financial and Capital Markets in January 2007 to hold discussions on strengthening the competitiveness of Japan's financial and capital markets, the results of which were compiled as the Interim Summary of Issues (Phase1) (published on June 13, 2007).

Since October 2007, the First Subcommittee of the Sectional Committee on Financial System of the Financial System Council has held nine sessions of deliberations on the following issues where in the need for institutional frameworks is particularly pressing, with a view to strengthening the competitiveness of Japan's financial and capital markets, based on the Interim Summary of Issues (Phase1):

- Diversification of financial instruments traded on exchanges,
- Making transactions among professionals more vibrant,
- Revamping of the firewall regulations between banking and securities businesses,
- Making the administrative monetary penalty system more effective against market misconduct

Regarding the review of the administrative monetary penalty system, the Working Group on Legislative Issues was established under the First Subcommittee for the purpose of conducting deliberations from an expert viewpoint.

This report is a compilation of the results of the deliberations by the First Subcommittee. It is hoped that institutional frameworks will be putting in place appropriately hereafter by those concerned, in accordance with this report.

I. Enhancement and reinforcement of exchange functions

1. Diversification of financial instruments traded on exchanges

Given the global circumstances surrounding exchanges, a progress in the diversification of financial instruments such as exchange traded funds (ETFs), derivatives and other transactions has been promoted in other countries. Moreover, as international competition among exchanges intensifies, overseas exchanges are forming exchange groups, through alliances among exchanges, are offering a wider variety of financial instruments ranging from stocks, bonds and financial derivatives to commodity derivatives.

It is important that Japan also add depth to its financial and capital markets and increase their global attractiveness by handling financial instruments comparable in diversity to those listed on overseas exchanges, and it is hoped that such diversification of financial instruments will enhance customer benefits.

It is also important to promote the development of new financial instruments and investment in computer systems by promoting competition among exchanges in order to strengthen the international competitiveness of Japanese exchanges. To this end, an institutional framework need to be put in place that will enable Japanese exchanges and exchange groups to offer comprehensive and wider variety of financial instruments ranging from stocks, bonds and financial derivatives to commodity derivatives.

(1) Diversification of ETFs

ETFs are investment tools that enable investors to diversify their investment easily and effectively at lower costs compared to investment in individual stocks. In addition, when compared with unlisted investment trusts, ETFs enable more flexible trading in a timely manner at market prices in exchanges. From the standpoint of enhancing customer benefits, there must be further promotion of ETF diversification.

To this end, it is appropriate that the following institutional frameworks be developed so as to enable the flexible trading of commodity-related ETFs and other various ETFs, as well as those listed on overseas exchanges, while paying attention to investor protection perspectives.

Further, the listing of commodity-related ETFs can bring us not only increasing the depth of the financial instruments market but also synergic effects, including an increasing of the depth of the commodity market through investments in assets subject to ETFs and hedge trading. Additionally, it is believed that increased cooperative relationships between financial instruments exchanges and commodity exchanges, through the development of new financial instruments and other activities, will lead to the full-scale collaboration and the like in the future.

(i) ETFs utilizing trusts issuing beneficiary certificates

Due to the implementation of the Financial Instruments and Exchange Act, it has become possible to create ETFs based on flexible instrument designs by utilizing trusts issuing beneficiary certificates, except when securities are the main investment targets of ETFs.

It is hoped that Japanese exchanges will develop listing regulations and take other measures,

under the framework necessary for investor protection, so as to enable the listing of ETFs utilizing trusts issuing beneficiary certificates.

(ii) Commodity-related ETFs utilizing investment trusts

With respect to commodity-related ETFs, it is appropriate to develop the following institutional frameworks to enable the utilization of investment trusts widely recognized by general investors, in addition to utilization of trusts issuing beneficiary certificates.

a) Direct investment in commodities in kind, etc.

It is appropriate to expand the main investment targets of investment trusts ("Specified Assets") and add commodities in kind and commodity derivatives thereto.

b) Investment trusts with redemption of commodities in kind, etc.

It is appropriate to put in place institutional frameworks that enable investment trusts, which invest in commodities in kind, to redeem commodities in kind only when the amount invested can be assessed properly and there is no problem in terms of investor protection.

