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## Master of Puppets: How Japan's Ministry of Finance Orchestrates Its Own Reformation

Gregory D. Ruback\*

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# Master of Puppets: How Japan's Ministry of Finance Orchestrates Its Own Reformation

Gregory D. Ruback

## Abstract

This Comment analyzes Japan's effort to create a competitive securities market that is free, transparent, and reliable. Part I describes Japan's regulatory environment, emphasizing the power and authority of the Ministry and its influence within the Japanese government and over the securities industry. Part II details elements of the Big Bang reforms and describes the current political situation that will influence the effectiveness of the reforms. Part III addresses the probable effectiveness of the reforms in the context of Japan's regulatory structure, past scandals and reforms, and current political environment. Finally, this Comment argues that the Ministry has the ability to control the reformation of the securities industry because of the Ministry's extensive influence within the government and over the securities industry. In addition, this Comment argues that the reforms initiated by the Japanese government will be ineffective in changing the regulation of the securities industry because the reforms threaten to reduce the Ministry's authority over the securities industry.

# MASTER OF PUPPETS: HOW JAPAN'S MINISTRY OF FINANCE ORCHESTRATES ITS OWN REFORMATION

*Gregory D. Ruback\**

Scandals in Japan have long been a way for the public to feel a catharsis even if little actually changes.<sup>1</sup>

## INTRODUCTION

The Ministry of Finance<sup>2</sup> ("Ministry") regulates Japan's securities markets<sup>3</sup> in an informal manner, using strong persuasion to supplant the use of legislation.<sup>4</sup> The key to this informal method of regulation is keeping the number of securities companies<sup>5</sup> low, while simultaneously prodding these companies into action by using incentives and implied threats.<sup>6</sup> Under the

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\* J.D. Candidate, 1999, Fordham University. This Comment is dedicated to my parents for all of their love and support.

1. See Peter Landers, *Limited Exposure: Scandal Shakes Japan Inc. But Doesn't Speed Reform*, FAR E. ECON. REV., Feb. 12, 1988, at 62 (reporting bribery scandal involving Ministry of Finance ("Ministry") officials).

2. See ROBERT C. HSU, THE MIT ENCYCLOPEDIA OF THE JAPANESE ECONOMY 336 (1994) (providing synopsis of Ministry). The Japanese Government established the Ministry in 1870 and it is the most elitist and the most powerful of all ministries in Japan. *Id.* The Ministry has the highest budget and the largest staff of all ministries. *Id.*

3. See *id.* at 236 (defining Japanese securities markets as consisting of primary market for new issues and secondary market for stock trading). The primary market concerns raising corporate funds through issuing shares of the company. *Id.* The secondary market consists of trading on the stock exchanges and over-the-counter trading in the offices of securities companies. *Id.*

4. See JOHN OWEN HALEY, AUTHORITY WITHOUT POWER: LAW AND THE JAPANESE PARADOX 163 (1991) (outlining administrative guidance as informal means of governmental persuasion); ELLIOT J. HAHN, JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM 113 (1984) (detailing significant feature of administrative guidance as minimal statutory authorization); see also C. Jeffrey Char, *Reforming Japan's Securities Markets: The Loss Compensation Scandal*, 10 INT'L TAX & BUS. LAW. 173, 190 (1993) (describing informal regulation of Japanese securities market); Ken Duck, *Now That the Fog Has Lifted: The Impact of Japan's Administrative Procedures Law on the Regulation of Industry and Market Governance*, 19 FORDHAM INT'L L.J. 1686, 1687 (1996) (designating administrative guidance as process using implied threats of action or inaction to effect compliance with administrative goal).

5. See HSU, *supra* note 2, at 308 (explaining that securities companies were established in accordance with Securities and Exchange Law of 1948 ("SEL") for underwriting and trading of securities).

6. See Curtis J. Milhaupt, *Managing the Market: The Ministry of Finance and Securities*

guidance of the Ministry, Japan's financial systems flourished.<sup>7</sup> Indeed, the informal regulation helped to propel the Tokyo stock market, the *Nikkei*, to become one of the world's premier markets.<sup>8</sup>

This type of regulation, however, created an environment that led to numerous scandals in Japan over the past ten years.<sup>9</sup> The scandals sparked criticism from both the Japanese public<sup>10</sup> and the international community.<sup>11</sup> The scandals also sparked a cycle of reforms to the Japanese Securities and Exchange Law<sup>12</sup> ("SEL") and the Ministry. Despite these reforms, however, scan-

*Regulation in Japan*, 30 STAN. J. INT'L L., 423, 451-52 (1994) (describing that reason behind Ministry keeping number of securities companies low is to maintain better control); see also HAHN, *supra* note 4, at 114-15 (elaborating on Ministry's use of threats and incentives); Duck, *supra* note 4, at 1687 (discussing administrative guidance).

7. See Barbara Wanner, *Financial Scandals Renew Focus on Bureaucratic Power*, JEI REPORT, Mar. 6, 1998, at 5 (explaining experts' belief that Ministry's method of regulation is reason for Japan's growth from 1950s through 1970s); see also Jon Choy, *Japan's Financial Market Big Bang: The First Shock Waves*, JEI REPORT, June 12, 1998, at 1 (describing post World War II financial system as contributing significantly to Japan's rapid economic expansion).

8. See TAKEJI YAMASHITA, JAPAN'S SECURITIES MARKETS: A PRACTITIONER'S GUIDE I (1989) (describing strength of Japan securities markets in late 1980s by explaining that at its height, in 1989, the trading volume for Japan's equity markets was 328.3 billion shares).

9. See Choy, *supra* note 7, at 3 (describing how informal contacts and collusion between Ministry and securities companies disadvantages Japan when questionable activities are allowed); see also Shen-Shin Lu, *Securities Regulation in Japan: An Update*, 22 DENV. J. INT'L L. & POL'Y 121, 150 (1993) (explaining circumstances of Recruit scandal of 1988); Wanner, *supra* note 7, at 1 (detailing 1998 scandal involving banks bribing Ministry officials).

10. See JONATHAN ISAACS & TAKASHI EJIRI, JAPANESE SECURITIES MARKET 138 (1990) (noting that Recruit Scandal festered in Japanese and international press for over one year); see also *id.* at 135 (mentioning outcry that occurred after Tateho Scandal came to light); Milhaupt, *supra* note 6, at 466 (establishing public's outcry after Loss Compensation scandal and demand for independent securities regulator); Wanner, *supra* note 7, at 8 (reporting public's anger at having to pay billions of dollars after failure of seven housing loan associations). The public was especially upset because the Ministry admitted that it had known the loan associations were in trouble for years but did nothing about it. Wanner, *supra*.

11. See E.B. Keehn, *Virtual Reality in Japan's Regulatory Agencies*, in JAPAN: ECONOMIC SUCCESS AND LEGAL SYSTEM 321 (Harald Baum ed., 1997) (describing international condemnation of regulatory style after Loss Compensation scandal in 1991); see also Gillian Tett, *Japan to Scale Back Probes into Financial Institutions Corruption*, FIN. TIMES, May 25, 1998, at 18 (reporting Western investors' dissatisfaction with Japanese governments' failure to overhaul its system for regulating financial institutions after *MoF-Tan* scandal).

12. Shoken Torihiki Ho [Securities and Exchange Law], Law No. 25 of 1948 [hereinafter SEL].

dals continued to occur in the Japanese securities market.<sup>13</sup>

In a further effort to address its market problems, the Japanese government recently made its boldest step in a long process of reform toward creating a free,<sup>14</sup> fair,<sup>15</sup> and global<sup>16</sup> market (the "Big Bang").<sup>17</sup> The planned reforms represent the government's philosophical shift in regulating the securities industry.<sup>18</sup> As part of the Big Bang, the Japanese government intends to restructure its securities regulation from a process based on informal regulation and protectionism to one based on oversight and market competition.<sup>19</sup>

This Comment analyzes Japan's effort to create a competitive securities market that is free, transparent, and reliable. Part I describes Japan's regulatory environment, emphasizing the power and authority of the Ministry and its influence within the Japanese government and over the securities industry. Part II details elements of the Big Bang reforms and describes the current political situation that will influence the effectiveness of the reforms. Part III addresses the probable effectiveness of the reforms in the context of Japan's regulatory structure, past scandals and reforms, and current political environment. Finally, this Comment argues that the Ministry has the ability to control the reformation of the securities industry because of the Ministry's extensive influence within the government and over the securities industry. In addition, this Comment argues that the reforms initiated by the Japanese government will be ineffective in changing the regulation of the securities industry because the

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13. See Edward J. Lincoln, *Japan's Economic Mess*, JEI REPORT, May 8, 1998, at 14 (stating that although deregulation and structural change occurred in Japan from mid 1970s to mid 1990s, there was little fundamental reform).

14. See Ministry of Finance, *Structural Reform of the Japanese Financial Market: Toward the Revival of the Tokyo Market by the Year 2001* (visited Mar. 16, 1998) <<http://www.mof.go.jp/english/big-bang/ebb7.htm>> (on file with the *Fordham International Law Journal*) [hereinafter *Structural Reform*] (defining free as "liberaliz[ing] entry, products, prices, etc.").

15. See *id.* (defining fair as "clarify[ing] and enhanc[ing] transparency of rules and to protect investors interest").

16. See *id.* (defining global as "establishing a legal system, accounting system, and supervisory regime consistent with globalization").

17. *Id.*

18. See Choy, *supra* note 7, at 1-7 (describing traditional system of regulation by Ministry and proposed reforms).

19. See *id.* (arguing that informal regulation and protectionism by Ministry is weakness of economy and detailing reform proposals).

reforms threaten to reduce the Ministry's authority over the securities industry.

### I. *REGULATORY ENVIRONMENT IN JAPAN'S SECURITIES INDUSTRY PRIOR TO THE BIG BANG*

Three interconnected factors define the regulatory environment in Japan's securities industry.<sup>20</sup> The dominant factor of the Japanese securities industry is the Ministry.<sup>21</sup> Another important element of securities regulation is the SEL.<sup>22</sup> A final contributing factor in shaping Japan's regulatory environment involves the scandals caused by the Ministry and securities companies and the reforms that followed the scandals.<sup>23</sup>

#### A. *Ministry of Finance*

The Ministry's extensive reach throughout all aspects of securities regulation makes it the dominant factor in shaping Japan's securities industry.<sup>24</sup> The basis for the Ministry's influence is its broad authority within the Japanese government.<sup>25</sup> The Ministry also retains extensive power over the securities industry because of its pervasive method of regulation.<sup>26</sup> Additionally, the Ministry's close ties with the securities companies further

20. See Tomoko Akashi, *Regulation of Insider Trading in Japan*, 89 COLUM. L. REV. 1296, 1297 (1989) (discussing adoption of SEL in 1948, Ministry's use of SEL, and effect of scandals and reforms on Ministry and SEL in analysis of regulation of insider trading in Japan).

21. See Clifford Chance, *Japan*, in INTERNATIONAL SECURITIES LAW 189 (1996) (stating that "[r]eal supervisory power over the Japanese financial system resides with the [Ministry]").

22. See Hideki Kanda, *Finance Bureaucracy and the Regulation of Financial Markets in Japan*, in JAPAN: ECONOMIC SUCCESS AND LEGAL SYSTEM 306 (Harald Baum ed., 1997) (stating that "[t]he fundamental statute for the regulation of capital markets in Japan is the Securities and Exchange Law.>").

23. See Shen-Shin Lu, *supra* note 9, at 127-52 (detailing scandals and reforms that shaped securities regulation in Japan).

24. See Milhaupt, *supra* note 6, at 444 (stating that Ministry is "perceived, both by itself and by the public, as the nation's most elite civil service, as guardian of the nation's economic health, and as breeding ground of prime ministers, in short as the pinnacle of the Japanese state").

25. See *id.* (stating that "[t]he sweeping range of [Ministry's] jurisdiction assures the centrality of its role in the Japanese bureaucracy").

26. See Michael K. Young, *Judicial Review of Administrative Guidance: Governmentally Encouraged Consensual Dispute Resolution in Japan*, 84 COLUM. L. REV. 923 (1984) (describing benefits to Ministry in using administrative guidance).

add to its broad authority over the securities industry.<sup>27</sup>

### 1. Broad Authority Within the Japanese Government

The Ministry's power within the Japanese government began at the Ministry's inception and grew over the years.<sup>28</sup> The Ministry's original power base derived from its responsibility for the collection of taxes.<sup>29</sup> This power slowly grew into complete responsibility over many aspects of the Japanese government's financial operations.<sup>30</sup>

#### a. Historical

The Japanese government founded the Ministry in 1869, after the collapse of its feudal system, as a tax gathering organization.<sup>31</sup> In the 1930s, the Ministry's authority over the Japanese economy expanded from the collection of taxes to the regulation of the Japanese financial system.<sup>32</sup> This authority expanded further after World War II with the dismantling of other more powerful forces of Japan.<sup>33</sup>

During World War II the military controlled Japan.<sup>34</sup> After the Allied victory over Japan, the Allied Occupational Force<sup>35</sup> dismantled the military and Home Ministry, thereby leaving a power vacuum.<sup>36</sup> In addition, the Allied forces dismantled the

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27. See PETER HARTCHER, *THE MINISTRY: HOW JAPAN'S MOST POWERFUL INSTITUTION ENDANGERS WORLD MARKETS* 8-30 (1998) (describing importance to Ministry of close ties with industry in guiding securities industry).

28. See Eamonn Fingleton, *Japan's Invisible Leviathan*, *FOREIGN AFF.*, Mar.-Apr. 1995, at 72 (outlining origin of Ministry as tax collector for Japanese Government and expansion to current powers within government as overseeing Japan's financial health).

29. *Id.*

30. *Id.*

31. See *id.* (describing Ministry as Japan's oldest surviving power center). From inception, the Ministry gained power through its members. *Id.* For example, four of its first recruits became four of the oligarchs who dominated Japan over the next 50 years as Prime Ministers and business leaders. *Id.*

32. See *id.* (stating that powerful Japanese military gave Ministry power over Japanese financial system to direct large amounts of capital into munitions industries).

33. See *id.* (describing evolution of Ministry during World War II caused by a power vacuum after military and Home Ministry were dismantled).

34. See *id.* (setting forth structure of Japanese governance during World War II as controlled by Japanese military and Home Ministry).

35. See KENNETH L. PORT, *COMPARATIVE LAW: LAW AND THE LEGAL PROCESS IN JAPAN* 636 (1996) (explaining that World War II ended in 1945 with Japan signing of Potsdam Declaration, at which time Japan came under the control of Allied Occupying Force).

