### Overview of Financial Instruments and Exchange Act Cabinet Orders and Ordinances (effective September 30, 2007)

Financial Services Agency

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### I. Basic Framework of the Reform

### 1. Basic contents of the Reform



- (1) Establish a flexible, cross-sectional framework for a wide range of financial instruments and services
- Expand the scope of regulated products and services
- Introduce cross-sectional requirements and restrictions for financial instruments businesses
- Add flexibility to business regulations based on the characteristics of financial instruments, or the customer's attributes
- (2) Enhance disclosure requirements
- Enhance disclosure requirements for listed companies
- Review regulations on tender offers and large shareholding reports: effective December 13, 2006, January 1 and April 1, 2007
- (3) Provide organizational structures for self-regulatory functions of financial instruments exchanges
- (4) Strict enforcement measures against securities violations: effective July 4, 2006
- Increase maximum criminal penalties (e.g., from 5 years in prison to 10 years for market manipulation)
- Expand the scope of criminal and administrative penalties on "misegyoku"

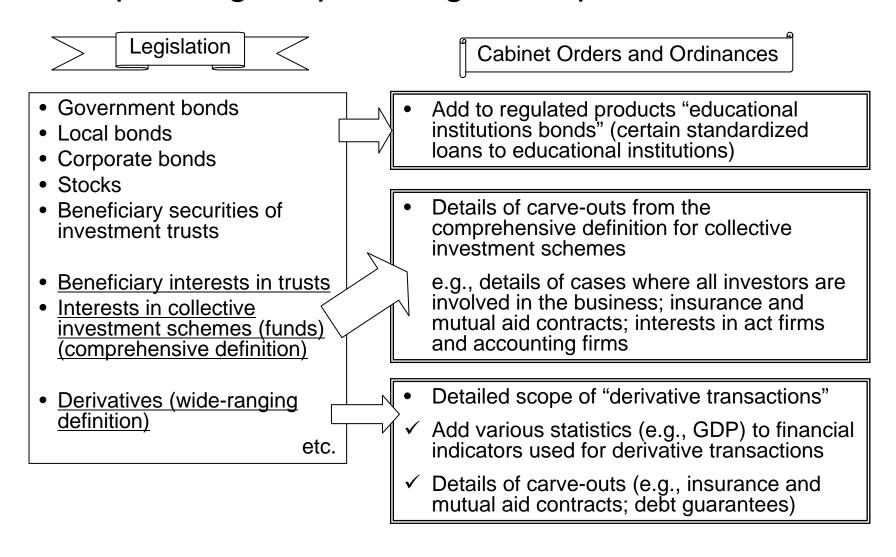
- Details of regulated products and services (e.g., exemptions for certain permissible products and activities)
- Details of regulatory rules on conduct of financial instruments business (e.g., restrictions on advertisement)
- Details of criteria for obtaining business registration
- Detailed scope of professional customers
- Details of quarterly reporting system and internal control reporting system
- Enhance disclosure requirements for corporate acquisition and reorganization
- Expand scope of "qualified institutional investors"
- Details of self-regulatory functions

### 2. Effective date of the Reform

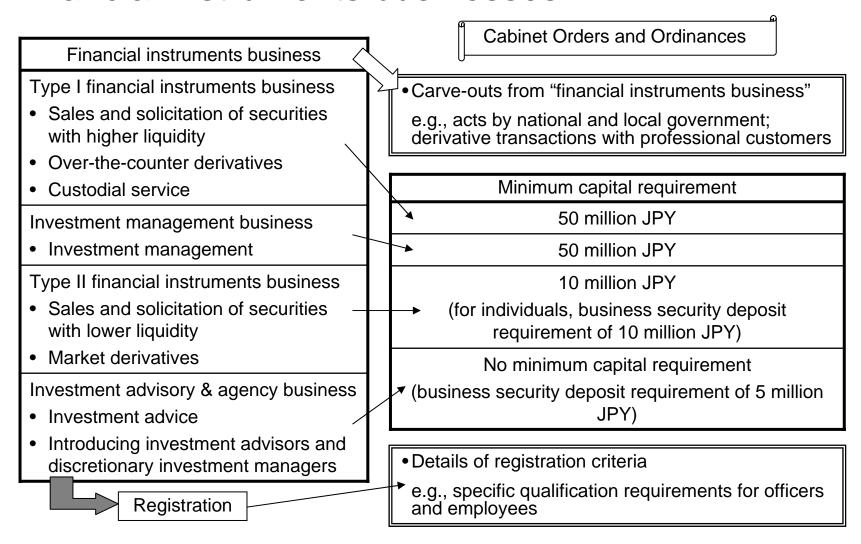
Measures	Effective Date
Strict enforcement measures against securities violations	• July 4, 2006
Review of regulations on tender offers and large shareholding reports	<ul> <li>December 13, 2006         (Shorten reporting deadline for special large shareholding reports: January 1, 2007)         (Mandatory electronic filing of large shareholding reports: April1, 2007)     </li> </ul>
Enhance disclosure requirements for listed companies	September 30, 2007     (applicable from fiscal year commencing on or after April 1, 2008)
<ul> <li>Establish a flexible, cross-sectional framework for a wide range of financial instruments and services</li> <li>Provide organizational structures for self-regulatory functions of financial instruments exchanges</li> </ul>	• September 30, 2007