(iii) Application of the Commodity Fund Act

Under the current Commodity Fund Act, when ETFs that invest directly in commodity derivatives are created by investment management firms, the restrictions pursuant to the Commodity Fund Act apply in addition to those pursuant to the Act on Investment Trusts and Investment Corporations (the Investment Trust Act). It can be an excessive burden in the creation of ETFs; furthermore, it can be hamper the convenience of general investors investing in ETFs.

It would, therefore, be appropriate not to require investment management firms to leave commodities investment advisory firms to their discretion when investment management firms are making investment decisions regarding ETFs that invest in commodity derivatives directly.

(iv) Designation of stock price indices on the public notice pursuant to the Investment Trust Act

Under the current system, stock indices linked to investment trusts with contribution in kind and redemption in kind are designated (subject to public notice) by the commissioner of the Financial Services Agency on an individual basis. However, it is appropriate to devise measures such as the comprehensive designation of stock price indices subject to public notice to the extent that it does not cause problems from the perspective of appropriate price formation and prevention of market manipulation, in order for timely and expeditious product design.

(v) Expansion of investment trusts with contribution in kind and redemption in kind

Under the current system, the investment targets of investment trusts with contribution in kind and redemption in kind are limited not to securities in general, but to stocks only. It is

appropriate to include securities that permit the proper assessment of investment amounts and do not present problems in terms of investor protection, such as bonds and beneficiary certificates of REITs (Real Estate Investment Trusts), in the investment targets of investment trusts with contribution in kind and redemption in kind.

(2) Alliances among financial instruments exchanges and commodity exchanges

In view of the situation in various foreign countries, it is necessary to put in place institutional frameworks enabling Japanese exchanges to offer a full product line-up, ranging from stocks, bonds and financial derivatives to commodity derivatives, as soon as possible by such means as forming groups through capital alliance among exchanges, in order to reinforce the business foundation and the international competitiveness of Japanese exchanges.

In doing so, there may also be views that the Commodity Exchange Act should be integrated into the Financial Instruments and Exchange Act. On the other hand, there also are those who point out that regulations from the perspective of facilitating commodity production and distribution remain necessary with respect to commodity derivative transactions. It is believed that attempting to integrate these acts immediately under these circumstances will have an adverse impact on the nature of the Financial Instruments and Exchange Act as an Act covering both financial instruments and financial trading.

In view of the aforementioned current conditions, a pressing task is to enable the mutual extension of products traded, through such means as capital alliance, under the overall framework, that financial instruments and financial transactions are regulated under the Financial Instruments and Exchange Act and while commodity derivative transactions are regulated under the Commodity Exchange Act, in order to develop a system as soon as possible for the formation of groups enabling a full product line-up and it is appropriate to take the following legal measures promptly.

(i) Positioning of opening a commodity derivative market

Opening a commodity derivative market is very similar to the opening of a financial instruments market in such respects as its public nature, the functions it is expected to perform, and risk management. Further, enabling the provision of a diverse product line-up, including commodity derivatives, as exchange groups may have synergic effects on both the financial instruments and commodity derivative markets.

Given such points, it is appropriate to categorize the opening of a commodity derivative market as a business related to financial instruments exchanges and to authorize the opening of said market by the subsidiaries and the like of financial instruments exchanges.

(ii) Opening of commodity derivative market within financial instruments exchanges themselves

Even if financial instruments exchanges themselves are to open a commodity derivative market, it is usually believed that there are few matters of concern it will interfere with the adequate and reliable operation of the financial instruments market.

Therefore, it is appropriate to expand the scope of business of financial instruments

exchanges themselves to provide them with an option of opening a commodity derivative market through the authorization of the prime minister under the framework of the Commodity Exchange Act, as would be the case of subsidiaries of financial instruments exchanges and the like.