36. See *id.* (explaining change in governance of Japan after World War II when Ministry adopted power after military and Home Ministry were dismantled).

*zaibatsu*,<sup>37</sup> another powerful economic force in Japan.<sup>38</sup> *Zaibatsu* were huge holding companies that dominated the Japanese economy and were run by the capitalist class.<sup>39</sup> With the powerful military, Home Ministry, and capitalist class in disarray, the Ministry filled the void.<sup>40</sup>

#### b. Structural

Currently, the Ministry's authority extends far beyond mere tax collection to include many aspects of the Japanese government.<sup>41</sup> Central to the Ministry's power within the Government is the Budget Bureau,<sup>42</sup> which is responsible for compiling the National Budget.<sup>43</sup> Responsibility over the budget gives the Ministry power because the system forces all other agencies to negotiate with the Ministry for their share of the budget.<sup>44</sup> Budget responsibility also gives the Ministry power because the Ministry has the ability to effect the behavior of Japan's National *Diet*<sup>45</sup>

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37. See Hsu, *supra* note 2, at 405 (defining *zaibatsu* as number of various affiliated companies that were controlled by one holding company and that typically maintained close cooperation).

38. See Milhaupt, *supra* note 6, at 433-36 (describing redistribution of *zaibatsu* shareholdings to public in effort to dissolve *zaibatsu*).

39. Fingleton, *supra* note 28, at 72.

40. See *id.* (explaining that Allied Forces dismantling of military, Home Ministry, and *zaibatsu* acted as catalyst to Ministry's obtaining present day powers).

41. See Duck, *supra* note 4, at 1714-15 (noting that budget power, along with tax and monetary power, give Ministry central position in Japanese bureaucracy).

42. See ADMINISTRATIVE MANAGEMENT BUREAU, MANAGEMENT AND COORDINATION AGENCY, PRIME MINISTER'S OFFICE, ORGANIZATION OF THE GOVERNMENT OF JAPAN 1997 54 (1997) (discussing authority of Budget Bureau ("BB") as responsible for investigating, planning, drafting, and consolidating budget).

43. See Duck, *supra* note 4, at 1714-15 (describing power of Ministry derived from budget responsibilities); see also Fingleton, *supra* note 28, at 70 (setting forth that *Diet* has no substantive budget power and merely approves Ministry's budget).

44. See Duck, *supra* note 4, at 1714-15 (examining Ministry's power over other Japanese agencies because of budgetary power); see also STEPHEN BRONTE, JAPANESE FINANCE: MARKETS AND INSTITUTIONS 132 (1982) (explaining Ministry's process for creating budget for other ministries). Officials of the various agencies spend five months negotiating with the Ministry for budget allotments. *Id.* The Ministry bases budget decisions on political as well as economic justifications. *Id.* The Ministry is likely to give a greater budgetary allotment to those other agencies that have a strong minister and that can mobilize support from the electorate. *Id.*

45. See ADMINISTRATIVE MANAGEMENT BUREAU, *supra* note 42, at 2 (discussing role of *Diet* in Japanese government as legislative branch of Japanese government that is composed of House of Representatives and House of Counsilors); see also Michael K. Young & Constance C.H. Jameson, *Introduction to Japanese Law*, in JAPAN BUSINESS LAW GUIDE (CCH) 2604 (M. Matsushita et al. eds., 1991) (describing derivation of present *Diet* from Imperial *Diet* established by Meiji Constitution in 1890). The Imperial *Diet*



("Diet") and Prime Minister by threatening to withhold completion of the budget.<sup>46</sup>

The Ministry also has responsibility over the National Tax Administration Agency,<sup>47</sup> the Financial Bureau,<sup>48</sup> the Interna-

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had limited power. *Id.* The Emperor retained all authority to propose and to draft legislation. *Id.* During the Taisho Era (1912-1926), the *Diet's* power increased as the *Diet* formalized and democratized its procedures. *Id.* The *Diet*, however, was unable to control the budget or to provide other meaningful checks on the exercise of executive power. *Id.* By the 1930s, the military and bureaucracy controlled Japan. *Id.* The military and bureaucracy were beyond any control of the *Diet* because they both had direct access to the Emperor. *Id.* In 1946, the Allied Forces implemented a Constitution that transformed the Imperial *Diet* into the National *Diet*. *Id.* The Japanese Constitution designates the National *Diet* as the highest organ of state power and the sole lawmaking organ of the state. *Id.*

46. See HARTCHER, *supra* note 27, at 205-208 (illustrating Ministry's power in Japan by detailing its ability to affect Prime Ministry through control over budget). In 1993, the Japanese people elected Prime Minister Hosokawa based on a platform of political reform and economic deregulation. *Id.* at 205. The new government espoused a bigger role for the marketplace and a lesser one for regulations. *Id.* Similarly, the government wanted a larger role for politicians over bureaucrats. *Id.* Hosokawa failed to fulfill this platform, however, because he left office in 1994. *Id.* at 205-207.

Hosokawa resigned as a result of proposing an unpopular increase in the consumption tax from three percent to seven percent. *Id.* The increase came at the insistence of the Ministry a year earlier. *Id.* at 205. Hosokawa took office with a promise to decrease taxes to assist an economy in the midst of a recession. *Id.* The Ministry agreed to the tax cut, but only if Hosokawa would include, in the same legislation, an increase in the consumption tax for the next year. *Id.* When Hosokawa initially refused to create legislation that included an increase in the consumption tax, the Ministry blocked the efforts to compile the national budget. *Id.* at 206. Ultimately, the Ministry won. *Id.* On February 3, 1994, Hosokawa announced that the tax cut would be followed by a tax increase. *Id.* at 207. The political uproar that followed the proposed tax increase was fatal to the credibility and popularity of the Hosokawa government. *Id.*

47. See ADMINISTRATIVE MANAGEMENT BUREAU, *supra* note 42, at 54-57 (setting forth role of National Tax Administration Agency ("NTAA") in Japanese government as responsible for assessment and collection of national tax). The NTAA investigates and inspects income and other tax bases and exposure of large scale tax evasion. *Id.* The NTAA also controls most aspects of liquor production and sale. *Id.*

48. See *id.* at 55 (discussing role of Financial Bureau ("FB") in Japanese government as coordinating treasury, public finance and monetary system, domestic finance, and international finance). The FB also researches, plans, and drafts the treasury system, the government debt system, the currency system, and the national property system. *Id.* In addition, this bureau adjusts the receipts and payments of treasury funds and the issue, redemption, and interest payment of government bonds. *Id.* Moreover, the FB controls and operates the Trust Fund Bureau Fund and controls of the Industrial Investment Special Account. *Id.* Furthermore, this bureau compiles the Fiscal Investment and Loan Program and also matters concerning loans to local governments. *Id.* The FB has general control over national property, management and disposal of non-administrative property, construction, maintenance, and management of housing for government officials. *Id.* Additionally, this bureau investigates, plans, and drafts

tional Finance Bureau,<sup>49</sup> the Insurance Department,<sup>50</sup> the Tax Bureau,<sup>51</sup> the Customs and Tariffs Bureau,<sup>52</sup> the Minister's Secretariat,<sup>53</sup> the Banking Bureau,<sup>54</sup> and the Securities Bureau.<sup>55</sup> To form a comparable authority in the U.S. system of administrative governance, the Department of Treasury,<sup>56</sup> the Office of Management and Budget,<sup>57</sup> the Securities and Exchange Com-

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the monopoly system and tobacco industries system and supervision over Japan Tobacco Inc. *Id.*

49. *See id.* at 56 (explaining role of Japan's International Finance Bureau ("IFB") as researching and planning international finance, foreign exchange, and matters concerning the adjustment of payment balances). The IFB manages the Foreign Exchange Fund, Foreign Exchange Special Account, foreign exchange rates, and control of foreign exchange transactions. *Id.* The IFB also authorizes and supervises foreign exchange banks and money changers. *Id.* The IFB controls foreign aid, overseas private investment, and inflow of foreign capital. *Id.* Additionally, the IFB controls the keeping of statistics on foreign exchange and the balance of payments. *Id.*

50. *See id.* at 15 (outlining structure of Ministry and showing that Insurance Department is part of Banking Bureau).

51. *See id.* at 54 (detailing responsibilities of Tax Bureau ("TB") as researching, planning, and drafting systems concerning taxes, including tax conventions between Japan and other countries). The TB also investigates tax revenue estimates and actual tax revenue. *Id.* In addition, the TB also plans and drafts systems for certified tax accountants and the Liquor Business Associations. *Id.* Moreover, the TB controls revenue of local public entities. *Id.*

52. *See id.* at 55 (describing duties of Customs and Tariffs Bureau ("CTB") as researching, planning, and drafting systems concerning customs duties and tonnage dues). The Bureau also enforces export and import regulations for goods, vessels, aircraft, and passengers. *Id.* Moreover, the Bureau investigates, plans, and drafts agreements on customs and tariffs and researches foreign customs systems. *Id.* Furthermore, the Bureau supervises and licenses customhouses and customs officers. *Id.*

53. *See id.* at 54 (assessing powers of Ministry's Secretariat ("MS") as Secretariat assisting Minister and Vice Ministers in general administration of Ministry and acting as liaison between different Bureaus to ensure efficient operation of government). The MS also oversees important matters that fall outside the scope of the individual bureaus. *Id.* In addition, the MS controls matters concerning secrecy, personnel changes, and discipline. *Id.* Furthermore, the MS supervises matters concerning public information and the Diet and manages the Local Finance Bureaus. *Id.*

54. *See Financial Supervision Agency Begins Work*, KYODO NEWS, June 22, 1998 [hereinafter KYODO NEWS] (noting that Securities Bureau recently merged with Banking Bureau to become Financial Planning Bureau after removal of investigatory duties of both by Diet to form Financial Supervision Agency ("FSA")).

55. *Id.*

56. *See* BRUCE WETTERAU, DESK REFERENCE ON AMERICAN GOVERNMENT 94 (1995) (detailing Department of Treasury's duties as managing federal government's monetary resources, operating U.S. mints, regulating U.S. banks, collecting taxes and customs duties, and overseeing Secret Service).

57. *See id.* at 27 (describing Office of Management and Budget's responsibilities as assisting U.S. President in preparing annual budget request, reviewing all executive branch proposals to Congress, and reviewing all legislation passed by Congress and sent to President for signing).

mission,<sup>58</sup> and insurance regulatory agencies<sup>59</sup> would have to merge.<sup>60</sup> Because of this authority within the Japanese government, the Ministry has been characterized as being unparalleled in the industrialized world.<sup>61</sup>

## 2. Broad Authority over the Securities Industry

The Ministry's authority over the securities industry equals its power within the Japanese government.<sup>62</sup> One major source for this authority comes from the Ministry's ability to draft legislation.<sup>63</sup> Another important source is the Ministry's regulation of the securities industry through administrative guidance.<sup>64</sup>

### a. Legislative Drafting

A large part of the Ministry's authority over the securities industry originates in its role as the drafter of legislation.<sup>65</sup> Japan's Constitution<sup>66</sup> gives the principal power to draft legislation to the *Diet*.<sup>67</sup> The bureaucrats of Japan's government actually

58. See LOUIS LOSS, *A Synopsis of Securities Regulation in the United States*, in JAPANESE SECURITIES REGULATION 4-5 (Louis Loss et al. eds., 1983) (discussing role of Securities and Exchange Commission ("SEC") in U.S. Government as administrative body that is responsible for securities regulation). The SEC regulates the securities markets through enforcing statutes, adopting rules, and holding hearings. *Id.* The SEC is an independent, multimember, bipartisan commission. *Id.* It has five Commissioners, which are appointed by the President with consent of the Congress. *Id.*

59. See GLOSSARY OF INSURANCE TERMS 132 (Thomas E. Green ed., 1996) (establishing that each state regulates insurance industry in that state and that regulatory agency is headed by Insurance Commissioner).

60. See Char, *supra* note 4, at 188 (describing role of Ministry in governance of Japan).

61. See HARTCHER, *supra* note 27, at 2 (stating that Ministry is "a political, economic, and intellectual force without parallel in the developed world.").

62. See Chance, *supra* note 21, at 189 (describing broad supervisory authority over Japanese financial system).

63. See George F. Parker, *The Regulation of Insider Trading in Japan: Introducing a Private Right of Action*, 73 WASH. U. L.Q. 1399, 1412 (1995) (stating that because Ministry has power to draft legislation and to enforce legislation, it also has inherited power to rule).

64. See Hsu, *supra* note 2, at 1 (defining administrative guidance as bureaucrats implementing official policies by giving suggestions or unwritten orders to regulated parties). Administrative guidance is based on the broad discretionary power of the bureaucracy rather than specific laws. *Id.*

65. See *supra* note 63 and accompanying text (describing Ministry's power to draft legislation).

66. KENPŌ. art. 41.

67. See Wanner, *supra* note 7, at 4 (examining legislative powers and authority in Japanese government).

draft the legislation, however, because of the lack of staff and policy development resources in the *Diet*.<sup>68</sup> In fact, bureaucrats draft over ninety percent of all legislation enacted by the *Diet*.<sup>69</sup>

The Ministry's authority over legislative drafting reaches as deep as the actual debates in the *Diet* regarding legislation drafted by the Ministry.<sup>70</sup> The bureaucrats usually script both sides of the debate between the supporters of the bill and its opponents.<sup>71</sup> The responsibility of the bureaucrats in drafting legislation is so broad that one bureaucrat has been quoted as saying that the *Diet* is an extension of the bureaucracy.<sup>72</sup>

### b. Administrative Guidance

The Ministry also retains pervasive authority over the securities industry by means of its practice of regulating through administrative guidance.<sup>73</sup> Administrative guidance is a process by which the Ministry obtains voluntary cooperation from securities companies through extra-legal means.<sup>74</sup> Generally, the Ministry

68. *See id.* at 1, 4 (describing *Diet's* lack of participation in legislation drafting process); *see also The Japan Puzzle: Hurling Towards Paralysis*, *ECONOMIST*, Mar. 21, 1998, at 22 [hereinafter *Japan Puzzle*] (describing absence of input by *Diet* in legislation drafting process). The bureaucracy is the only institution in Japan's government that is capable of weighing competing ideas and formulating solutions. *Id.* Most of the legislation created by the Japanese government starts at low levels at the various ministries and works its way up through the ministries until it is ready for the *Diet*. *Id.* Once in the *Diet*, bureaucrats are called to handle the tricky questions. *Id.* The minister of the applicable Ministry is only involved to shepherd the bill through the *Diet*. *Id.* The role of the cabinet is to coordinate the legislative agenda and to seek a consensus with other political parties. *Id.* The Prime Minister has little real power. *Id.*

69. *See Parker, supra* note 63, at 1412 (detailing breadth of Ministry's ability to draft legislation).

