Japanese Securities Regulation: Problems of Enforcement

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INTRODUCTION

In light of Japan's emergence as a superpower in the financial community and the growing concerns of foreign investors about the nations inadequate regulatory schemes, there has been an increase in the importance of the sources of Japanese securities laws and regulations, the regulatory authorities that govern Japanese securities transactions, and the ultimate problems of enforcement.

The Securities and Exchange Law of 1948 ("SEL")1 and the Commercial2 and Civil Codes3 are Japan's main sources of securities laws and regulations.4 Although these statutes bear some resemblance to the United States' securities laws,5 not all Japanese laws are self-executing,6 and therefore, they require a ministerial ordinance or enforcement order to be effective.

The most powerful regulatory authority in Japan is the Minister of Finance7 and its secretariat, the Ministry of Finance.8 The second most powerful is the Securities Dealer's Association,9 a self-regulatory organization whose members are the securities companies themselves.

Although the securities regulations in Japan are vast and broad, enforcement problems still remain.10 These problems are largely due to the fact that the political ideology of the Ministry of Finance has not evolved to meet the growing changes of a modern Japan.11 The Ministry's preference to give "administrative guidance" rather than actually to police the

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3. See id. § 11.12 (citing Minpō (Civil Code), Law No. 89 of 1896 [hereinafter Minpō]).
4. See generally Int'l Capital Mkts, supra note 2, (discussing the sources of Japanese Laws and regulations); ISR, supra note 1, Booklets One-Three and Recent Developments (1986) (same).
6. See Int'l Capital Mkts, supra note 2, § 11.03; supra note 110 and accompanying text.
7. See infra note 121 and accompanying text.
8. See infra note 123 and accompanying text.
9. See infra note 143 and accompanying text.
11. See infra note 184 and accompanying text.
activities of the securities companies contributes to this problem. The enforcement problems are further exacerbated by the Ministry's close ties to the securities business and the conflicts of interest that ensue. Indeed, a major scandal in August 1991 placed the Ministry of Finance's regulatory procedures under great criticism and resulted in several proposals for reform.

This Note explores the regulatory scheme of Japanese securities regulations, the problems of enforcement, and several proposals for reform. Part I discusses the sources of Japanese securities laws and regulations, including the Securities and Exchange Law of 1948 and Japan's Commercial and Civil Codes. Part II describes the regulatory bodies that exist within the Japanese system of securities, including public regulatory authorities, self-regulating organizations, and advisory councils. Part III addresses enforcement problems with respect to securities regulations, focusing on the August 1991 scandal involving four main brokerage houses. Part IV then offers a review of several proposals currently under consideration by the Ministry of Finance to tighten its control and policing of securities violations. Finally, this Note concludes that the Ministry of Finance's proposals for change are inadequate for solving the regulatory problems which exist in Japan. This Note emphasizes the need to separate the administration of the securities industry from the regulation of the industry by creating an independent regulatory body that is distinct from the Ministry of Finance.

I. SOURCES OF SECURITIES LAWS AND REGULATIONS

The SEL, along with Japan's Commercial Code and governmental legislation in the form of cabinet orders, ministerial ordinances, and rules, provides the basic sources of securities laws and regulations in Japan. The SEL in effect consolidates and incorporates the United States Securities Act of 1933 and the Securities Exchange Act of 1934. The SEL imposes disclosure requirements in both the primary (distribution) and secondary (trading) markets of securities as well as requirements for regulation of securities transactions, securities companies, and stock exchanges. In addition, the SEL includes a provision, similar to the

12. See infra note 197 and accompanying text.
13. See infra note 181 and accompanying text.
14. See infra note 217 and accompanying text.
15. See generally ISR, supra note 1, Booklet One (discussing Japanese securities laws and regulations); Int'l Capital Mkts, supra note 2, at § 11 (same).
16. The United States's intent behind these acts is to give full disclosure and prevent fraud in the securities industry. Although Japan’s SEL is based upon a philosophy of disclosure, it is unclear whether Japan’s intent was also to prevent fraud since the consolidation of the Acts occurred during the United States occupation of Japan. In fact, under pressure from American occupation authorities, Japan created an independent watchdog agency similar to the United States SEC but later abandoned it four years later when the occupation forces left. See Impoco, Pulling Strings in Japan’s Market, U.S. News & World Rep., Aug. 12, 1991, at 37.
17. See infra notes 19-27 and accompanying text.
Glass-Steagel Act in the United States, prohibiting commercial banks from entering the securities business.  