In addition to the foregoing legal and other measures, it will be necessary to stipulate the required regulations in the Commodity Exchange Act on such matters as the opening of a commodity derivative market by financial instruments exchanges, as well as the acquisition and holding of voting rights of commodity exchanges by financial instruments exchanges and the like, in order to enable the alliances among by financial instruments exchanges and commodity exchanges. Further, it is necessary to consider the handling of restrictions on the holding of voting rights of financial instruments exchanges in cases where commodity exchanges establish and hold financial instrument exchanges as their subsidiaries, together with the establishment of regulations for the opening of a financial instruments market within commodity exchanges themselves. Appropriate collaboration among the authorities concerned is anticipated in this respect.

(3) Handling of emissions trading, etc.

Various foreign countries have also begun trading such things as emissions quotas in the exchanges. Although it is believed that emissions quotas are similar in some respects to financial instruments, their legal positioning and the valuation method, among other things, are not necessarily clear under current conditions. Meanwhile, it is believed that transactions similar to financial trading, such as emissions trading, will also increase in Japan in the future. Permitting such transactions as the related business of financial instruments exchanges is conceivable if the framework is such that establishing trading platforms within financial instruments exchange groups will not pose problems in terms of, for example, public benefit or investor protection. It is also necessary to examine the handling of emissions quotas as a financial instrument from a broad perspective, keeping in mind the specifics of the manner in which emissions trading is carried out, in the event that conditions for the trading thereof are set with the clarification of the legal positioning and the valuation method of emissions quotas.

2. Making transactions among professionals more vibrant

In other countries, markets with a high degree of freedom intended for professional investors are expanding, such as the AIM (Alternative Investment Market) in the United Kingdom and the market based on rule 144 A of the United States Securities and Exchange Commission (SEC). This trend has been intensifying the international competition in creating attractive markets.

Frameworks for rigorous investor protection, including statutory information disclosure, have been put in place in Japan for the markets where general investors participate directly. However, it has been pointed out that the costs incurred in connection with statutory information disclosure, etc. place a burden on foreign companies and Japanese start-ups, limiting their access to the Japanese market.

Accordingly, it is crucial to establish platforms with a high degree of freedom intended for professional investors in Japan, thereby making the country’s financial and capital markets more vibrant and strengthening their international competitiveness.

More specifically, while it is considered that the importance of information disclosure, etc. will continue to increase further in the financial and capital markets from the perspective of investor protection, it is also possible to adopt the principle of self-responsibility for professional investors, who have sufficient ability to gather and analyze information. In that sense, professional investors should be differentiated from general investors and platforms with a high degree of freedom intended for professional investors should be developed as soon as possible.

It is considered that the following effects might be expected from the introduction of such platforms with a high degree of freedom:

- Enabling foreign companies and domestic start-ups to raise the long-term funds necessary for their growth with greater ease by reducing costs related to regulatory requirements such as information disclosure, etc.;
- Raising the attractiveness of Japan's financial and capital markets for professional investors by expanding financing opportunities, as well as promoting financial innovation through competition among professional investors; and
- Allowing general investors to enjoy the benefits of asset management conducted by the professional investors, who assess the future of corporations and exercise their specialized asset management skills.

Two types of frameworks are conceivable in regards to trading platforms intended for professional investors; (i) a framework utilizing the existing system of private offerings to professionals (limited to qualified institutional investors) and (ii) an expanded framework which includes specified investors. For each of these frameworks, it is appropriate to take such measures as described below.

If adequate self-discipline is not exercised by professional investors in transactions with a high degree of freedom, it is possible that professional investors participating in such transactions and general investors behind them could suffer unexpected losses due to fluctuation of market prices and other factors. It should be duly noted by professional investors that they are required to act with responsibility as professionals, ensuring due process and risk management.

(1) Framework utilizing existing framework of private offerings to professional investors (limited to qualified institutional investors)

It is appropriate to examine the following issues and take necessary measures in regards the trading platforms utilizing the private offering system for qualified institutional investors, for which disclosure requirements are not applied, and the PTS (proprietary trading system) system.

(i) Trading platforms

It is possible to establish trading platforms utilizing the existing PTS system.

(ii) Disclosure requirements

Disclosure requirements are not to be applied, since the securities concerned are issued based on private offerings to professional investors.

(iii)Restrictions on resale, etc.

Since there are restrictions on the resale of securities issued by way of private offerings to professional investors, the distribution of securities, which should be traded within the platforms intended for professional investors, to general investors out of the platforms for professional investors is prevented.