70. *See Wanner, supra* note 7, at 4 (setting forth argument that bureaucrats hold ascendant position to lawmakers in Japan).

71. *Id.*

72. *See id.* (stating that Japan is government of administration, not laws).

73. *See Young, supra* note 26, at 923 (emphasizing various powers gained by ministries when using administrative guidance).

74. *See HALEY, supra* note 4, at 163 (reviewing Ministry's system for regulating securities industry). The Ministry often regulates the securities industry without direct statutory authority and thus without following institutionalized laws. *Id.* Instead, the Ministry acts through negotiation and compromise to gain consensus. *Id.* Through gaining consensus, regulation by the Ministry also escapes adjudicatory law. *Id.* Specifically, Japan's court system is reluctant to review orders of the Ministry if the regulated party consented to them. *Id.*; *see also HAHN, supra* note 4, at 118 (defining institutional law as those that are created by political body and adjudicatory law as means by which institutionalized laws are reviewed and as means by which non-legal rules are legitimized).

avoids invoking direct statutory authority to effect behavior.<sup>75</sup> Instead, it uses provisions of the SEL as support for threats and incentives to coerce the regulated parties to consent to the regulatory action.<sup>76</sup> Administrative guidance allows the Ministry to gain broader authority over the securities markets<sup>77</sup> and greater flexibility in regulation.<sup>78</sup>

The Ministry's main support for threats and incentives derives from the licensing provisions of the SEL.<sup>79</sup> A financial crisis in the securities industry precipitated the adoption of this licensing system.<sup>80</sup> By 1965, Japanese securities companies became seriously overextended from excessive promotional activities.<sup>81</sup> The collapse of the securities market in the same year forced some companies into bankruptcy and left many others in poor health.<sup>82</sup> The Ministry was unable to prevent the crisis through available legal tools.<sup>83</sup> As a result, the *Diet* amended the SEL to include the licensing requirement.<sup>84</sup>

The ability to license corporations provides the Ministry with the ability to guide securities companies in a desired direction by implicitly threatening to suspend or revoke those licenses if the companies do not consent to direction.<sup>85</sup> Similarly, the

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75. HALEY, *supra* note 4, at 163.

76. See Milhaupt, *supra* note 6, at 450 (describing importance of licensing section of SEL to Ministry's regulatory posture).

77. See Young, *supra* note 26, at 936 (stating that "[b]ecause the use of administrative guidance frees an agency from the specific moorings of the governing statutory language, it may not only expand the scope of its activity, but also redefine the very nature of the regulatory mandate.").

78. See *id.* (examining advantages of Ministry's use of administrative guidance); see also Duck, *supra* note 4, at 1708 (stating that "[t]he flexibility or extra-legal nature of administrative guidance means that its exercise is not always constrained by any legal limits").

79. See Milhaupt, *supra* note 6, at 450 (describing Ministry's use of licensing section of SEL to regulate securities industry).

80. See *id.* at 449-50 (detailing adoption of licensing system in response to crisis in securities industry).

81. See Christopher P. Wells & Haruko Yamamori, *Securities & Banking Law, in JAPAN BUSINESS LAW GUIDE* (CCH) 55,104 (M. Matsushita et al. eds., 1991) (examining reasons for 1965 collapse of Japan's securities market).

82. See *id.* (noting effects of collapse of securities market in 1965).

83. See *id.* (discussing Ministry's inability to prevent 1965 market crisis because legal tools of Ministry were inadequate to handle crisis at that time).

84. See *id.* (explaining *Diet's* reasons for amending SEL and effects of amendments); see also Milhaupt, *supra* note 6, at 449-50 (detailing decline in securities companies after implementation of licensing system from 600 securities in 1962 to 277 in 1968).

85. SEL art. 35; see MISAO TATSUTA, *SECURITIES REGULATION IN JAPAN* 71 (1970)

Ministry can direct securities firms by threatening to deny licenses to engage in new lines of business, or by offering an incentive of permission to develop a new product.<sup>86</sup> Most securities companies follow administrative guidance because they know that any future requests of the Ministry will depend on their present behavior.<sup>87</sup>

Licensing is also an important part of administrative guidance because licensing allows the Ministry to limit the number of securities firms operating in the industry.<sup>88</sup> With a limited number of firms in operation, the Ministry monitors the industry more easily.<sup>89</sup> Moreover, the Ministry can engage in preventive regulation by barring market entry to unqualified or unscrupulous securities companies.<sup>90</sup> Thus, the Ministry has full control over competition in the market because the Ministry controls not only the products sold through licensing but also the number of market participants.<sup>91</sup>

The Ministry benefits from regulating through administrative guidance because there is little judicial review of the Minis-

(outlining elements of SEL Article 35). The Ministry may revoke or suspend a license if the amount of stated capital of the securities company has decreased to below the statutory minimum. *Id.* The Ministry may also revoke a license if the company has been convicted of a fine pursuant to the SEL. *Id.* In addition, the Ministry may revoke a license if the securities company has violated the law, an administrative order pursuant to the law, or the qualification attached to the license. *Id.* Moreover, the Ministry may revoke a license if the securities company is on the verge of insolvency and the revocation is indispensable to prevent further losses by investors. *Id.*

86. See Milhaupt, *supra* note 6, at 451 (examining Ministry's power over securities companies through use of licensing provision of SEL); see also Hideki Kanda, *Developments in Japanese Securities Regulation: An Overview*, 29 INT'L LAW. 599, 609 (1995) (detailing Ministry's authority over securities companies). Security companies are not allowed to market any product that is not explicitly endorsed by the Ministry. *Id.*

87. See BRONTE, *supra* 44, at 130 (setting forth that companies that ignore administrative guidance risk future retribution by Ministry); see also Duck, *supra* note 4, at 1703-04 (stating that "[r]ecipients of guidance, because of the need for close amicable relations with bureaucrats, generally do not challenge administrative guidance.").

88. See Milhaupt, *supra* note 6, at 451-52 (highlighting that reduced number of securities companies to regulate is advantage to limiting grant of licenses).

89. See *id.* (noting ease of regulating securities industry when number of securities companies is low).

90. See *id.* (noting further advantage to licensing system is preventing securities firms that may potentially cause damage to industry and public from entering securities industry); see also MOF Opposes Calls for Japanese SEC, Offers Merger of Investigation Bureaus, INT'L SEC. REG. REP., July 29, 1991, at 2 (explaining that Ministry has stated that "it is more efficient and preferable for us to stop malpractice before it happens.").

91. See Choy, *supra* note 7, at 2-3 (discussing absolute power of Ministry over Japanese securities market).

try's work.<sup>92</sup> Administrative guidance generally does not change the legal relationships of the parties receiving guidance.<sup>93</sup> Japanese courts, in fact, traditionally considered challenges to administrative guidance to be non-justiciable.<sup>94</sup> Generally, the court accepts the argument that the companies exercised voluntary compliance and therefore the plaintiffs had no claim for relief.<sup>95</sup> The non-judiciability of informal regulatory guidance gives the Ministry almost absolute control over the regulatory process when coupled with its ability to draft, interpret, and enforce the laws.<sup>96</sup>

### 3. Extent of Reach Within Securities Companies

The Ministry's relationship with the securities companies is another factor that facilitates its authority within the securities industry.<sup>97</sup> One aspect of this relationship is the Ministry's practice of disseminating information to the industry through a small number of large firms.<sup>98</sup> The Ministry also controls the securities companies by ensuring that the securities companies rely on the Ministry for valuable information.<sup>99</sup>

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92. See Young, *supra* note 26, at 933 (setting forth that "administrative guidance is an act of factual and not legal character"). See generally Duck, *supra* note 4, at 1703-07 (outlining judicial role in administrative guidance regulatory structure).

93. See Young, *supra* note 26, at 933 (explaining that administrative guidance lacks legal effect because legal relationship between Ministry and securities companies is not changed by regulating through administrative guidance); see also Duck, *supra* note 4, at 1704 (stating that ministries do not act in way that creates legal rights when they exercise their influence informally).

94. See Young, *supra* note 26, at 954 (noting Japanese courts' attitude that administrative guidance issues fall outside their domain); see also PORT, *supra* note 35, at 636 (explaining that administrative courts were separated from judicial courts because judicial courts were established to adjudicate civil cases and had no power to deal in orders by administrative agencies).

95. See Young, *supra* note 26, at 954 (discussing courts' traditional deference to Ministry in matters of administrative guidance).

96. See *id.* at 936 (stating that "[a]dministrative guidance permits agencies to regulate not only beyond the limits of the law but also, on occasion, in direct contravention of the law").

97. See Char, *supra* note 4, at 189-92 (describing Ministry's relationship with securities companies by outlining various practices involving intermingling of employees).

98. See Milhaupt, *supra* note 6, at 452 (detailing Ministry's use of four largest ("Big Four") securities companies in regulating industry).

99. See Wanner, *supra* note 7, at 119 (explaining Ministry's method of controlling securities companies by drafting vague legislation).

## a. Securities Companies

The Japanese securities industry is divided into three tiers accounting collectively for 220 securities companies.<sup>100</sup> The first tier dominates the securities industry and consists of three major companies known as Nomura Securities,<sup>101</sup> Daiwa Securities,<sup>102</sup> and Nikko Securities.<sup>103</sup> Before the failure of the fourth largest security company, Yamaichi Securities,<sup>104</sup> in 1997, the industry referred to the first tier as the Big Four.<sup>105</sup> The Ministry uses the first tier securities companies as a means of controlling the rest of the industry.<sup>106</sup> Regular meetings between the Ministry and the first tier securities companies ensure that the Ministry's views disseminate quickly.<sup>107</sup> The balance of the industry consists of the second tier of securities companies, designated the "Middle Ten" medium-size companies,<sup>108</sup> and the third tier of companies consisting of the remaining smaller companies.<sup>109</sup>

## b. Relationship Between the Ministry and the Securities Companies

The Ministry's interaction with securities companies is exemplified by a couple different practices.<sup>110</sup> One practice involves the Ministry placing former Japanese government bureau-

100. See JONATHAN ISAACS, *JAPANESE EQUITIES MARKETS* 111 (1990) (describing generally structure of securities industry in Japan).

101. See *id.* at 112 (stating that Nomura Securities was founded in 1925 as offshoot of bond trading department of Daiwa Bank and is premier securities firm in Japan).

102. See *id.* at 114 (detailing that Daiwa Securities was established in 1902 as part of Fujimoto Bill Broker company and is second largest securities firm in Japan).

103. See *id.* at 115 (explaining that Nikko Securities is third largest securities company in Japan).

104. See David P. Hamilton & Bill Spindle, *Market's Harsh Justice Staggers Yamaichi*, *ASIAN WALL ST. J.* Nov. 24, 1997 (discussing Yamaichi Securities opening in 1897 and closing in November 1997).

105. See Char, *supra* note 4, at 179 (designating Big Four securities companies as Nomura Securities, Daiwa Securities, Nikko Securities, and Yamaichi Securities).

106. See *id.* (explaining that structure of Japan's securities market aids its functioning because smaller securities companies look to larger securities companies for guidance in operations).

107. See Milhaupt, *supra* note 6, at 453 (describing Big Four companies as Ministry's "foot soldiers" in its regulation of securities industry).

108. ISAACS, *supra* note 100, at 111.

109. *Id.*

110. See Duck, *supra* note 4, at 1696-1704 (outlining practices of *amakudari* and *MoF-Tan*, and effect of practices on Japanese governments guidance of industry).



crats into the private sector.<sup>111</sup> A second practice involves the securities companies placing employees in jobs at the Ministry.<sup>112</sup>

i. *Amakudari*

*Amakudari* (literally - decent from heaven) is the process by which the Ministry places retiring bureaucrats in executive positions in the securities industry.<sup>113</sup> The Ministry uses the *amakudari* system both to reward its bureaucrats for years of loyalty and hard work, and to give incentives to the junior bureaucrats by making room for them at the top by retiring senior bureaucrats into the private sector.<sup>114</sup> Whether the retiring bureaucrat gets the job depends on the bureaucrat's ties with the corporation and whether the bureaucrat has been sympathetic to industry.<sup>115</sup> One commentator defines *amakudari* as the primary tool and proof of complete economic guidance by the Japanese bureaucracy.<sup>116</sup>

ii. *MoF-Tan*

Another example of the close working relationship between the Ministry and the securities companies involves a practice known as *MoF-Tan*.<sup>117</sup> The practice of *MoF-Tan* involves employ-

111. See HARTCHER, *supra* note 27, at 32-37 (detailing Ministry's practice of *amakudari* as giving Ministry bureaucrats ability to enter private sector upon retirement with strong assistance from Ministry).

112. See *id.* at 57 (introducing financial institutions practice of using *MoF-Tans* in dealing with Ministry).

113. See Hsu, *supra* note 2, at 10 (elaborating on *amakudari* system as originated in early Meiji period when government created industrial and commercial undertakings for functionless samurai); see also Duck, *supra* note 4, at 1694 (explaining *amakudari* has roots in Meiji Era where, familial ties and bonds of friendship formed at Japan's national universities). These ties resulted in influential positions being distributed to friends and allies by those in power. Duck, *supra*.

114. See HARTCHER, *supra* note 27, at 33-34 (analyzing function of *amakudari* for Ministry to retire employees into companies that Ministry regulates).

115. FRANK K. UPHAM, LAW AND SOCIAL CHANGE IN POSTWAR JAPAN 167 (1987); see also Wanner, *supra* note 7, at 5 (explaining that Japan's National Public Service Law precludes bureaucrats from working for firms that they once supervised for at least two years). The National Public Agency can waive that requirement, however, if the bureaucrat's ministry requests. *Id.* In 1997, 164 former officials from the Ministry held jobs as executives or auditors at 128 financial firms. *Id.*

116. See CHALMERS JOHNSON, MITI AND THE JAPANESE MIRACLE: THE GROWTH OF INDUSTRIAL POLICY 1925-75 (1982) (describing generally *amakudari* system as used by Ministry of International Trade and Industry).