#### II. Contents of the Reform

### 1. Expanding scope of regulated products



## 2. Cross-sectional and flexible regulation of financial instruments businesses



### 3. Regulatory treatment of fund business

Cabinet Orders and Ordinances

### Funds for general investors (registration requirement)

- Type II financial instruments business (sales and solicitation of fund interests by the fund member)
- Investment management business (investment management of fund assets by the fund member)

Funds for professional investors (notification requirement)

- Exemptions from registration requirement
- (1) Fund member delegates all investment management authority
- Member is exempted from obtaining investment management business registration
- ✓ Detailed criteria (e.g., the delegatee must be a registered investment manager)
- (2) Investment management of offshore funds
- ✓ Detailed criteria (e.g., less than 10 Japanese resident investors, all of which must be qualified institutional investors)
- Investment management by fund member is exempted (sales and solicitation of fund interests requires registration)
- Detailed criteria
- √ 1 or more qualified institutional investor
- √ 49 or less general investors (indirect investors through LLP/LPS fund of funds are included in the number count)

### 4. Regulation of conduct of financial instruments business

- (1) Detailed rules on advertisement
- Advertisement rules apply when providing similar information to a large number of persons (via mail, facsimile, e-mail, etc.)
- Details of information to be indicated in advertisements (e.g., fee, risk information)
- Indication of certain material information (e.g., existence of exposures to loss) must be clear and accurate, and in large letters
- Reduced requirement for television and radio commercials, billboard advertisements and novelty advertisements
- (2) Details of obligation to deliver documents prior to entering into contract
- Details of information to be stated in the documents tailored information for different types of contract
- Certain material information (e.g., risk information) must be written in plain language
- Details of cases where delivery is exempted (e.g., where the customer received such document for a similar contract)
- (3) Details of prohibited acts
- Prohibition on unsolicited promotion applicable to over-the-counter financial futures transactions
- Prohibition on solicitation without confirming will of customer, and solicitation against will – applicable to financial futures transactions in general
- Requirement to provide explanation suitable for each customer when delivering statutory customer documents

# 5. Classification of customers: professional customers and general customers

Cabinet Orders and Ordinances Specified investors (1) Cannot request nonprofessional treatment (professional (2) Designated companies Qualified institutional customers) Local government investor Financial Public companies Japanese government instruments firm is Joint-stock companies whose Bank of Japan exempted from capital is reasonably believed to be 500 million JPY or more certain obligations (2) Can request non-(e.g., delivery of professional treatment Foreign companies statutory customer Designated documents) etc. companies (3) Can request (3) Designated individuals professional treatment Individual (i) with trading Customers other Designated individuals experience of one year or more, than specified and (ii) whose net asset, and (4) Cannot request investéd assets, are investors professional treatment reasonably believed to be each (general customers) worth 300 million JPY or more Individuals other than etc. (3)Special protective measures under the Financial Products Sales Act (e.g., presumption of damages) are not available for specified investors

# 6. Cross-sectional regulatory system for similar financial products and services

Apply same rules of conduct to similar financial products and services that have strong investment characteristics

- Specified deposits (Banking Act)
- Specified insurance (Insurance Business Act)
- Specified trust (Trust Business Act)
- Commodity futures (Commodity Exchange) Act
- Real estate syndication business (Real Estate Syndication Business Act)

Recognized investor protection organization

 Resolves complaints and mediates disputes regarding financial instruments firms Cabinet Orders and Ordinances

- Foreign currency denominated deposits
- Derivative deposits

etc.

- Variable insurance and pension funds
- Foreign currency denominated insurance and pension funds
- Derivative deposits

etc.

- Trusts other than certain trusts that do not have strong investment characteristics (e.g., charitable trusts, custodial trust)
- Expand scope of subject firms to other similar financial service providers (e.g., banks, insurance companies, trust companies)

# 7. Ensure proper operation of self-regulatory functions of financial instruments exchanges

Financial instruments exchanges can delegate its self-regulatory functions to:

- a separate specialized entity (self-regulatory corporation); or
- a specialized internal committee (self-regulatory committee)

Cabinet Orders and Ordinances

Detailed scope of self-regulatory functions

- Monitoring of trading in the markets
- Examination of trading participants' qualifications
- Disciplinary actions and other measures against trading participants
- Examination of disclosures by listed issuers
- Disciplinary actions and other measures against listed issuers

etc.