However, since the restrictions on resale do not apply to securities already held by general investors through measures other than private offerings to professional investors, these securities are, in general, not eligible for trading limited to professional investors.

(iv) Regulations on unfair trading

It is appropriate to have an approved financial instruments firms association designate securities to be traded through platforms intended for professional investors as "securities traded" (securities with respect to which association members may be solicited to buy, sell or otherwise trade in) to enable the proper enforcement of the regulations on unfair trading.

(v) Other matters

Another possibility is for exchanges to establish financial instruments firms as their subsidiaries, or as other forms of affiliates, to perform PTS operations, thereby providing trading platforms intended for professional investors. In this case, it is believed that PTS operations may be categorized as exchange-related operations in view of the following points:

- Providing diverse trading platforms as exchange groups will enhance the attractiveness of exchanges and contribute to facilitating the business operations of them;
- PTS and financial instruments exchange markets share common characteristics in that they provide platforms for collective and organized trading of financial instruments by way of certain methods, and also have similarities in terms of risk management methods; and
- It is believed that financial instruments firms specializing in PTS generally will not interfere with the fairness or impartiality of the business operations of exchanges, even if they are subsidiaries, etc. of the exchanges.

It is further believed that there is generally little possibility that PTS operations will interfere with the financial soundness and the fairness of the business operations of the exchanges.

Hence, it is appropriate to allow exchanges to establish financial instruments firms as their subsidiaries, etc. of exchanges that engage in PTS operations, as far as the sustainment of specialization in PTS operations is ensured and structures that ensure the neutrality of the said subsidiaries, etc. with respect to exchange-based financial instrument markets set up by the parent companies (the exchanges) are developed.

Likewise, it is believed that there is generally no particular problem with exchanges holding a stake of less than 50% in financial instruments firms engaging (specializing) in PTS operations.

(2) Expanded framework including specified investors as participants

From the perspective of adding diversity to trading platforms, it is appropriate to develop exchange markets in a following manner based on a new discipline that relies on self-responsibility as regards to disclosure requirements, etc. by expanding the scope of participants to include specified investors.

(i) Trading platforms

It is appropriate to develop exchange markets based on a new discipline that relies on self-responsibility as regards to disclosure requirements, etc.

(ii) Provision of information to investors

Considering that the market participants are professional investors only, it is appropriate to exempt the participants from existing statutory disclosure requirements based on public disclosure and allow relevant parties to provide or analyze information voluntarily. However, specified investors might include those who are not in a position to request provision of information against issuing entities or to gather information directly by themselves. From the perspective of preventing false or inappropriate explanations or presentations as to the descriptions of corporations, it is appropriate to establish the following institutional frameworks;

- The issuing entity shall be required to provide accurate information concerning descriptions and risks of companies or issuing entities at least once a year to participants in markets intended for professional investors.
- As regards to the specific contents of the information to be provided, forms, standards, etc. should not be stipulated by law. Details such as the language in which the information is provided, the forms (including whether only consolidated financial statements should be provided or not), accounting standards, or whether or not an audit report is to be attached will be determined voluntarily based on the rules introduced by the entity in charge of opening the markets.
- As regards timely disclosure, it is conceivable to establish a mechanism where the entity in charge of opening the market consolidates the necessary information and provides it to investors in a timely manner.
- In this case, it is also conceivable to utilize the similar mechanism for the provision of information by issuing entities to participants.
- It is necessary to consider civil liability provisions and mechanisms for preventing the provision of false information, etc. for the case where the information provided is false,etc.

(iii) Restrictions on resale, etc.