117. See HARTCHER, *supra* note 27, at 57 (explaining that *MoF-Tan* comes from

ees of regulated banks and securities companies who maintain offices within the Ministry to better facilitate the exchange of information.<sup>118</sup> The Ministry deliberately drafts vague legislation to gain more control over the regulatory process.<sup>119</sup> As a result, securities companies and other financial institutions send *MoF-Tans* into the Ministry to determine what to do to comply with the laws and regulations.<sup>120</sup> The Ministry benefits from this practice because, through the dialogue with the *MoF-Tans*, the Ministry develops a sense effective policies work more than others.<sup>121</sup> The securities companies benefit from this interaction because they are able to participate in the policy-making process of the Ministry.<sup>122</sup> In addition, the securities companies can also gather valuable information from the Ministry.<sup>123</sup> The most common type of information that the *MoF-Tans* will gather is the date of Ministry inspections.<sup>124</sup>

### B. *The Securities and Exchange Law*

The SEL is a second major influence in the Japanese securities market.<sup>125</sup> The SEL's initial strength resulted directly from

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MoF, which is English acronym for Ministry of Finance and *tan*, which is Japanese for responsibility); *see also* Duck, *supra* note 4, at 1695-1703 (describing *MoF-Tan* system as part of institutional arrangements that generate informal contact between Ministry and business).

118. *See* Duck, *supra* note 4, at 1701 (stating that "Japanese banks and securities companies station permanent employees at [Ministry] to obtain information for [Ministry] bureaucrats.").

119. *See* Wanner, *supra* note 7, at 5 (discussing Ministry's power to draft legislation in detailing extraordinary power wielded by Ministry).

120. *See id.* (describing Ministry's drafting of vague legislation as effort to maintain power over securities companies).

121. *See id.* (discussing benefit of drafting vague legislation is gaining closer working relationship with securities companies).

122. *See* Duck, *supra* note 4, at 1701-02 (describing securities companies' ability to participate in policymaking process of Ministry by having *tans* employed at Ministry).

123. *See id.* (detailing one reason that securities companies employ *MoF-Tan* is to gather important information from Ministry such as inspection dates).

124. *Id.*; *see* Kazunari Yokota, *Banks Vow to Change Ways amid Scandal*, NIKKEI WKLY., Feb. 2, 1998, at 3 (quoting bank official as stating that "[w]e knew two or three months ahead of time which month the inspectors would be coming"); *see also* ISAACS & EJIRI, *supra* note 10, at 119-20 (setting forth that Article 55 of the SEL permits Ministry to inspect business conditions, financial position, accounting books, documents and other articles of securities companies if Minister deems it in public interest). The inspections are structured either to uncover suspected malpractice or market abuses or to identify basic and to correct basic problems in policy and operation. ISAACS & EJIRI, *supra*. The inspections are usually used to enforce the Ministry's administrative guidance. *Id.*

125. *See* Ken Tsunematsu & Shuji Yanase, *Japan*, in INTERNATIONAL SECURITIES REG-

the Allied Occupational Force following World War II.<sup>126</sup> Later modifications to the SEL, however, reduced its importance in shaping the Japanese securities markets.<sup>127</sup>

### 1. Original Securities and Exchange Law

Japan enacted the Securities and Exchange Law of 1948<sup>128</sup> as a result of the Allied Occupation<sup>129</sup> following World War II.<sup>130</sup> The Allied forces commissioned the Supreme Commander of Allied Powers<sup>131</sup> ("SCAP") to supervise the *Diet* in creating a new constitution and new laws based on those of the United States.<sup>132</sup> The *Diet's* first attempt at a securities and exchange law failed because SCAP did not find the attempt sufficiently comparable

ULATION 4 (Robert C. Rosen et al. eds, 1997) (stating that SEL is principle source of securities regulation in Japan).

126. See Makoto Yazawa, *A Synopsis of Securities Regulation in Japan*, in JAPANESE SECURITIES REGULATION 29 (Louis Loss et al. eds., 1983) (describing creation of SEL and influence of Allied Occupational Force on SEL).

127. *Id.*

128. SEL, *supra* note 12.

129. See PORT, *supra* note 35, at 31 (examining effect of Allied Occupation on Japan's government following surrender of Japan in 1945 after World War II including leadership of Allied Occupational Force by Supreme Commander of Allied Powers ("SCAP")).

130. See Yazawa, *supra* note 126, at 29 (explaining role of "Occupation Authorities" in implementing SEL as influencing *Diet* to enact securities laws based on securities laws of United States).

131. See NISUKE ANDO, SURRENDER, OCCUPATION, AND PRIVATE PROPERTY IN INTERNATIONAL LAW: AN EVALUATION OF U.S. PRACTICE IN JAPAN 9 (1991) (stating that on August 14, 1945 U.S. President Truman secured consent of England, China, and Soviet Union to designate U.S. General of Army Douglas MacArthur as Supreme Commander of Allied Powers and authorized him to accept Japan's surrender).

132. See PERCY R. LUNEY, JR. & KAZUYUKI TAKAHASHI, JAPANESE CONSTITUTIONAL LAW vii (1993) (discussing Allied Occupation of Japan and consequent restructuring of Japanese government). The adoption of the Japanese Constitution, which was based on that of the United States, signaled a radical departure from the traditional governance of the Japanese people. *Id.* Japan replaced a system of governance based on the divinity of the emperor with a system based on majority rule. *Id.* Generally, the Japanese people adopted the new Constitution and the ideals of popular sovereignty and democracy. *Id.* Remnants of old rule remain, however, in the first chapter of the Constitution, which provides for the survival of the emperor system. *Id.*

Remnants of the old rule are also pervasive in Japanese society. *Id.* at 31. One example is the rule of the Liberal Democratic Party ("LDP") from 1955 to 1993. *Id.* Although mechanisms were in place to change the rule of political parties, the populous did not take advantage of the mechanisms to change parties during this time period. *Id.* Another example is the limited fight of the judiciary to protect civil liberties compared to that of the U.S. judiciary. *Id.* The Japanese Bill of Rights remains an important part of Japanese society, but is more pervasive in an extra-legal form. *Id.*

to the U.S. system.<sup>133</sup> This initial attempt included a separate Securities and Exchange Commission but did not have a registration system for securities companies.<sup>134</sup> Instead, the *Diet* used the same licensing system for stock exchanges and securities brokers as it used before the war.<sup>135</sup> SCAP disapproved of this version and urged the Japanese government to amend the law.<sup>136</sup> As a result of this pressure, the *Diet* enacted an SEL that was modeled after the Securities Act of 1933<sup>137</sup> ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") of the United States.<sup>138</sup>

As adopted in 1948, the SEL mirrored the U.S. securities laws.<sup>139</sup> The SEL included a provision for an independent regulatory board similar to the SEC of the United States.<sup>140</sup> The law also provided anti-fraud rules and disclosure requirements in the primary and secondary markets.<sup>141</sup> Moreover, the SEL implemented a registration system for securities, broker-dealers, and

133. See Milhaupt, *supra* note 6, at 431 (1994) (detailing that initial version of SEL failed to be approved by SCAP because of divergence with securities laws of United States).

134. See Yazawa, *supra* note 126, at 29 (explaining that initial version of SEL included licensing system in place of registration system).

135. See *id.* at 28 (discussing initiation of licensing requirement for broker dealers and underwriters in 1938).

136. *Id.*

137. 15 U.S.C. § 77a-77aa (1991); see Loss, *supra* note 58, at 6 (summarizing Securities Act of 1933 ("1933 Act") as covering initial distribution of securities). The purpose of the 1933 Act is to ensure full and accurate disclosure of the initial distribution. *Id.*

138. 15 U.S.C. § 781-7811 (1991); see Loss, *supra* note 58, at 7 (reviewing purpose of Securities Act of 1934 ("1934 Act") as covering post-registration trading). One purpose of the 1934 Act is to afford continual disclosure to people who trade in securities. *Id.* Another purpose is to prevent and to afford remedies for fraudulent practices in securities trading and manipulation of the markets. *Id.* In addition, Congress designed the 1934 Act to regulate the markets and to control the amount of the nation's credit that goes through those markets. *Id.*

139. See TATSUTA, *supra* note 85, at 10 (stating that in 1948, *Diet* enacted bill based on memorandum supplied by occupation forces to amend *Diet's* original 1947 Securities and Exchange Law, copying main provisions of 1933 Act and 1934 Act). The SEL also included provisions for the segregation of securities business from banking and independent certified public accountants. *Id.* at 11.

140. See *id.* (summarizing elements of SEL as registration of securities, establishment of independent securities regulator, registration of broker-dealers and securities companies, segregation of securities business from banking, and independent certified public accountants).

141. See Kanda, *supra* note 22, at 306 (stating that SEL provides mandatory disclosure and anti-fraud rules); see also Char, *supra* note 4, at 176 (explaining that SEL governs both primary and secondary markets).

securities exchanges.<sup>142</sup>

## 2. Modification of the Original SEL

In practice, the SEL proved ineffective compared to its U.S. counterpart because of amendments made by the Japanese government and a lack of formal enforcement by the Ministry.<sup>143</sup> The Japanese government revised the original regulatory structure because it conflicted with the way the Japanese government traditionally regulated its securities industry.<sup>144</sup> For example, the Japanese government and the public generally tolerated certain types of insider trading as a way of doing business.<sup>145</sup> Moreover, the Japanese government traditionally regulated the industry through informal administrative guidance supported mainly by the licensing provision of the SEL, rather than rule based supervision supported by the SEL in full.<sup>146</sup>

A key aspect of the SEL of 1948 was the creation of the Japanese Securities and Exchange Commission ("JSEC").<sup>147</sup> The initial proposal by the Ministry for the JSEC focused on preserving the Ministry's authority over the securities industry and gave the

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142. See TATSUTA, *supra* note 85, at 11 (listing system of registration for securities, broker dealers, and securities exchanges as feature of SEL).

143. See Akashi, *supra* note 20, at 1297-1301 (comparing effectiveness of SEL with U.S. securities laws); Harvey L. Pitt & David B. Hardison, *Games Without Frontiers: Trends in the International Response to Insider Trading*, 55-AUT LAW & CONTEMP. PROBS. 199, 219 (1992) (stating that Ministry "has traditionally been viewed as champion of Japanese securities firms rather than as a public watchdog").

144. See Shen-Shin Lu, *Are the 1988 Amendments to Japanese Securities Regulation Law Effective Deterrents to Insider Trading?*, 1991 COLUM. BUS. L. REV. 179, 181-82 (1991) (stating that Japanese felt that SCAP had implemented too many "overreaching occupational provisions"); see also Milhaupt, *supra* note 6, at 432 (stating that "SEL represented a wholesale importation of a securities regulation framework developed in a vastly different economic and political environment").

145. See Pitt & Hardison, *supra* note 143, at 216 (setting forth that insider trading in Japan has long been tolerated). See, e.g., Milhaupt, *supra* note 6, at 439 (explaining use of insider trading in Japan as part of regular course of business). Traditionally, institutional investors controlled the majority of the market and relied on long term relationships and exchange of information to monitor their investments. Milhaupt, *supra*; see also Char, *supra* note 4, at 180 (stating that "[i]t is widely known that when a Japanese company is preparing to issue new securities at market price, its underwriters will often collude to artificially raise the market price of the issue in order to allow the issuer to raise funds at a more favorable price and lower overall cost.").

146. See Yazawa, *supra* note 126, at 28 (discussing creation of licensing requirement for broker dealers and underwriters in 1938).

147. See Milhaupt, *supra* note 6, at 432 (assessing original regulator of Japan's securities industry under SEL).

JSEC limited powers.<sup>148</sup> SCAP rejected this plan because SCAP wanted to create an independent organization similar to the Securities and Exchange Commission.<sup>149</sup> SCAP initially proved successful when the *Diet* formed the JSEC independent of the Ministry.<sup>150</sup> This formation imputed the JSEC with full authority as a securities regulator as well as with the responsibility to promulgate and to amend regulations.<sup>151</sup> The Ministry, however, proved victorious in the end with the abolition of the JSEC in 1952.<sup>152</sup>

During this same period, the *Diet* removed Article 163<sup>153</sup> from the Securities and Exchange Law.<sup>154</sup> The Japanese government designed Article 163 to be used in conjunction with Article 164<sup>155</sup> to prevent short-swing trading by insiders.<sup>156</sup> Article 163 set forth an important disclosure requirement that obligated insiders to disclose their stock holdings and to report changes therein to the government.<sup>157</sup> Article 164 required a director or principle shareholder of a corporation to disgorge to the corporation profits resulting from certain types of short-swing trading.<sup>158</sup> The repeal of Article 163 in 1953 significantly weakened the effectiveness of Article 164.<sup>159</sup> The Ministry removed Article

148. See *id.* (discussing Ministry's input in creation of Japan Securities and Exchange Commission ("JSEC")).

149. See Tatsuta, *supra* note 85, at 10 (describing SCAPs' vision of Japanese regulator of securities industry was to have regulator similar to SEC).

150. Milhaupt, *supra* note 6, at 433.

151. *Id.*

152. See ISAACS & EJIRI, *supra* note 10, at 2 (explaining that after JSEC's abolition Ministry created new advisory board called Securities and Exchange Council to investigate and determine important matters concerning securities transactions); see also Milhaupt, *supra* note 6, at 433 (quoting Japanese government as stating JSEC "needlessly complicating matters in the name of economic democracy").

153. SEL, *supra* note 12, art. 163.

154. See Shen-Shin Lu, *supra* note 144, at 190 (describing that Japanese government removed Article 163 of SEL because Ministry deemed it ineffective and too burdensome); see also Parker, *supra* note 63, at 1403 n.23 (noting recodification of SEL by Securities Fairness Law of 1992 ("SFL")). The SFL recodified SEL art. 188 to SEL art. 163. Parker, *supra*. Also, the SFL recodified SEL art. 189 to SEL art. 164. *Id.* In addition, the SFL recodified SEL art. 58 to SEL art. 157. *Id.*

155. SEL, *supra* note 12, art. 164.

156. See Shen-Shin Lu, *supra* note 144, at 190-91 (detailing that without Article 163 of SEL reporting duty under Article 164 was useless as preventative to insider trading). Article 164 was modeled after Section 16(b) of the 1934 Act. *Id.*

157. SEL, *supra* note 12, art. 163.

158. *Id.* art. 164.

159. See Akashi, *supra* note 20, at 1300 (stating that removal of Article 163 from SEL left Japanese regulators without effective means of monitoring trades by insiders).