A. SEL And Related Statutes

The SEL provides for disclosure requirements, regulations of securities transactions, regulations of parties engaging in securities transactions, such as securities companies, securities exchanges, securities dealers associations, and securities finance corporations, and regulations against fraudulent securities transactions such as unfair dealing, securities manipulation, and insider trading.

In addition to the SEL and SEL Enforcement Order, four main Ministerial Ordinances also contain disclosure requirements. Similar to United States securities regulations, Japanese securities laws are premised on the concept of full disclosure. The disclosure requirements are extremely extensive, and include mandating disclosure at the time of the public offering. The issuers of publicly offered securities and the issuers of securities traded on the stock exchanges or over-the-counter markets must also comply with continuous disclosure requirements. In addition, there are disclosure requirements applicable to tender offers. Pen-

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18. See SEL, supra note 1, art. 65.
19. See SEL, supra note 1, arts. 3 to 27-8; Securities and Exchange Law Enforcement Order, Cabinet Order No. 321 of 1965, arts. 2-14 [hereinafter SEL Order], reprinted in ISR, supra note 4, Booklet Two, at 90-99.
20. See SEL, supra note 1, arts. 46 to 51, 58, 107 to 133; SEL Order, supra note 19, arts. 18-2 to 26.
21. See SEL, supra note 1, arts. 28 to 66; SEL Order, supra note 19, arts. 15 to 18.
22. See SEL, supra note 1, arts. 80 to 106, 134 to 156.
23. See id. arts. 67 to 79.
24. See id. note 1, arts. 156-2 to 156-14.
25. See id. art. 58.
26. See id. art. 125.
27. See id. arts. 189 to 90, 205.
28. See Ministerial Ordinance Concerning Registration, etc. of Public Offering or Secondary Distribution of Securities, MOF Ordinance No. 5, January 30, 1973, as amended through 1985, reprinted in ISR, supra note 1, Booklet Three, at 1; Ministerial Ordinance Concerning Registration, etc. With Respect To Public Offering Or Secondary Distribution Of Foreign Government Bonds, etc., MOF Ordinance No. 26, April 17, 1972, as amended through 1984, reprinted in ISR, supra note 1, Booklet Three, at 29; Ministerial Ordinance Concerning Registration, etc. With Respect To Public Offering Or Secondary Distribution Of Foreign Investment Trust Certificates, MOF Ordinance No. 78, November 18, 1972, as amended through 1985, reprinted in ISR, supra note 1, Booklet Three, at 136; Ministerial Ordinance Concerning Registration etc. With Respect To Tender Offers Of Securities, MOF Ordinance No. 38, June 9, 1971, as amended through 1982 reprinted in ISR, supra note 1, Booklet Three, at 39.
29. Disclosure at public offering may be accomplished through the filing of a securities registration statement as well as through the use of a prospectus. See SEL, supra note 1, arts. 4 to 12, 13 to 17.
30. Issuers may achieve the disclosure requirements by the filing of securities reports and any amendments thereto, semi-annual reports, and extraordinary reports. See SEL, supra note 1, arts. 24 to 27; SEL Order, supra note 19, arts. 4 to 5.
31. See SEL, supra note 1, arts. 27-2 to 27-8.
alties for violations of the above disclosure requirements may be as high as three million yen, or $22,600, and may include imprisonment with hard labor for up to three years.\textsuperscript{32}

In addition to disclosure requirements, the Japanese laws regulate securities transactions. Securities transactions are regulated by the SEL, as well as by two specific Ministerial Ordinances.\textsuperscript{33} Regulations of securities transactions include regulations involving securities companies and securities exchanges.\textsuperscript{34} Moreover, penalties for violating these regulations range from a penal fine of up to 300,000 yen, or $2,260, and/or imprisonment with hard labor for up to three years to a non-penal fine of up to 300,000 yen.\textsuperscript{35}

In addition, Japanese securities law regulates the industry’s participants themselves. As with the disclosure requirements, regulations of parties engaged in securities transactions also emanate from four main Ministerial Ordinances\textsuperscript{36} as well as from the SEL. These regulations involve numerous rules and restrictions that are imposed upon securities companies.\textsuperscript{37} The regulations also give a complete list of prohibited ac-