It is appropriate to limit the issuance and trading of securities issued or traded in the new markets to professional investors (i.e. specified investors, which include qualified institutional investors) as a prerequisite of exemption from existing disclosure requirements. Specifically, the following measures can be considered, in reference to the restrictions on resale related to the existing system of private offerings to qualified institutional investors (private offerings to professional investors);

・No one shall offer to general investors to sell, solicit them for the application to purchase or resell securities to them, which are traded in the markets intended for professional investors (including pre-listing securities and those already issued overseas; hereinafter collectively referred to as “securities for professionals”) unless, in principle, it is subject to statutory information disclosure.
・Financial instruments firms shall not sell (including selling, purchasing, mediating or commissioning sales and purchases, and acting as an agent in sales and purchases) to or solicit general investors as regards securities for professionals.
・When selling to or soliciting professional investors, financial instruments firms shall be required to notify the professional investors of the restriction on resale to general investors.
・On the other hand, in case where the general investors hold securities for professionals as the owner, they shall be permitted to sell such securities in the markets intended for professional investors or to professional investors. (In this case, financial instruments firms should be permitted to sell, purchase, mediate, commission or represent sales or purchases without solicitation.)

(iv) Regulations on unfair trading

Since the participation of specified investors may result in significant liquidity, etc., regulations similar to the existing ones applied to listed securities should be applied.

(v) Other matters

・As regards the current disclosure requirements applied to domestic corporations with 500 or more shareholders, it is considered appropriate, for example, to relax the current standards (for example, increasing the number of minimum shareholders from 500 to 1000 (regardless of whether or not the company's securities are traded in the markets intended for professional investors)), given significant liquidity expected from the development of markets intended for professional investors and historical developments of situation of the corporations submitting annual securities reports for more than ten years since the introduction of current system.
・Given that the purpose of the Take Over Bid system is to ensure transparency and fairness in securities transactions that may affect the control of corporations, it is appropriate to treat the securities traded in the markets intended for professional investors in the same way within this system.
・Given that the purpose of the large shareholdings reporting system is to enhance the fairness and transparency of the markets by promptly providing investors with important information from the viewpoint of influence on business management, etc., it is appropriate to treat the securities traded in the markets intended for professional investors in the same way within this system. In doing so, it is appropriate to examine, in the future, the appropriate level of threshold of reporting obligation. (Under the current system, reporting is required when shareholdings exceed 5% and 1% or more changes in the shareholdings thereafter.) from the perspective of the need to provide information promptly, taking into account of the characteristics of the markets intended for professional investors.
・It is also conceivable that Japanese exchanges will jointly establish exchanges with overseas exchanges to open exchange markets intended for professional investors. In this case, if Japanese exchanges are to establish, as their subsidiary or another form of

affiliate, an exchange within their group that sets up markets intended for professional investors and there is no problem in terms of public benefit or investor protection, it is appropriate, in view of the following points, to permit overseas exchanges to acquire and hold the remaining voting rights (less than 50%).

—It is believed that the utilization by Japanese exchanges of the know-how, etc., of overseas exchanges in opening markets intended for professional investors is an effective method, from the perspective of strengthening their competitiveness.
—It is believed that Japanese exchanges establishing, as their subsidiary or another form of affiliate, an exchange within their group that sets up markets intended for professional investors has little problem, also from the perspective of ensuring sound and appropriate management of medium and long-term operations of the exchanges.

It is appropriate to make necessary improvements to the remote membership system, such as permitting business reports from foreign securities firms, based on the fiscal year in their mother country, from the perspective of promoting investments by foreign investors.

3. Other matters

In Japan, as regards the short selling of securities, the existing regulations require a trader to make a clear indication of, and a broker to confirm, whether or not a sell order is a short selling. At the same time, the regulations, in principle, prohibit short selling at prices lower than prices most recently announced by financial instrument exchanges. As for the regulations on short selling in the United States, pricing regulations were reviewed in June 2007, while maintaining and tightening the requirement to make clear indications and confirmations. It was pointed out that a review of the Japanese pricing regulations on short selling is also necessary in view of this situation.

II. Revamping of firewall regulations between banking and securities businesses

Firewall regulations between banking and securities businesses were introduced in 1993, when mutual market entry by the business category-based subsidiary method was put in place, in order to prevent the adverse effects of conflicts of interest and the abuse by banks and the like of their dominant bargaining position, among other things.

Under the legal systems of the United States, which has served as Japan’s model, the FRB (Federal Reserve Board) relaxed the firewall regulations in 1997 and the regulations were re-examined by such means as the legislation of the Gramm Leach Bliley Act in 1999. Firewall regulations have also been relaxed as necessary in Japan, giving consideration to the actual situation, in the series of systemic reforms.