163 because the Ministry was ill-equipped to handle all of the disclosures.<sup>160</sup>

The Japanese government also weakened the effectiveness of the SEL by ignoring the benefits of Article 157 of the SEL.<sup>161</sup> The Japanese government modeled Article 157 after Rule 10b-5<sup>162</sup> of the 1934 Act.<sup>163</sup> In the United States, the courts interpret Rule 10b-5 as a general anti-fraud provision combating many types of insider trading and market manipulation.<sup>164</sup> In fact, Rule 10b-5 forms an extremely effective weapon for the U.S. Securities and Exchange Commission.<sup>165</sup> The Ministry, however, refused to enforce Article 157 on the theory that it could not be strictly construed to cover insider trading.<sup>166</sup>

Another important modification of the SEL is the imple-

160. See Parker, *supra* note 63, at 1408 (highlighting Ministry's dissatisfaction with Article 163 because Ministry was not equipped to deal with large volume of information submitted in compliance with Article 163).

161. See *id.* (stating that Ministry's "non-use of Article [157] has proven even more detrimental to insider trading regulation than the removal of Article [163] and JSEC."). Article 157 sets forth in pertinent part:

No person shall commit any act set forth in the following Items:

To employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities;

- (1) To obtain money or other property by using documents or any other representation which contains an untrue statement of a material fact or omits to state a material fact necessary to make the statement therein misleading with respect to buying selling or other transactions of securities;
- (2) To make use of any false quotation for the purpose of soliciting buying, selling or other transactions of securities . . . .

SEL, *supra* note 12, art. 157.

162. 17 C.F.R. § 240.10b-5.

163. See Shin-Shen Lu, *supra* note 144, at 186 (stating that "Article [157] was a copy of Rule 10b-5 of the American Securities Exchange Act of 1934.").

164. Parker, *supra* note 63, at 1405 (describing Rule 10(b) as tool against market manipulation); see also Shin-Shen Lu, *supra* note 144, at 186 (stating Rule 10b-5 is all purpose fraud provision for securities regulations).

165. Parker, *supra* note 63, at 1409.

166. See Akashi, *supra* note 20, at 1298 (discussing reasons for Ministry's reluctance to enforce Article 157 because Article 157 was too vague to be enforced); see also Shen-Shin Lu, *supra* note 9, at 132 (outlining prosecutors reluctance to prosecute Article 157 violations because of difficulty in winning Article 157 cases). In the Japanese judicial system, a prosecutor must prove the defendant's intention to commit the crime and the definite cause and effect of the crime. Shen-Shin Lu, *supra*. Once a defendant is prosecuted, a guilty decision is expected. *Id.* If a prosecutor accumulates too many not guilty judgments, the prosecutor will be deemed incompetent. *Id.* Because Article 157 is vague as to what constitutes a violation, prosecutors are reluctant to use it for fear that failure will hurt their reputations. *Id.*

mentation of a licensing system for securities companies.<sup>167</sup> The licensing system requires the Ministry to look at a number of standards in order to allow a company to deal in securities.<sup>168</sup> For example, the applicant company must have sufficient financial status to enter the business.<sup>169</sup> Also, the applicant company must have sufficient knowledge and experience.<sup>170</sup> Moreover, the proposed business must be necessary and appropriate in light of market needs.<sup>171</sup> Originally, the Japanese government justified the implementation of the licensing system as improving the economic health of the securities industry by withholding licenses from weak firms.<sup>172</sup> In practice, however, the licensing system has come to define the Ministry's method of regulating the securities industry in Japan.<sup>173</sup>

### C. *Modern Day Scandals and Reforms*

Recent scandals form a final influential factor shaping the Japanese securities market.<sup>174</sup> The interaction between the Ministry and the securities companies created an environment ripe for such scandals.<sup>175</sup> In turn, these recent scandals resulted in further reform to the Japanese securities regulatory structure.<sup>176</sup>

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167. See Milhaupt, *supra* note 6, at 150 (stating that licensing system has important effect on Ministry's regulatory style and on Japanese securities industry).

168. See TATSUTA, *supra* note 85, at 69-70 (summarizing standards promulgated by Ministry that companies must meet to obtain their licenses as financial requirement, experience requirement, and necessity of business requirement).

169. *Id.*

170. *Id.*

171. *Id.*

172. See Milhaupt, *supra* note 6, at 450-52 (outlining creation of licensing system to improve financial soundness of securities industry).

173. See *id.* at 450 (stating that Ministry used licensing system as powerful tool in regulating securities industry by getting securities companies to act by threatening to deny licenses to securities companies to enter new lines of business or by granting permission to market new products); see also TATSUTA, *supra* note 85, at 70-71 (stating that criteria for granting licenses are considerably abstract and flexible to allow Ministry broad discretion).

174. See Shen-shin Lu, *supra* note 9, at 131-49 (describing amendments to SEL dealing with insider trading and compensating losses because of Tateho Chemical Industries and Loss Compensation scandals).

175. See *id.* (analyzing cause of Tateho Chemical Industries and Loss Compensation scandals that show that disregard of securities laws by industry and Ministry caused scandals).

176. See *id.* (describing Tateho Chemical Industries scandal and Loss Compensation scandal and ensuing reforms).



## 1. Scandals

The Ministry's regulatory style over the securities industry created an environment conducive to corruption.<sup>177</sup> The extensive intermingling of Ministry officials with industry employees created many opportunities for malfeasance.<sup>178</sup> Additionally, the lack of judicial oversight precluded any meaningful check on the Ministry's actions.<sup>179</sup>

### a. Tateho Chemical Industries

Tateho Chemical Industries was a small, publicly-listed manufacturer of insulating materials and electrofused magnesia for electric heaters.<sup>180</sup> In August 1988, Tateho incurred a loss of ¥24 billion (US\$200 million) against a capitalization of ¥2.5 million (US\$210,000) in the bond futures market.<sup>181</sup> During the weeks before Tateho announced the loss, numerous insiders unloaded over 20,000 shares.<sup>182</sup> Additionally, Hanshin Sogo Bank, one of the eight banks with which Tateho did business, sold 337,000 shares on the day before the announcement.<sup>183</sup> Commentators reported that Hanshin possibly obtained prior knowledge of Tateho's loss because of a conference held between Tateho and all of its bankers the day before Tateho announced its loss.<sup>184</sup> After the incident, the Osaka Stock Exchange<sup>185</sup> conducted an

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177. See Choy, *supra* note 7, at 3 (explaining that collusion between Ministry and securities companies led to corruption).

178. *Id.*

179. See Young, *supra* note 26, at 954 (discussing impact of lack of judicial review of administrative guidance).

180. See ISAACS & EJIRI, *supra* note 10, at 135 (describing background of Tateho Chemical Industries in detailing Japan's history of insider trading).

181. Shen-Shin Lu, *supra* note 9, at 130; see also Chance, *supra* note 21, at 196 (detailing how Tateho Chemical Industries lost money engaging in practice of *Zai-tech*, which is practice of Japanese companies using their cash surplus to trade in securities markets in effort to generate additional profits).

182. See Shen-Shin Lu, *supra* note 9, at 130 (listing insiders who sold shares of Tateho Chemical Industries before announcement of loss to public).

183. See *id.* (describing sale by Hanshin Sogo Bank of its holdings of Tateho Chemical Industries).

184. See *id.* (stating that Japanese government did not prove that Hanshin Sogo Bank used insider information but there were "strong suspicions to the contrary").

185. See Ichiro Kawamoto, *Regulation of Exchange Markets*, in JAPANESE SECURITIES REGULATION 108 (Louis Loss et al. eds., 1983) (detailing Japan's eight securities exchanges). The securities exchanges are located in Tokyo, Osaka, Nagoya, Kyoto, Fukuoka, Hiroshima, Niigata, and Sapporo. *Id.* Securities exchanges in Japan must be licensed with the Ministry to operate. *Id.* These exchanges have regulatory power over

investigation and reported that none of the sales of stock preceding the announcement involved confidential information.<sup>186</sup>

### b. The Loss Compensation Scandals

In 1991, the press revealed that Japan's major securities companies compensated clients for losses incurred as a result of trading.<sup>187</sup> In total, seventeen securities companies paid more than ¥171 billion (US\$1.1 billion) to 608 organizations and nine individuals.<sup>188</sup> Prior to this scandal, the business community knew that securities firms were compensating their best customers for losses.<sup>189</sup> In fact, after a similar scandal in 1989 involving Daiwa Securities, the Ministry issued a circular stating that securities firms should refrain compensating clients for losses incurred.<sup>190</sup> By compensating their best customers for losses, securities companies developed and maintained lucrative under-

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the securities companies, but that power is checked by the Ministry. *Id.* at 109. For example, before listing a company, an exchange must first obtain approval from the Ministry. *Id.* at 110-11. Similarly, before an exchange can de-list a company, it must first gain the approval of the Ministry. *Id.* at 111.

186. Shen-Shin Lu, *supra* note 9, at 238 n.65. The Osaka Stock Exchange stated that:

The Osaka Stock Exchange has made every effort to investigate the true facts related to the possibility of insider trading of Tateho stock. According to our investigation, there is no evidence of insider trading. But we found trading which might cause misunderstanding. We feel sorry about this incident, since it came right after our notification to all listed companies to monitor insider trading. We strongly point out that insider trading is unfair and damages investor's confidence in securities markets. Triggered by this incident, we want to make every effort to prevent the misuse of confidential information by insider trading, and to protect the trustworthiness of the trading markets. We also hope listed companies, securities firms, and related persons will prevent insider trading.

*Id.*

187. See Milhaupt, *supra* note 6, at 460 (describing disclosure of Loss Compensation scandal by press in June of 1991).

188. See *Securities Scandal Tops the Diet Agenda, MOF Working to Save Scarred Reputation*, INT'L SEC. REG. REP., Aug. 13, 1990, at 8 (outlining breadth of scandal by stating dollar amount that securities companies paid clients in compensation for market losses incurred by clients).

189. See Char, *supra* note 4, at 175 (stating that public was well aware of securities companies compensating important customers for trading losses); see also Milhaupt, *supra* note 6, at 462 (setting forth public's knowledge of securities companies protecting clients against market fluctuations).

190. See Char, *supra* note 4, at 177 (discussing Ministry's issuance of circular following Daiwa Securities' admission of loss compensation in 1989); see also Milhaupt, *supra* note 6, at 461 (pointing out that Daiwa paid out ¥10 billion (US\$77 million) to customers).

writing, brokerage, and fund management business.<sup>191</sup>

At the time of the 1991 scandal, Article 50<sup>192</sup> of the SEL prohibited only the promise of payment as part of a solicitation of an investment transaction, but not the payment of loss compensation.<sup>193</sup> A company could still compensate clients for losses if there was no agreement prior to the transaction.<sup>194</sup> Loss compensation, however, contravened a Ministry circular prohibiting such practice regardless of the existence of a prior promise.<sup>195</sup> Both the securities companies and the Ministry ignored the circular, which, consequently, had little effect in preventing loss compensation payments. In fact, some reports indicate that the Ministry ignored the loss compensation payments by the securities companies for approximately one year.<sup>196</sup> Furthermore, the Big Four firms revealed that the Ministry had occasionally pressured securities companies to compensate major clients for trading losses.<sup>197</sup>

### c. The Failure of a Member of the Big Four

On November 24, 1997, Yamaichi Securities Co., one of Japan's largest securities companies, announced its closing.<sup>198</sup> A leading cause of the failure is that more than ¥200 billion (US\$1.6 billion) in losses were previously undisclosed.<sup>199</sup> A for-

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191. See Char, *supra* note 4, at 178 (describing securities companies compensating best customers to maintain positive working relationship with best customers).

192. SEL, *supra* note 12, art. 50.

193. *Id.*

194. See Nicole J. Ramsay, *Japanese Securities Regulation: Problems of Enforcement*, 60 *FORDHAM L. REV.* S255, S273 (1992) (describing limitation of Article 50 in preventing compensation of losses).

195. Ministry of Finance Circular Directive No. 2150 (1989) (Japan); see Char, *supra* note 4, at 177 (describing prohibitions to securities companies compensating losses of clients).

196. See Nickerson, *Japan Feeling Backlash From Stock Scandal*, *BOSTON GLOBE*, June 30, 1991, at 65 (reporting that Ministry knew of securities companies' practice of compensating clients approximately one year before media exposed scandal).

197. See Keehn, *supra* note 11, at 323 (explaining that President of Nomura Securities argued that Ministry informally approved payment of loss compensation to clients as way to keep Tokyo market buoyant during bubble economy and its early aftermath); see also Duck, *supra* note 4, at 1722 (stating that one result of Loss Compensation scandal was resignation of Minister of Finance); Milhaupt, *supra* note 4, at 468 (designating Minister of Finance at time of scandal as Ryutaro Hashimoto).

198. Douglas Ostrom, *Yamaichi Securities' Failure Underscores Japan's Financial Fragility* *JEI REPORT*, Dec. 5, 1997, at 1.

199. See Hamilton & Spindle, *supra* note 104 (listing major undisclosed losses as primary factor in closing of Yamaichi); see also Ostrom, *supra* note 198, at 1-2 (stating

mer head of the Securities Bureau of the Ministry testified in front of the *Diet* that Yamaichi attributed customers' losses to a third entity to improve the appearance of business results.<sup>200</sup> The press also reported that Yamaichi later covered these losses for the client and moved them to an overseas unit.<sup>201</sup> The Ministry official further testified that he knew about the huge losses of Yamaichi in 1991.<sup>202</sup> The official's testimony indicates that despite knowing about the losses, he did nothing to ensure that Yamaichi properly settled the losses.<sup>203</sup> When the *Diet* asked whether action by the Ministry could have helped avoid the failure of Yamaichi, the official testified affirmatively.<sup>204</sup>

#### d. *MoF-Tan*

In January 1998, the Tokyo Prosecutor's Office raided the Ministry's headquarters for the first time in fifty years.<sup>205</sup> The scandal concerned the practice of the *MoF-Tans* bribing Ministry officials to get information from bank examiners.<sup>206</sup> One bank examiner allegedly received lavish dinners and a loan to purchase a bank-owned apartment at a discounted price.<sup>207</sup> In return, this examiner allegedly warned the two banks of future inspections and helped bank officials conceal an improper loan.<sup>208</sup> Allegedly, another examiner also received over ¥2.2 million (US\$18,300) in entertainment bribes for informing one

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that additional reasons for failure as falloff in business as consequence for corporate extortionist scandal, weak stock market, and prospect of deregulation of stock commissions).

200. See Norihiko Shirouzu, *Ex-Regulator Knew of Losses at Yamaichi*, WALL ST. J., Feb. 5, 1998, at A17.

201. See *id.* (describing practice of Yamaichi of moving accounts overseas to prevent detection).

202. See *id.* (reporting that head of Securities Bureau testified that he remembered being consulted by Yamaichi executive in 1991 about dispute between Yamaichi and corporate over losses client incurred).