## 8. Disclosure requirements tailored to the nature of securities

Disclosure requirements tailored to each type of securities

- Corporate finance type securities (e.g., stocks, bonds)
  - Backed by credit value of issuer itself
- Asset finance type securities (e.g., fund interests, ABS)
  - Backed by value of assets held by issuer

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Details of enhanced disclosure contents for asset finance type securities

- Information regarding the assets (e.g., investment real estate, fund of funds)
- Information regarding the asset manager (e.g., internal control structure)
- Information regarding asset management services (e.g., basic investment policy)

### 9. Quarterly reporting system

- Applicable to listed companies
- Reporting deadline:
  - 45 days after the end of each fiscal quarter
     (60 days, for the 2<sup>nd</sup> fiscal quarter of banks and insurance companies)
- Details of information to be disclosed in quarterly reports
  - Consolidated quarterly financial statements
     (if the issuer does not prepare consolidated statements, non-consolidated quarterly financial statements)
  - Banks and insurance companies must submit consolidated <u>and</u> nonconsolidated quarterly financial statements for the 2<sup>nd</sup> fiscal quarter
- Types of consolidated quarterly financial statements
  - Consolidated quarterly balance sheets
  - Consolidated quarterly profit and loss statements
  - Consolidated quarterly cash flow statements
- Audit of quarterly financial statements
  - Audit is certified by quarterly review report

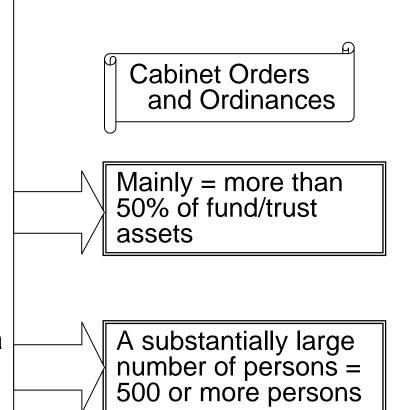
# 10. Enhancing internal control over financial reporting

- Applicable to listed companies
- Internal control report
  - Filed together with (annual) securities reports
  - Details of information to be included (e.g., name and title of issuer's representative (and CFO), basic framework of internal control regarding financial reporting, scope and procedures of management assessment)
- Internal control audit report
  - Certifies audit of internal control reports
  - Details of information to be included (e.g., audit opinion regarding internal control report)
- Certification letter
  - Filed together with (annual) securities reports and quarterly reports
  - Issuer's representative (and CFO) must certify the contents of the securities report or quarterly report

# 11. Disclosure requirements for fund interests and other securities with low liquidity

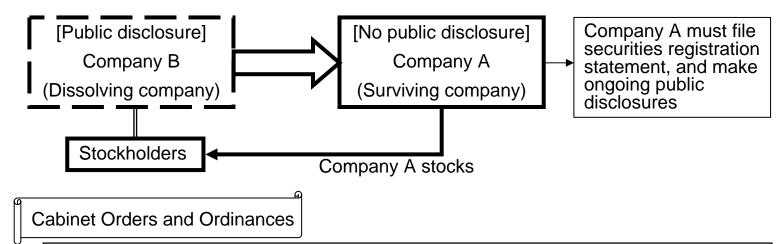
Securities with low liquidity (e.g., interests in collective investment schemes, beneficiary interests in trusts)

- Disclosure requirements (filing of securities registration statement and ongoing disclosure) apply if:
  - -The fund/trust invests **mainly** in securities;
  - -The total amount of the offering is 100 million JPY or more; and
  - -The offering results in the offered securities to be held by a substantially large number of persons



# 12. Disclosure requirements for corporate restructuring

- In the case of corporate restructuring (e.g., merger) where the stockholders of the subject company (e.g., dissolving company) receive securities issued by an entity other than the subject company (e.g., surviving entity), the issuer of the securities must make public disclosure (e.g., filing of securities registration statement) if:
- (1) Public disclosure has not been made for such securities; and
- (2) Public disclosure is made for stocks issued by the subject company



Details of additional information to be included in the securities registration statement for corporate restructuring (e.g., information regarding the corporate restructuring agreement, parties to the restructuring, financial status after restructuring)

(If the issuer (Company A) is a public disclosure company, similar information is disclosed as timely disclosure in the extraordinary reports)

## 13. Expanding scope of qualified institutional investors

etc.

- Offerings of securities are exempted from public disclosure requirement, if solicitation is made only to qualified institutional investors
- Previous scope of qualified institutional investors (QIIs):
  - Banks, securities firms, insurance companies
  - Corporations that file securities reports, which hold securities of 10 billion JPY or more must make filing to become QII
  - Foreign governments, foreign financial institutions - must make filing to become QII

Cabinet Orders and Ordinances

Expanded scope of qualified institutional investors:

- Trust companies and foreign trust companies (excluding custodial trust companies) – must make filing to become QII
- Corporations that hold securities of <u>1 billion</u> JPY or more - must make filing to become QII
- Individuals that hold securities of 1 billion JPY or more, who have held securities trading accounts for more than 1 year must make filing to become QII

etc.