It has been pointed out that the existing firewall regulations are not necessarily functioning effectively as measures to deter the acts that the regulations target primarily, such as the adverse effects of conflicts of interest and the abuse by banks and the like of their dominant bargaining position. There have been also requests to relax regulations on exchanging undisclosed customer information, officers and employees holding concurrent posts, and other matters as the formation of financial groups, etc., progresses, for such reasons as the following:

・The regulations are interfering with the provision of comprehensive services as financial groups and undermining, rather than enhancing, user convenience;

- The regulations are interfering with comprehensive risk management and compliance, which are required for financial groups; and
- From the perspective of international competitiveness, Japanese financial institutions are placed at a disadvantage to American and European financial groups in terms of competitive conditions.

Further, it has been pointed out that the current trend in various foreign countries, as regards the regulatory framework, is to request that financial institutions develop internal control systems pursuant to their own disciplines with respect to such things as the management of the conflicts of interest within their financial group, while the authorities adequately monitor the situation.

Based on the foregoing, it is appropriate to provide a new regulatory framework as follows, as regards firewall regulations, in order to:

(i) seek to ensure greater effectiveness in terms of preventing such things as the adverse effects of conflicts of interest and the abuse of dominant bargaining position, while
(ii) addressing requests for improved user convenience, comprehensive internal control systems of financial groups, etc.

Financial groups should bear firmly in mind that, while the promotion of new businesses will be further facilitated under the new regulatory framework, stricter discipline will be required of them in terms of business administration.

1. Ensuring both the prevention of adverse effects of conflicts of interest and the prevention of abuse of dominant bargaining position by banks and others

(1) Prevention of adverse effects of conflicts of interest

It is important to ensure the effectiveness of regulations by legally requiring securities firms, banks and the like to develop a system for managing conflicts of interest and by conducting an appropriate monitoring by the authorities, in order to ensure the prevention of the adverse effects of conflicts of interest.

A specific possibility is to require that various financial institutions develop and appropriately operate a system for managing conflicts of interest, clearly setting forth such things as (i) the extraction and identification of conflicts of interest, (ii) the management of conflicts of interest (building of Chinese Walls, etc.) and retention of records, and (iii) the formulation of policies pertaining to the management of conflicts of interest as aims within the supervisory guidelines.

Further, financial institutions should be required to disclose in a clear fashion the outline of the management policies on conflicts of interest that they formulate, from the perspective of promoting the establishment of management systems by financial institutions.

(2) Prevention of abuse of dominant bargaining position by banks and others

Banking laws, and relevant regulations prohibit banks and the like from granting credit to customers on the condition that the customers engage in transactions related to the business operations of such banks or the subsidiaries and other affiliates thereof.

In addition, in order to prevent the abuse by banks and others of their dominant bargaining position, it is appropriate that the Financial Instruments and Exchange Act and relevant regulations prohibit securities firms from executing financial instrument trade agreements or conducting soliciting activities by abusing the dominant position of their parent banks, subsidiary banks and the like. A possibility in this context is to enable the Securities and Exchange Surveillance Commission to conduct inspections of securities firms, their parent banks, subsidiary banks, and the like.

Further, in order to ensure effective prevention of the abuse of dominant bargaining positions by banks and the like, it is important for the banks themselves to develop systems for the appropriate processing of information provided by customers and others, as well as for the authorities to reinforce the mechanism for utilizing the information received from customers and others for inspection and supervision.

2. Revamping of the firewall regulations

(1) Restriction on exchange of undisclosed customer information

It is necessary to pay sufficient attention to the increase in the awareness of the protection of customer information in the financial sector in considering how firewall regulations should be, and it is not necessarily appropriate to permit the sharing of undisclosed customer information against customers' wishes.

In view of the aforementioned requirement, the following approach, based on considerations for customer attributes, is appropriate as a means of confirming customer intentions.