203. See *id.* (reporting that Securities Bureau head testified as to Ministry's inaction after learning of Yamaichi hiding losses).

204. See *id.* (reporting that Securities Bureau head testified as to whether prior intervention by Ministry would assist Yamaichi).

205. See Wanner, *supra* note 7, at 1, 8-9 (outlining argument that Prime Minister Hashimoto and his cabinet convinced Prosecutor's office to raid Ministry in order to weaken Ministry's power so that Ministry is less able to fight reforms).

206. See Yokota, *supra* note 124, at 3 (reporting scandal involving bank officials and government inspectors).

207. Wanner, *supra* note 7, at 3.

208. *Id.*

bank of the inspection schedule and for releasing proprietary information of another bank.<sup>209</sup> The scandal caused the resignations of Finance Minister Hiroshi Mitsuzuka and Administrative Vice Minister Takeshi Komura, the arrest of two examiners, and the suicide of a third examiner suspected of receiving bribes.<sup>210</sup>

## 2. Regulatory Reforms

The scandals of the Japanese securities industry soon resulted in the imposition of a number of regulatory reforms.<sup>211</sup> One type of reform involves structural changes to the Ministry's supervisory authority over the industry.<sup>212</sup> The other type of reform strengthens the SEL's powers.<sup>213</sup>

### a. Structural

The Japanese government established the Securities and Exchange Surveillance Commission ("SESC") to ensure fairness in the securities markets and thus rebuild investor confidence after the Loss Compensation scandal.<sup>214</sup> The SESC began with a staff of 202 people.<sup>215</sup> The design for the SESC, however, only allowed for twelve staff members for market surveillance and twenty-six for inspections.<sup>216</sup> The staff of thirty-eight retained responsibility for tracking the operation of 265 securities firms with about 3,000 branches and approximately 153,000 employees.<sup>217</sup> The U.S. Securities and Exchange Commission, by comparison, employed 2,600 staffers, 800 of whom performed sur-

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209. *Id.*

210. See Makoto Sato, *Finance Ministry Reeling From Attack*, NIKKEI WKLY., Feb. 2, 1998, at 1 (reporting that Ministry investigated both bank examiners in 1995 but did not find any serious misconduct). The Secretariat Director, Toshiro, later apologized for a loose investigation of the examiners. *Id.*

211. See Shen-Shin Lu, *supra* note 9, at 131-45 (discussing reforms implemented after Tateho Chemical Industries scandal to SEL to prevent insider trading); Char, *supra* note 4, at 194-200 (outlining reform measures taken after Loss Compensation scandal to SEL to prevent loss compensation payments in securities transactions).

212. See Char, *supra* note 4, at 194-200 (explaining creation of Securities and Exchange Surveillance Commission ("SESC") as structural change to regulation of securities industry).

213. See Shen-Shin Lu, *supra* note 9, at 131-45 (detailing amendments to SEL after Tateho Chemical Industries scandal to prevent insider trading).

214. See Chance, *supra* note 21, at 190 (detailing impetus of Japanese government creating SESC as to rebuild confidence of public in securities markets).

215. Keehn, *supra* note 11, at 326.

216. *Id.*

217. *Id.*

veillance and inspections.<sup>218</sup>

The SESC powers include conducting investigations of unlawful conduct that undermines the fairness of the securities markets,<sup>219</sup> including the power to search offices for evidence as well as to inspect the records of registered broker-dealers.<sup>220</sup> The SESC is not authorized, however, to bring its own enforcement actions.<sup>221</sup> When the SESC finds a violation, it has the option of making a formal accusation to the public prosecutor's office or of making a recommendation that the Finance Minister bring sanctions against the offender.<sup>222</sup> After receiving a recommendation from the SESC on enforcement, the Minister of Finance must respect such recommendations.<sup>223</sup> The Minister, however, is not required by law to act on the recommendations.<sup>224</sup> In addition, the law establishing the SESC allows the Ministry to carry out the same tasks as the SESC.<sup>225</sup> This overlap in powers results in the SESC following the Ministry through investigations to prevent duplicative efforts.<sup>226</sup>

The establishment of the SESC followed a path similar to the establishment of the JSEC fifty years earlier.<sup>227</sup> The Ad Hoc Council on the Promotion of Administrative Reform<sup>228</sup> originally called for an independent agency to regulate the securities markets.<sup>229</sup> The Ministry, however, chose to maintain its author-

218. *See id.* (comparing resources of SESC to those of SEC).

219. *See* Milhaupt, *supra* note 6, at 470 (detailing authority of SESC to conduct investigations into securities malfeasance).

220. *See* Char, *supra*, note 4, at 199 (describing powers of SESC as including ability to enter securities companies as part of investigatory authority).

221. *Id.*

222. *See* Milhaupt, *supra* note 6, at 471 (setting forth process for SESC to institute action against miscreants in Japan's securities industry as involving recommendations to public prosecutors office or Ministry but not having ability to take independent action).

223. *Id.*

224. *Id.*

225. *See* Keehn, *supra* note 11, at 326 (stating that Ministry made sure that SESC establishment law allowed Ministry to possess same investigatory authority).

226. *See id.* (explaining that Ministry's ability to possess same investigatory authority as SESC meant that SESC followed lead of Ministry in investigations).

227. *See* Milhaupt, *supra* note 6, at 432-33 (comparing creation of SESC with creation of JSEC in 1948 by stating that both times Ministry struggled to prevent losing its power to independent agency).

228. *See id.* (explaining that Prime Minister Toshiki Kaifu directed Ad Hoc Council to undertake consideration of reform measures after Loss Compensation scandal, including establishment of securities market oversight agency).

229. *See* Keehn, *supra* note 11, at 325 (explaining Council was quasi-official governmental body that recommended that SESC be created independent of Ministry).

ity over the SESC.<sup>230</sup> The Ministry stated that an independent agency was not necessary because the licensing system could better monitor the securities companies.<sup>231</sup> The Ministry also stated that an independent agency would not work because of its isolation from the information and authority accruing to the Ministry under the licensing system.<sup>232</sup>

After the launching of the SESC, commentators spoke of its weakness.<sup>233</sup> One commentator observed that the SESC will have a position similar to an inside council that can observe and make recommendations, but does not have power to affect the securities market.<sup>234</sup> Another commentator has stated that the creation of the SESC was a superficial attempt at reforming securities regulation.<sup>235</sup>

### b. Statutory Reforms

The Japanese government also instituted statutory reforms to the SEL as a result of several scandals.<sup>236</sup> One of these reforms aims to prevent future insider trading from occurring.<sup>237</sup> Another statutory reform prohibits loss compensation.<sup>238</sup>

### i. Insider Trading Reforms

The inclusion of Articles 166<sup>239</sup> and 167<sup>240</sup> in the SEL in

230. *Id.* at 322-25.

231. See Milhaupt, *supra* note 6, at 467 (detailing that head of Securities Bureaus explained that Japanese licensing system limits number of securities firms entering industry and prevents easy exit, thus diminishing need for SEC style agency).

232. *Id.*

233. Keehn, *supra* note 11, at 322.

234. See Shen-Shin Lu, *supra* note 9, at 148 (stating that “[t]his new watchdog, which is under the aegis of the [Ministry] and has a position similar to an inside council, observes, investigates, and reports, but it does not have the teeth to bite into the securities market.”).

235. See Keehn, *supra* note 11, at 322 (stating that “the creation of the SESC turned out to be a textbook example of how reformist sentiments can be systematically short-circuited by the entrenched power of the bureaucracy”).

236. See Shen-Shin Lu, *supra* note 9, at 131-45 (discussing reforms to SEL to prevent insider trading as result of Tateho Chemical Industries scandal); Char, *supra* note 4, at 194-200 (outlining amendments to SEL to prevent payment of compensation by securities companies to customers for losses incurred by customers in securities markets).

237. Shen-Shin Lu, *supra* note 9, at 131-45.

238. Char, *supra* note 4, at 194-200

239. SEL, *supra* note 12, art. 166. Article 166 defines corporate insiders as:

(1) The officers, agents, employees and other persons who are engaged in the

1988 formed a major part of the reform after the Tateho scandal.<sup>241</sup> By including Articles 166 and 167 in the SEL, the Japanese government definitively prohibits insider trading and thus clears up the vagueness caused by Article 157.<sup>242</sup> Article 166 prohibits insider trading by a corporate insider,<sup>243</sup> while Article 167 prohibits insider trading in connection with tender offers.<sup>244</sup> A violation of Article 166 occurs when an insider obtains knowledge of an important fact relating to the business of a listed corporation<sup>245</sup> and then buys or sells securities of that corpora-

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business of the corporation when they acquire the knowledge in connection with the performance of their duties;

- (2) The shareholders or ordinary investors provided in the Preferred Capital Contribution Law who are prescribed by Ministerial Ordinance as those similar shareholders who have the right provided in Paragraph 1 of the Commercial Code . . . when they acquire the knowledge in connection with the exercise of such right;
- (3) Any person who has the power over the corporation based on a statute . . . when he acquires the knowledge in connection with the exercise of such power;
- (4) Any person who has a contractual relationship with the corporation . . . when he acquires the knowledge in connection with entering into or performing the contract.

*Id.*

240. *Id.* art. 167.

241. See Shen-Shin Lu, *supra* note 144, at 209 (outlining addition of Articles 166 and 167 to SEL to prevent insider trading).

242. See *id.* (stating that because Article 157 is too vague to be used in insider trading cases, Japanese government needed to clarify concept of insider trading to make it illegal and thus amended SEL to include Articles 166 and 167).

243. SEL, *supra* note 12, art. 166.

244. *Id.* art. 167.

245. *Id.* art. 166. An important fact is defined as:

- (1) The fact that the executive organ of the subject listed corporation, etc. has made the decision to perform any of the following matters or made the decision not to perform an such matter . . . :
  - A. the issue of shares of stock, convertible bonds or bonds with subscription rights to shares;
  - B. the reduction of capital;
  - C. acquisition by the corporation of its own shares of stock pursuant to the provisions . . . ;
  - D. the stock split;
  - E. the payment of dividends or profit or surplus or the distribution of cash in the course of a business period . . . ;
  - F. the merger or consolidation of the corporation;
  - G. the transfer of the whole or a part of the business or enterprise of the corporation or the transfer of the whole or a part of the business or enterprise of another corporation;
  - H. dissolution of a corporation . . . ;
  - I. the commercialization of a new product . . . ;



tion before the information is released to the public.<sup>246</sup> A violation of Article 167 occurs when an insider obtains information regarding the execution or cancellation of a tender offer and then buys shares or options of a company involved before that information is known to the public.<sup>247</sup> Both articles apply the prohibition of insider trading to “tippees.”<sup>248</sup> The articles prohibit any person who has been informed of an important fact by a person related to the corporation to trade on that information.<sup>249</sup>

The inclusion of Article 163<sup>250</sup> in the SEL also resulted from the Tateho scandal.<sup>251</sup> Article 163 requires corporate officers with more than ten percent of issued shares to file a report to the Ministry following their purchase or sale of any corporate shares.<sup>252</sup> The reinstatement of Article 163 into the SEL means that Article 164 serves as a more effective tool to prevent short-swing profits by insiders.<sup>253</sup> Pursuant to Article 164, when the Ministry determines that a short swing violation occurred, it sends the information to the corporation, after giving the insider an opportunity to deny the allegations.<sup>254</sup> At that point, either

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- (2) The happening of any of the following events:
- A. damages caused by calamity or business;
  - B. a change in any principal shareholder;
  - C. an event which will give rise to de-listing or cancellation of registration of specified securities . . . ;
  - D. any other matters prescribed by Cabinet Order. . . ;
- (4) The existence of a difference between the forecast amount of sales, ordinary profit or net income of the subject listed corporation, etc. which it has newly calculated or any such amount contained in its final accounts for the relevant period and any such amount which the corporation has published in its most recent forecast . . . .

*Id.*

246. *Id.* art. 166.

247. *Id.* art. 167.

248. See Shen-Shin Lu, *supra* note 144, at 211 (defining “tippee” as “[a]ny person who receives an issuer’s business’ material facts directly from the corporate-related parties.”).

249. SEL, *supra* note 12, arts. 166(3), 167(4).

250. *Id.* art. 163.

251. Shen-Shin Lu, *supra* note 144, at 203.

252. *Id.*

253. SEL, *supra* note 12, art. 164. Preventing short swing trading refers to reviewing any profits gained “by a purchase after six months of a sale or a sale after six months of a purchase” to determine if there is any “unfair use of secret information” by a corporate insider. SEL, *supra*; see Shin-Shen Lu, *supra* note 144, at 203 (explaining that inclusion of Article 163 acts to provide strength for Article 164).

254. See Shen-Shin Lu, *supra* note 144, at 203 (describing role of Ministry in

the corporation takes action, or the information becomes public so that the shareholders may take action.<sup>255</sup>

## ii. Loss Compensation

The Loss Compensation Scandal resulted in the broadening of Article 50<sup>256</sup> of the SEL to cover all forms of compensation.<sup>257</sup> The amendment includes punishment for not only the securities companies that compensate clients for investment losses, but also for the recipients of these types of payments.<sup>258</sup> This new law makes loss compensation a criminal offense and the punishment includes possible jail time and monetary penalties.<sup>259</sup>

## II. NEW REFORMS FOR OLD WEAKNESSES

The Japanese government recently began another cycle of reforms to improve the regulation of the securities industry.<sup>260</sup> Prime Minister Hashimoto initiated this reform process, known as the Big Bang, in 1996.<sup>261</sup> Hashimoto, however, no longer oversees the reform process because of his resignation in July 1998.<sup>262</sup>

### A. *The Big Bang*

The Big Bang reform process arose out of Prime Minister Hashimoto's vision for Japan.<sup>263</sup> He initiated the reforms to ensure Japan's economic vitality.<sup>264</sup> A major part of the reforms

preventing short swing trading by using authority of Article 163 to gather information and 164 to disclose information to insiders' corporation or to public).

255. *Id.*

256. SEL, *supra* note 12, art. 50.

257. See Char, *supra* note 4, at 194-95 (describing amendments to SEL because of Loss Compensation scandals that makes investment loss payback criminal offense that carries penalties of up to one year in prison or a fine of up to ¥1 million (US\$7,692).

258. SEL, *supra* note 12, art. 50.

259. *Id.*

260. See Ministry of Finance, *The Main Steps Taken Leading up to the Big Bang* (visited Mar. 16, 1998) <<http://www.mof.go.jp/english/big-bang/ebb6.htm>> (on file with the *Fordham International Law Journal*) [hereinafter *Main Steps*] (outlining major events of Big Bang from its inception on November 11, 1996 to March 31, 1997).