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\item \textsuperscript{32} See id. arts. 197, 198, 200, 205. Article 197 provides a fine of up to 3 million yen and/or jail time with hard labor for up to three years. Article 198 provides a fine of up to one million yen and/or imprisonment with hard labor for up to one year. Article 200 provides for a fine of up to five hundred thousand yen and imprisonment for up to six months. Article 205 provides for a fine of up to three hundred thousand yen. As of March 31, 1992 the exchange rate was 132.75 yen for one U.S. dollar. Business Digest, N.Y. Times, Mar. 31, 1992, at D1, col. 1.
\item \textsuperscript{33} See Article 1 of The Ministerial Ordinance Concerning Rules, etc. Of Soundness Of Securities Companies, MOF Ordinance No. 60, November 5, 1965, as amended through 1985, reprinted in ISR, supra note 1, Booklet Two, at 125; Ministerial Ordinance Concerning Registration, etc. With Respect To Stabilization Transactions Of Securities, MOF Ordinance No. 43, June 14, 1971, as amended through 1983, reprinted in ISR, supra note 1, Booklet Three, at 47.
\item \textsuperscript{34} Regulations involving securities companies include requirements for delivery of sale/purchase notes, depository of guaranty money in conjunction with margin transactions, and the disclosure of opposite party transactions. See SEL, supra note 1, arts. 46, 48, 49. Regulations for transactions involving securities exchanges include guaranteed deposit requirements, approvals and orders for listing, delisting procedures and applications, displays of volume of total transactions, sales, and publication of price list, reports of quotations and volume of transactions, commissions, and margins. See id. arts. 108-3, 110 to 113, 122 to 123, 131 to 132. These regulations cover persons permitted to engage in the sale and purchase of securities transactions, and provide the qualifications for futures trading on the securities market by financial institutions. See id. art. 107.
\item \textsuperscript{35} See id. arts. 206, 208. Article 206 provides for a fine for up to three hundred thousand yen. Article 208 provides for a non-penal fine for up to three hundred thousand yen.
\item \textsuperscript{36} See Japan Ministerial Ordinance Concerning Securities Companies, MOF Ordinance No. 52, September 30, 1965, as amended through 1985, reprinted in ISR, supra note 1, Booklet Two, at 115; Japan Ministerial Ordinance Concerning Rules, etc. Of Soundness Of Securities Companies, MOF Ordinance 60, arts. 2, 3, (November 5, 1965), as amended to 1985, reprinted in ISR, supra note 1, Booklet Two, at 125; and Ministerial Ordinance Concerning Securities Business By Short Term Money Market Companies, MOF Ordinance 24, (April 6, 1982), reprinted in ISR, supra note 1, Booklet Two, at 130.
\item \textsuperscript{37} Rules include conditions, standards, and application procedures for licenses; approval requirements for changes of business, such as method-of-business operations; mergers of securities companies; and the registration standards and authority of securities
tivities,\textsuperscript{38} including bucketing,\textsuperscript{39} nominal transfers,\textsuperscript{40} the engagement of securities companies in the public offering of corporate bonds,\textsuperscript{41} and the engagement of financial institutions in the securities business.\textsuperscript{42} Penalties against parties engaging in such prohibited behavior may also be as high as three million yen and may include imprisonment with hard labor for up to three years.\textsuperscript{43}

The SEL also contains a number of provisions, encompassing a broad range of regulations against fraud and manipulation. These provisions parallel United States regulations and prohibit unfair dealing, manipulation, taking advantage of a special position and insider trading.

The SEL provision against unfair dealing is found in a general anti-fraud statute\textsuperscript{44} that is modelled after Section 10b-5 of the United States Securities Exchange Act of 1934.\textsuperscript{45} A violation of this prohibition may subject the violator to imprisonment with hard labor for up to three years and/or a penal fine of up to three million yen.\textsuperscript{46} In addition, an injunction may be issued by the court, upon the request of the Finance Minis-

\textsuperscript{38} See SEL, supra note 1, arts. 28 to 36, 62 to 64-4. Restrictions include restrictions on trade names; restrictions on directors assuming concurrent duties; restrictions on engaging in concurrent business, pledging, or making loans of securities; and restrictions on the extension of credit by underwriters. See id. arts. 41 to 43, 51, 61.