(i) Personal information
Although there is no regulation in the United States on the sharing of personal information within a group (separately, providing an opportunity of opt-out to customer is mandatory pursuant to the Fair Credit Reporting Act), customer opt-ins are required in Europe. It is also appropriate to maintain the opt-in approach in Japan, as regards the handling of personal information. [1]

(ii) Corporate customer information
There is no special regulation in either the United States or Europe on the sharing of corporate customer information. It has also been pointed out that sharing such information may give benefits to customers if more diversified and higher-quality financial services can be provided, or that the procedure for the submission of a letter of consent to customers way impose such burdens as internal authorization on corporations (Japanese ‘Ringi’ system). However, in view of the possibility that some corporations may prefer not to permit the sharing of information thereon, it is appropriate to grant them an opportunity for an opt-out with respect to the handling of corporate information. [2]

Further, financial institutions are currently permitted to share customer information for the purpose of internal controls without customer consent, subject to the approval of the

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[1] Opt-in: Sharing information on the basis of gaining active customer consent.
[2] Opt-out: Notifying customers in advance of information-sharing and giving customers, who do not wish to have their information shared, the opportunity to disapprove.

authorities. In regards to this, it is appropriate to eliminate the requirement for approval from the authorities, given that the financial groups will be required to develop an internal system for managing conflicts of interest. In the foregoing case, it will be necessary to develop a framework enabling strict supervisory measures, such as requesting a notification or some kind of report on the development status of information management systems, etc., in addition to prohibiting the use of information shared for the purpose of internal management for other purposes, in order to prevent the adverse effects of information sharing.

(2) Regulations on officers and employees holding concurrent posts

It is appropriate to abolish regulations on officers and employees holding concurrent posts in accordance with the imposition of the requirement on securities firms, banks and the like to develop a system for managing conflicts of interest.

(3) Other matters

(i) Cross-marketing regulations concerning issuance entities

As regards sales and marketing targeted at issuance entities, employees of banks and the like are permitted to visit corporate customers jointly with the employees of securities firms. Further, they are also permitted to offer advice concerning such matters as IPO(Initial Public Offering), as well as to refer corporate customers capable of going public to underwriting securities firms. On the other hand, employees of banks and the like are not permitted to go beyond providing advice and referrals on underwriting and propose or negotiate the specifics of underwriting terms and conditions, due to the high likelihood that such undertakings fall under the very category of "underwriting."

Some have pointed out, with respect to the aforementioned situation, the need to relax regulations from the perspective of further facilitating the provision of comprehensive services by financial groups to corporations. However, many others have also pointed out that allowing banks to propose and negotiate the terms and conditions of underwriting in the place of securities firms, which bear the underwriting risks, will pose problems from such perspectives as the risk management and the independence of securities firms, particularly when the reinforcement of the underwriting screening system is being sought of securities firms. Given the aforementioned indications, further relaxation of regulations regarding cross marketing activities targeted at issuance entities should be continually considered.

(ii) Limitation on eligibility for lead managing underwriter status

The existing system is such that securities firms are prohibited, as a rule, from becoming the lead managing underwriter of securities issued by their parent companies, subsidiaries, or the like. Regulations concerning the capital increase of companies already listed have been relaxed, subject to certain requirements, under the implementation of the Financial Instruments and Exchange Act. However, IPO (capital increase at the time of initial public offering) is not permitted unless the company has been rated.

It is appropriate to devise measures such as the relaxation of regulations on IPO, if the transparency of pricing can be secured with the involvement in the pricing process of other securities firms that are, for example, independent in terms of capital and staffing.

III. Making the administrative monetary penalty system more effective against market misconduct

In order to make Japan’s financial and capital markets more attractive, and to secure the trend of moving from savings to investment, it is important to enhance the credibility of the Japanese markets by improving market fairness and transparency.

To this end, it is necessary to provide sufficient deterrence for market abuse and violations of disclosure regulations in the financial and capital markets.

The administrative monetary penalty system under the Financial Instruments and Exchange Act was implemented from this perspective in 2005, and it has produced some results over the past two years. As regards the administrative monetary penalty system, from the perspective of enhancing effective deterrence of violations, based on the report entitled "Recommendations on the Administrative Monetary Penalty System" compiled by the Working Group on Legislative Issues established under the First Subcommittee, it is appropriate to conduct the necessary reviews regarding such matters as the level of penalty, the scope of coverage, and the statute of limitation.