261. *Id.*

262. See Barbara Wanner, *Three Way Race for LDP President Sparks Debate, Maneuvering*, JEL REPORT, July 24, 1998, at 1 (reporting Prime Minister Hashimoto's resignation July 13, 1998 to accept responsibility for huge LDP losses in Diet elections).

263. See *Structural Reform*, *supra* note 14 (outlining Prime Minister Hashimoto's plans for Japan's economic future with ultimate goal of ensuring economic vitality).

264. *Id.*

adversely affect the Ministry's ability to regulate the securities industry.<sup>265</sup>

### 1. Background

The Big Bang seeks to adhere to the principles of a free, fair, and global market.<sup>266</sup> To achieve its goals, the Big Bang looks to liberalize market entry, products, and prices.<sup>267</sup> This reform process intends to clarify and to enhance the transparency of rules and to protect investors' interests.<sup>268</sup> The Big Bang also includes plans to establish a legal system, accounting system, and supervisory regime consistent with globalization.<sup>269</sup>

Commentators report that the reform package has potential to weaken the Ministry's power over the securities industry.<sup>270</sup> One threat to the Ministry is the removal of the Ministry's ability to guide securities companies through licensing.<sup>271</sup> Another threat is the removal of the Ministry's authority for supervising the industry.<sup>272</sup> The Ministry, however, acted as advisor to the Prime Minister on all of the financial reforms.<sup>273</sup> The result of this arrangement left the Ministry with the ability to determine

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265. See Choy, *supra* note 7, at 15 (describing Ministry's loss of supervisory and regulatory authority to new independent regulatory agency if reform proposals succeed).

266. See *Structural Reform*, *supra* note 14 (discussing Japanese government's plans to implement capitalist ideals to their securities regulation system).

267. *Id.*

268. *Id.* (detailing that government plans to promote entry by companies into securities, banking, and insurance sectors and to expand activities in which securities companies and banks can engage).

269. *Id.* (discussing Japanese government's plan to create transparent and credible market through disclosure of information necessary to establish own-risk principle and clarification of rules and to promote active punishment for rule violations).

270. See Choy, *supra* note 7, at 15 (stating that under proposed reforms Ministry will lose some of its supervisory and regulatory powers).

271. See *id.* at app. 1 (listing attempted abolishment of licensing requirement as part of Financial Systems Reforms Bill ("FSRB")). The Diet enacted the FSRB on June 5, 1998 and it will go into effect on December 1, 1998. *Id.*

272. See Jon Choy, *Hashimoto Fills Diet's Docket with Reforms*, JEI REPORT, Mar. 21, 1997, at 4 (describing that purpose of FSA was to take over supervisory duties over securities industry).

273. See *Japan Puzzle*, *supra* note 68, at 21 (stating that Ministry served as main advisor to Hashimoto in creating and shaping reform package because Ministry was "only institution capable of weighing competing ideas and formulating workable solutions."). See generally, *Main Steps*, *supra* note 260 (detailing Prime Minister Hashimoto issuing directions to Minister of Finance and Minister of Justice to engage in financial system reform).

what reforms to make while still ensuring its control over the securities industry.<sup>274</sup> The reforms process schedule for completion stretches over a five year period.<sup>275</sup>

Currently, the need for economic vitality is strong as Japan is in its worst recession since World War II.<sup>276</sup> The recession highlights a number of weaknesses in the Japanese economy.<sup>277</sup> According to observers, one weakness in Japan's economy is that competition is subordinate to regulatory control.<sup>278</sup> The Ministry controls not only the firms that enter the market but also the firms corporate structures.<sup>279</sup> In addition, the Ministry controls the types of products that could become available in Japan.<sup>280</sup> Another weakness exposed by the recession, according to commentators, is the level of collusion between regulators and financial institutions.<sup>281</sup> Commentators once viewed this collusion as the strength of the Japanese economy.<sup>282</sup> The close working relationship was hailed because of the ability of the private sector to have a voice in regulation.<sup>283</sup> Once the parties involved began to act in their self interest as opposed to Japan's interest, however, the strength became a weakness.<sup>284</sup>

274. See *Japan Puzzle*, *supra* note 68, at 21 (stating that "many people at the finance ministry devoted most of their waking hours to thinking up ever more ingenious ways of pandering to the prime minister's wishes, while at the same time ensuring that they could hang on to their own particular piece of turf.").

275. See *Structural Reform*, *supra* note 14 (stating goal of reforms is to revitalize Tokyo market by year 2001).

276. See *Hashimoto's Curious Comeback*, *ECONOMIST*, June 20, 1998, at 43 (reporting June 12, 1998 statement by Japanese government's Economic Planning Agency that Japan is in worst recession since World War II).

277. See Choy, *supra* note 7, at 1 (reporting that Japanese government and public has realized that Japan's financial markets, institutions, and regulations have significant weaknesses).

278. See *id.* (reporting that Japanese regulatory system came to be known as convoy system whereby companies did not compete, but instead, moved together as quickly as slowest could proceed). This system protected companies in the Japan market, but exposed the entire industry to the competition of the world market. *Id.*

279. *Id.* at 2.

280. *Id.* at 1-2.

281. See *id.* at 2-3 (reporting collusion between regulators and financial institutions as negative aspect of financial system and institutional practices).

282. See *id.* (describing collusion between Ministry and financial institutions as benefit because it allowed private sector to present views to regulators and to vet potential policies or actions).

283. See Choy, *supra* note 7, at 3 (stating traditional perception of collusion between regulators and financial institutions).

284. *Id.*

## 2. Elements of the Big Bang

The Big Bang's effects on the Ministry are two fold.<sup>285</sup> The reorganization of the supervisory duties from the Ministry to the Prime Minister's office is one way the reforms affect the Ministry.<sup>286</sup> The second effect is the planned substitution of the licensing system with a more open registration system.<sup>287</sup>

### a. Reorganization of Supervisory Duties: The Financial Supervision Agency

On June 22, 1998, the Financial Supervision Agency<sup>288</sup> ("FSA") began operation.<sup>289</sup> The *Diet* charged the FSA with the inspection and supervision of the securities industry, banks, insurers, some non-bank money lenders, and agricultural and labor financial institutions.<sup>290</sup> The Japanese government also plans for the FSA to fight money laundering and other international financial crimes.<sup>291</sup> For securities supervision, the *Diet* removed the SESC from the Ministry and placed it into the FSA.<sup>292</sup>

The Prime Minister's Office supervises the FSA.<sup>293</sup> Masaharu Hino, who previously led the Nagoya High Public Prosecutors Office, heads the new agency.<sup>294</sup> The head of the FSA is required to cooperate with the ministers of the agencies

285. See Choy, *supra* note 272, at 4 (detailing duties of FSA, which will gain some power over securities companies from Ministry); see also Choy, *supra* note 7 at app. 1 (outlining FSRB, which includes provisions that weaken Ministry's power by replacing licensing system with registration system).

286. Choy, *supra*, note 272.

287. Choy, *supra*, note 7.

288. See Shino Yuasa, *Japan's Financial Supervision Agency to Start Work on Monday*, AGENCE FRANCE-PRESSE, June 21, 1998 (describing FSA opened on June 22, 1998, to oversee financial institutions).

289. *Id.*

290. See Choy, *supra* note 272, at 4 (detailing wide authority of FSA over areas of industry that Ministry did not supervise such as agricultural and labor financial institutions that were previously supervised by Ministry of Agriculture, Forest and Fisheries and Minister of Labor, respectively).

291. See, KYODO NEWS, *supra* note 54 (noting planned additional duties of FSA).

292. See Choy, *supra* note 272, at 4.

293. See KYODO NEWS, *supra* note 54.

294. *Id.*; see also Yuasa, *supra* note 288 (reporting head of FSA set forth new principles of FSA). The first principle is to create a fair and transparent financial oversight board. Yuasa, *supra*. The second principle is to carry out strict and effective monitoring. *Id.* The third principle is to facilitate the exchange of views with international oversight entities. *Id.* The fourth principle is to improve expertise. *Id.* The fifth principle is to coordinate inspection, monitoring and oversight measures. *Id.*

that have policy making authority over the supervised industries.<sup>295</sup> Specifically, the head of the FSA must confer with the Ministry if the FSA wants to close down a financial institution.<sup>296</sup> Furthermore, the Finance Ministry is still responsible for creating financial policies, including the budget and legislation for the industry.<sup>297</sup>

The Japanese government staffed the FSA with 403 members to supervise the securities, banking, insurance and other financial institutions.<sup>298</sup> By comparison, in the United States there are 3,000 staff members supervising the securities industry<sup>299</sup> and another 8,000 inspectors supervising the banking industry.<sup>300</sup> Three hundred and seventy-three of the 403 FSA staff members are from the Ministry.<sup>301</sup> All of the staff members transferred to the FSA, except for high ranking officials, are allowed to return to the Ministry.<sup>302</sup>

#### b. Licensing

The Big Bang abolishes the licensing system and implements a more open registration system.<sup>303</sup> Firms wishing to enter the market must only notify the Ministry after they buy and sell shares.<sup>304</sup> Securities companies that conduct securities un-

295. Choy, *supra* note 272, at 5.

296. See KYODO NEWS, *supra* note 54 (noting that "there remains some murkiness about its jurisdiction").

297. Choy, *supra* note 272, at 5.

298. KYODO NEWS, *supra* note 54.

299. U.S. Securities and Exchange Commission, *GPRA Strategic Plan 3* (Sept. 1997) (visited Aug. 31, 1998) <<http://www.sec.gov/asec/gpra1197.htm>> (on file with the *Fordham International Law Journal*).

300. See Sandra Sugawara, *In the Daiwa Bond Trading Case, A Regulatory World of Difference*, WASH. POST, Oct. 13, 1995, at D2 (reporting that Japan has 1,000 banks compared with 13,000 banks in United States).

301. KYODO NEWS, *supra* note 54.

302. *Id.*

303. See Choy, *supra* note 7, at app. 1 (outlining FSRB, which includes provisions that reduce restrictions on entry into securities market and marketing of products by securities companies); see also The Securities and Exchange Council, *Comprehensive Reform of the Securities Market: For a Rich and Diverse 21<sup>st</sup> Century June 13, 1997* (visited March 16, 1998) § II, at 1, <<http://www.mof.go.jp/english/tosin/e1a505f4.htm>> (on file with the *Fordham International Law Journal*, (stating that "[p]reventative regulations limiting activity and products should be repealed to the extent possible, and policies should shift to one that builds up an environment in which market discipline operates effectively.")).

304. See Choy, *supra* note 7, at app. 1 (describing registration process envisioned in Prime Minister's reforms).

derwriting, over-the-counter securities derivatives trading, and operate proprietary trading systems, however, must still request approval from the Ministry.<sup>305</sup>

A similar reform concerns the diversification of securities companies' services.<sup>306</sup> This reform requires only that the securities companies file notifications when engaging in product lines clearly specified in laws and ordinances.<sup>307</sup> Ministry approval is only needed for product lines that are not listed in the laws.<sup>308</sup> If the product line conflicts with the public interest<sup>309</sup> or impairs investor protection because of difficulties in calculating risks, it will not receive approval from the Ministry.<sup>310</sup> To facilitate this proposal, the SEL will be amended to expand the definition of securities.<sup>311</sup> The definition of securities will be expanded to cover all of the new types of products that securities companies will be allowed to market.<sup>312</sup> The SEL will also be amended to enhance rules governing actions taken by securities companies.<sup>313</sup> These amendments will include provisions to protect against damage caused by conflicting interests among securities companies and provisions to require greater disclosure from financial intermediaries regarding their products.<sup>314</sup>

### B. *Changes In Power*

The political environment surrounding the Big Bang has changed since its inception in 1996.<sup>315</sup> The first change is the

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305. *Id.*; see also Ministry of Finance, *About the Financial System Reform (The Japanese version of the Big Bang)* (visited Mar. 16, 1998) <<http://www.mof.go.jp/english/big-bang/ebb1.htm>> (on file with the *Fordham International Law Journal*) [hereinafter *About the Financial System Reform*] (describing proposals for review of licensing regime for securities companies).

306. See Choy, *supra* note 7, at app. 1 (outlining FRSB provision to amend SEL regarding diversification of securities companies services).

307. *Id.*

308. *Id.*

309. *Id.*

310. *Id.*

311. *Id.* (detailing FRSB provision to amend SEL regarding expansion of definition of securities).

312. *Id.*

313. *Id.* (outlining provisions of FSFB to amend SEL regarding building framework that enables users to make transactions with confidence).

314. *Id.*

315. See *Leaving It to the Old Man*, *ECONOMIST*, Aug. 1, 1998, at 34 [hereinafter *Old Man*] (describing election of Prime Minister Obuchi after resignation of Prime Minister Hashimoto).

transfer of power from Prime Minister Hashimoto to Prime Minister Obuchi.<sup>316</sup> The second change is the withdrawal by the Tokyo Prosecutors Office from investigating Ministry officials.<sup>317</sup>

### 1. Changes in Leadership

Although Prime Minister Ryutaro Hashimoto initiated and guided the latest reform process,<sup>318</sup> he resigned on July 13, 1998 to accept responsibility for the losses that his party, the Liberal Democratic Party ("LDP"), incurred in the upper house elections the previous day.<sup>319</sup> Commentators report that the LDP lost the seats because of the public's dissatisfaction with the way the Japanese government was handling the economic crisis in Japan.<sup>320</sup>

The LDP elected Keizo Obuchi<sup>321</sup> in place of Hashimoto on July 30, 1998.<sup>322</sup> Commentators opine that his election was the result of strong support by LDP party boss Noboru Takeshita.<sup>323</sup> Takeshita held the position of Minister of Finance and then Prime Minister of Japan, but resigned his post as Prime Minister after it was disclosed that he was involved in a bribery scandal.<sup>324</sup>

316. *Id.*

317. See Tett, *supra* note 11 (reporting that Japanese government may be trying to wind down its investigation into Ministry by transferring lead prosecutor to rural outpost).

318. See *About the Financial System Reform*, *supra* note 305, at 1 (describing Prime Minister's involvement of reform process as issuing directions to Minister of Finance and Minister of Justice to start financial system reform); see also Choy, *supra* note 272, at 4 (reporting Hashimoto submitting reform bills to *Diet*).

319. Choy, *supra* note 272, at 4.

320. See Barbara Wanner, *Upper House Polls Shake Up Japanese Politics, But Outlook for Change Remains Uncertain*, JEI REPORT, July 24, 1998, at 1 (setting forth public sentiment concerning economy and recent *Diet* elections).