\textsuperscript{39} See id. art. 50.

\textsuperscript{40} See id. art. 47.

\textsuperscript{41} See id. art. 44.

\textsuperscript{42} See id. art. 45.

\textsuperscript{43} See id. arts. 197, 199, 200, 205, 208. Article 199 provides for a fine of up to one million yen and/or imprisonment with hard labor for up to one year. Article 208 provides for a fine of up to three hundred thousand yen.

\textsuperscript{44} See SEL, supra note 1, art. 58. Article 58 reads as follows:

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

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

(2) To obtain money or other property by using documents or any other representation which contains an untrue statement of a material fact or any omission to state a material fact necessary to make the statements therein not misleading; and

(3) To make use of any false quotation for the purpose of soliciting buying, selling or other transactions of securities.

\textsuperscript{45} Section 10b-5 of United States Securities Exchange Act of 1934 reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

\textsuperscript{46} See SEL, supra note 1, art. 197(2).
ter, to immediately cease the illegal activity.\textsuperscript{47} Unlike Section 10b-5, however, this SEL provision does not provide the direct basis for civil liability.\textsuperscript{48} To receive a civil remedy, an investor must sue under the general provisions of contract or tort law contained in the Civil and Commercial Codes.\textsuperscript{49}

The anti-manipulation provisions found in the SEL also mirror United States securities regulations. The SEL provision prohibiting manipulation of the securities market\textsuperscript{50} is similar to Section 9(a) of the United States Securities Exchange Act of 1934.\textsuperscript{51} The SEL prohibits the follow-

\textsuperscript{47} See id. art. 187.
\textsuperscript{48} See Int'l Capital Mkts, supra note 2, § 11.10; ISR, supra note 1, Booklet One, at 63.
\textsuperscript{49} See ISR, supra note 1, Booklet One, at 63; Int'l Capital Mkts, supra note 2, §§ 11.10, 11.12 (citing Minp6, supra note 3, art. 709; Shôhô, supra note 2, art. 266-3, § 2); see infra notes 108-09 and accompanying text.
\textsuperscript{50} See SEL, supra note 1, art. 125. Article 125 reads as follows:

No person shall engage in the following acts for the purpose of creating a false or misleading appearance with respect to the status of transactions in any security, including but not limited to a false or misleading appearance of active trading or of certain securities listed on a securities exchange:

1. To effect any false sale and purchase transaction in the security concerned which involves no transfer of title thereto;
2. To sell securities based upon a prior agreement with another person that the same securities, at the same time and at the same price, will be purchased by such person;
3. To purchase securities based upon a prior agreement with another person that the same securities, at the same time and at the same price, will be sold by such person; and
4. To entrust or to be entrusted with such acts as mentioned in the preceding Items.

2. No person shall engage in the following acts for the purpose of inducing the purchase or sale of any security on the securities market:

1. To effect or to entrust or to be entrusted, by himself or with other persons, a series of transactions in the security concerned creating false active trading in such security or making the price of such security fluctuate;
2. To circulate a rumor to the effect that the price of any such security will fluctuate because of market manipulations by himself or by other persons; and
3. To wilfully make a representation which is false or misleading with respect to any material fact, when transactions in the security concerned are intended.

3. No person shall effect or entrust or be entrusted, by himself or with another person, a series of transactions of the security for the purpose of pegging, fixing or stabilizing the price of such security, in contravention of Cabinet Order.

\textsuperscript{51} Section 9(a) of Securities Exchange Act of 1934 reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

1. For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no
ing activities with respect to listed securities: washed sales, statements that affect the market price of the security, willful misrepresentation, matched orders, and any other activity that is used to distort the market price. Any person violating this provision will be liable for all resulting damages, including damages to persons who bought or sold the security at a price affected by the illegal conduct. The problem with this type of activity, however, is that without a criminal or administrative hearing it is very difficult to prove manipulation of the securities. This is so because the Finance Ministry's methods of regulation prevent evidence of such misconduct from entering the public domain.