321. See *Old Man*, *supra* note 315, at 34 (reporting new Prime Minister Obuchi's background as entering *Diet* in 1963 with support of Noboru Takeshita, LDP party boss, then becoming cabinet secretary under Prime Minister Takeshita in 1987, then in 1992, Takeshita made Obuchi head of *Keiseikai*, largest faction within LDP).

322. *Id.*

323. See *id.* at 34 (stating that Takeshita picked Obuchi because Takeshita wanted "to call the shots again, and, above all, to get the LDP back to its old way of doing things.").

324. See Shen-Shin Lu, *supra* note 9, at 150 (describing Recruit scandal as involving large number of politicians and bureaucrats accepting bribes from Recruit magazine). The bribes were made to the politicians and bureaucrats in order to prevent them from changing the timing of Government recruiting of college graduates. *Id.* Recruit magazine made bribes to politicians and bureaucrats in the form of confidential information about the upcoming public offering of stock for one of Recruit magazine's subsidiaries and the sale of that stock to politicians and bureaucrats before the company went pub-



One of Prime Minister Obuchi's first acts was to appoint a new Minister of Finance.<sup>325</sup> The new Minister, Kiichi Miyazawa, was also involved in the bribery scandals as Minister of Finance under Prime Minister Takeshita.<sup>326</sup>

## 2. Changes in Investigation

Another important change in Japan politics is the abandonment of the investigation into Ministry officials accepting bribes from *MoF-Tans*.<sup>327</sup> The lead prosecutor of the investigation was reassigned to the rural outpost of Toyama.<sup>328</sup> Moreover, the force of seventy prosecutors that once stormed into the Ministry<sup>329</sup> has been decreased to thirty.<sup>330</sup>

### III. THE BIG BANG WILL HAVE NO LASTING IMPACT ON THE MINISTRY OF FINANCE

The chances of any significant changes coming from the Big Bang reform process are slight. The ability of the Ministry to effect the Japanese government's behavior helps to ensure that much of the Ministry's power remains unchanged.<sup>331</sup> In addition, the structure of the present changes compared to past reforms shows that the present reforms lack the requisite formal-

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lic. *Id.* In all, 44 politicians bought the stock before Recruit magazine's subsidiary went public in 1986, and sold it by 1988 for a total profit of ¥730,000,000 (US\$6 million). *Id.* The scandal reached the highest of Government posts and included the Prime Minister at the time, Noboru Takeshita, the Minister of Foreign Affairs, Abe, the Minister of Finance, Kiichi Miyazawa, and former Prime Minister Nakasone. *Id.* Although authorities prosecuted 20 people for bribery, most of them served as company directors or officers, not politicians. *Id.* Indeed, authorities prosecuted only six politicians and they were congressmen and aids. *Id.* Most significantly, however, is that not one person involved in the scandal was charged with any type of securities regulation violation. *Id.*

325. *Old Man*, *supra* note 315, at 34.

326. *Id.*

327. See Tett, *supra* note 11, at 18 (reporting abandonment of investigation into financial institution corruption).

328. See Sheryl WuDunn, *Japan's Corruption Fighter Is Shunted Aside*, N.Y. TIMES, Aug. 18, 1998, at D1 (reporting that although Katsuhiko Kumazaki was not sole prosecutor behind investigation into Ministry, he was to head of Tokyo Prosecutor's Office and his transfer substantially ends investigation).

329. See Tett, *supra* note 11, at 18 (noting number of prosecutors that were involved in investigation of Ministry as part of recent bribery scandal).

330. *Id.*

331. See *supra* notes 43-61 and accompanying text (setting forth Ministry's authority within government by listing various bureaus of Ministry and authority of those bureaus); *supra* notes 63-69 and accompanying text (detailing Ministry's ability to effect behavior of Diet and Prime Minister by being primary advisor to both).

ties to create any impact.<sup>332</sup> Furthermore, the political changes in Japan and Japan's historical tolerance of malfeasance in the securities industry signify the likelihood that the reform process will produce little meaningful change.<sup>333</sup>

*A. The Ministry's Power Within the Government and Over the Securities Industry Reduces the Likelihood of Meaningful Change*

The likelihood that the Big Bang reforms will make significant changes to securities regulation in Japan is low because those changes will also weaken the power of the Ministry. Historically, the Ministry has been reluctant to relinquish power over the securities industry and thus is unlikely to relinquish that power through the present reform process.<sup>334</sup> The Ministry controls sufficient power within the Japanese government and over the securities industry to ensure that it can also control the reform process.<sup>335</sup>

The Ministry's power ranges from drafting legislation and controlling the budget to placing retired employees at securities firms.<sup>336</sup> Specifically, the Ministry's budgetary power ensures its ability to influence other government agencies, the LDP, and the Prime Minister.<sup>337</sup> This control limits the amount of changes that the Japanese government can make to the Ministry. Similarly, the Ministry's unique expertise in issues of securities regulation<sup>338</sup> ensures the Ministry's control of legislative and reform drafting. In fact, the Ministry functioned as an integral

332. See *supra* notes 211-59 and accompanying text (outlining past attempts to reform both Ministry and SEL).

333. See *supra* notes 324-30 and accompanying text (arguing that change of leadership and withdrawal of prosecution efforts against Ministry indicate retreat in reform efforts).

334. See *supra* notes 147-52 and accompanying text (detailing creation of Japan's independent securities regulator (JSEC) in 1948 and subsequent abolishment of regulator and adoption of regulatory responsibilities by Ministry); *supra* notes 214-35 and accompanying text (explaining original desires for creation of SESC in 1992 as independent body and subsequent creation of SESC as part of Ministry).

335. See *supra* notes 24-27 and accompanying text (outlining Ministry's authority over securities industry).

336. See *supra* notes 43-124 and accompanying text (detailing Ministry's authority over securities industry, including within government and over securities industry).

337. See *supra* notes 43-46 and accompanying text (setting forth amount of power Ministry retains by controlling budget).

338. See *supra* note 68 and accompanying text (describing Ministry's ability to draft legislation); *supra* note 273 and accompanying text (describing reliance of Prime Minister on Ministry when drafting reform proposals).

participant in the creation of the present reform system.<sup>339</sup> Thus, the Ministry could hold on to its power over the securities industry while drafting the reforms.<sup>340</sup> Additionally, the Ministry maintains substantial control over the securities companies because of extensive intermingling between the Ministry and securities companies' employees.<sup>341</sup> This power enables the Ministry to retain control over the securities industry even if the Japanese government removes its supervisory duties.

*B. The Structure of the Reforms Indicates a Low Likelihood of Meaningful Change*

An analysis of the structure of the reforms affecting regulation of the securities industry indicates that the present reforms will fail to produce meaningful change.<sup>342</sup> One weakness in the structure of the reforms concerns the proposals replacing the licensing system with a registration system. The proposals only allow securities companies to market products already listed in the SEL as approved products.<sup>343</sup> Thus, securities companies must still gain permission to market products that are not included in the SEL either from the Ministry or from the enactment of a law amending the SEL to include the new type of product. Similarly, securities companies can avoid the licensing procedure to operate, but only if they do not engage in underwriting, over-the-counter securities derivatives trading, or operation of proprietary trading systems.<sup>344</sup> The majority of securities companies, however, engage in these activities and thus will still need to be licensed.

Also, a comparison to past attempts to create an independ-

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339. See *supra* note 273 and accompanying text (discussing Ministry's involvement in drafting of reforms).

340. See *supra* note 274 and accompanying text (outlining commentators' opinion that Ministry's participation in creation of reforms ensured its ability to maintain power over securities industry).

341. See *supra* notes 110-24 and accompanying text (detailing practices of *amakudari* and *MoF-Tan* as exemplifying Ministry's extensive influence within securities companies).

342. See *supra* notes 214-35 and accompanying text (highlighting past reforms to indicate that present reforms are an attempt to correct situation that past reforms could not correct).

343. See *supra* note 307 and accompanying text (describing section of FSRB concerning registration for securities products).

344. See *supra* note 305 and accompanying text (detailing section of FSRB concerning registration of securities companies).

ent securities regulator reveals the weaknesses in the new Financial Services Agency. The initial proposal for the creation of the SESC in 1992 called for that agency to be independent of the Ministry.<sup>345</sup> As a foreshadowing of the current reform measures, the Ministry stated that the SESC could not operate independently of the Ministry because the SESC did not have sufficient authority.<sup>346</sup> The Ministry was referring to the SESC's inability to gain information and power because it would not have access to the licensing system. Now, seven years later, the Japanese government has created a new agency that lacks that same authority. Specifically, the Ministry will still retain control over part of the licensing system.<sup>347</sup> In addition, the SESC was not empowered to take action on its own when it found malfeasance in the securities industry.<sup>348</sup> Similarly, the head of the FSA is required to cooperate with the head of the Ministry before making a decision that will greatly impact the securities industry.

Another weakness in the structure of the reforms is the limited staffing of the FSA. The Japanese government created the FSA with a staff which is limited for its duties and which pales in comparison to the SEC of the United States. The FSA is staffed with 403 employees that are responsible for supervising the securities industry, the banking industry, the insurance industry, some nonbank money lenders, agricultural and labor financial institutions.<sup>349</sup> By comparison, in the United States, the Securities and Exchange Commission employs 3,000 staff members to supervise the securities industry and the various banking regulators employ 8,000 inspectors to supervise the banking industry.<sup>350</sup> Also, a majority of the FSA employees can transfer back to the Ministry. This ability is significant because, as the most elite agency in the Japanese government, the Ministry is likely the agency of choice for ambitious bureaucrats to work. Thus, these

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345. See *supra* note 229 and accompanying text (describing attempt of Provisional Council on Administrative Reform to remove SESC from Ministry authority).

346. See *supra* note 232 and accompanying text (stating Ministry's justification for maintaining authority over SESC).

347. See *supra* notes 303-14 and accompanying text (outlining licensing reform proposals that allow Ministry to retain power through licensing).

348. See *supra* note 221 and accompanying text (discussing limit on SESC's power to bring action against securities companies).

349. See *supra* note 290 and accompanying text (outlining responsibility of FSA).

350. See *supra* notes 299-300 and accompanying text (stating number of employees supervising both securities industry and banking industry).

bureaucrats will tend to be sympathetic to the Ministry when working for the FSA.

C. *The Current Political Situation in Japan Reduces the Likelihood that the Big Bang Will Succeed*

The changing political situation in Japan indicates that the reform process will not be as sweeping as originally planned.<sup>351</sup> Prime Minister Hashimoto proposed a restructuring of the regulation of the securities market to bring meaningful reform to the Japanese government.<sup>352</sup> Hashimoto, however, can no longer ensure that the reforms are implemented according to his vision because of he resigned in July 1998.<sup>353</sup> Today, the task of ensuring the removal of supervisory duties of the Ministry and replacing the licensing system with a registration system falls to new Prime Minister Obuchi.<sup>354</sup>

The reformation of securities regulation in Japan will slow down because of this new development in Japanese politics. Obuchi represents an older, more entrenched style of leadership in Japan. Indeed, his main support in the LDP comes from former Minister of Finance and Prime Minister Takeshita.<sup>355</sup> Commentators believe that Takeshita placed Obuchi in the Prime Minister's office to move the LDP back to traditional ways of operation.

Traditionally, Japan has not been adverse to securities malfeasance. Indeed, the Recruit scandal and the Tateho Chemical Industries scandal proves that blatant malfeasance was not prosecuted.<sup>356</sup> The Loss Compensation scandal, the failure of Yamaichi, and the current *MoF-Tan* scandal show that the Minis-

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351. See *supra* notes 318-30 and accompanying text (outlining political change in Japan).

352. See *supra* notes 260-69 and accompanying text (detailing vision of Prime Minister Hashimoto for reform process).

353. See *supra* notes 262-320 and accompanying text (discussing resignation of Hashimoto).

354. See *supra* note 315 and accompanying text (identifying Prime Minister Obuchi as successor to Prime Minister Hashimoto).

355. See *supra* notes 315-23 and accompanying text (explaining Obuchi's election as Prime Minister as caused by LDP party boss Takehita).

356. See *supra* note 324 and accompanying text (describing circumstances of Recruit scandal including fact that no participant of scandal was prosecuted for securities violations despite fact that scandal involved bribing of politicians with inside information regarding initial public offering of stocks); *supra* notes 180-86 and accompanying text (discussing fact that although Hanshin Sogo Bank sold large amount of stock of

try even had a hand in the securities malfeasance, or at least turned a blind eye toward the malfeasance.<sup>357</sup> Furthermore three of the four political figures in the reform process were implicated in scandals. Prime Minister Hashimoto resigned as Minister of Finance after the Loss Compensation scandal. Nobura Takeshita and Kiichi Miyazawa resigned as Prime Minister and Minister of Finance after the Recruit scandal.

A final indication that the Japanese government may not continue to reform the Ministry of Finance is the relaxation of enforcement actions against the Ministry. The prosecutor leading the team investigating the Ministry was transferred to a rural outpost, and his team of prosecutors was severely downsized.<sup>358</sup> The relaxation of enforcement actions against Ministry officials contravening established laws makes it unlikely that there will be new laws created that further reform the Ministry.

#### IV. CONCLUSION

If the Japanese government wishes to effect real reform on the economy, then it must take more drastic steps. Isolating the supervisory duties over the securities market from the Ministry with the FSA represents a step in the right direction, but ultimately will prove too small a step. To be effective, the new agency must be vested with appropriate resources. Similarly, the shift from licensing to registration will not suffice to create meaningful reform. The Ministry still wields substantial power with the reform proposals. The licensing system must be abolished altogether and replaced with a registration system and the FSA must be fully staffed and completely independent from the Ministry for the reforms to be effective. Until full control of supervision is taken from the Ministry, meaningful change will not occur.

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Tateho Chemical Industries after bank had private meeting with Tateho but before Tateho announced huge operating losses to public no securities violation was found).

357. See *supra* notes 196-97 and accompanying text (examining that Ministry knew of compensation payments by Big Four securities companies and even pressured securities companies to make compensation payments to support stock market); *supra* notes 200-04 and accompanying text (discussing knowledge of Ministry Bureau that Yamaichi Securities was involved in improprieties with customer accounts and that Ministry intervention may have prevented closing of Yamaichi Securities); *supra* notes 205-10 (outlining scandal involving financial institutions bribing Ministry officials).

358. See *supra* notes 327-30 and accompanying text (discussing abandonment of investigation of Ministry).