The SEL provision that prohibits taking advantage of a special position and insider trading is similar to Section 16(b) of the U.S. Securities

change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

C.F.R. § 240.9a.
52. See Int'l Capital Mkts, supra note 2, § 11.11.
53. See SEL, supra note 1, arts. 30, 126, 197, 207.
54. See Int'l Capital Mkts, supra note 2, § 11.11.
55. See id.
56. See infra note 166 and accompanying text.
57. See SEL, supra note 1, arts. 189 to 190; see also Int'l Capital Mkts, supra note 2, § 11.13 (discussing insider trading provisions of the SEL); ISR, supra note 1, Booklet One, at 68-69 and Recent Developments (same); Note, Outside Investors: A New Breed Of Insider Traders?, in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. S319, S329-31 (1992) (discussing insider trading in Japan). Article 189 reads as follows:

For the purpose of preventing the unfair use of secret information of a corporation which may have been obtained by an officer or principal shareholder . . . of the corporation by reason of his office or position in the corporation, if such person realizes any profit by a purchase within six months after sale, or sale within six months after purchase, of shares of the corporation, the corporation may order him to tender such profit to the corporation.

2. If the corporation fails to claim, pursuant to the provisions of the preceding Paragraph, within sixty days after any shareholder of the corporation made a request that the corporation shall make a claim pursuant to the provisions of the preceding Paragraph, such shareholder may assert a claim in the name of and on behalf of the corporation.

3. The right to assert a claim against an officer or principal shareholder under the provisions of the preceding two Paragraphs shall expire unless the claimant exercises it within two years from the date on which such profit was realized.

4. The provisions of the preceding three Paragraphs shall not be applied to cases where such principal shareholder was not such at the time of either purchase or sale.

Article 190 reads as follows: "No officer nor principal shareholder of a corporation, the shares of which are listed for trading on a securities exchange, shall sell such portion of same shares as he does not actually hold."
Exchange Act of 1934.\textsuperscript{58} This provision states that directors, supervisors, and ten-percent shareholders must disgorge any short-swing profits.\textsuperscript{59} This requirement, however, applies only to trading in stock, and not to a shareholder unless he or she held ten percent of the shares at the time of both the sale and purchase.\textsuperscript{60}

Commentators note, however, that a 1953 amendment to the SEL\textsuperscript{61} diminished the effectiveness of the provisions against insider trading.\textsuperscript{62} The amendment repealed an article that had imposed a duty upon insiders to give notice of changes in their holdings. Without this notification requirement, it has become increasingly difficult to monitor abuses.\textsuperscript{63} As a result, the provisions against insider trading are not often used.\textsuperscript{64}

As with the other anti-fraud provisions in the SEL, violation of this insider trading provision constitutes a criminal act.\textsuperscript{65} Penalties include imprisonment with hard labor of up to three years and/or a fine for up to three million yen.\textsuperscript{66} Still, despite this legislation, there have been no convictions for insider trading in Japan.\textsuperscript{67} Although one might argue that

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58. Section 16(b) of the Securities Exchange Act of 1934 reads as follows:
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For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted issuer) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not purchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.
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17 C.F.R. § 240.16b

59. See SEL, supra note 1, art. 189; see also Int'l Capital Mkts, supra note 2, §§ 11.13, 11.11 (discussing insider trading and short-swing provisions of the SEL).

60. See SEL, supra note 1, art. 189; see also Int'l Capital Mkts, supra note 2, § 11.13 (discussing insider trading provisions of the SEL).

61. See SEL, supra note 1, Article 188 Deleted.


63. See id.

64. The Ministry of Finance has filed formal charges in just one insider trading case in the past year, whereas approximately three hundred cases are exposed by the SEC annually.

65. See SEL, supra note 1, art. 197.

66. See SEL, supra note 1, arts. 207, 205 item 1.

insider trading violates the general anti-fraud provision, regulators have never used this provision as a basis for criminal sanctions. It is considered too vague and general for insider dealings.

B. Other Securities Laws

In addition to the SEL, there are three other statutes which provide securities regulations: The Law on Foreign Securities Firms, which governs foreign securities companies; the Securities Investment Trust Law, which governs management and securities companies dealing in investment trusts; and the Certified Public Accountants Law, which governs Japanese and foreign accountants.

Although the SEL strictly regulates Japanese securities firms, there are no specific provisions of the SEL that permit foreign securities firms to engage in securities transactions in Japan. As a result of this gap in the SEL, the Law on Foreign Securities Firms ("FSFL") was enacted in 1971. The FSFL regulates brokers and dealers who are established abroad and doing business in Japan. These brokers and dealers are subject to the same regulations as those applicable to domestic securities companies. Specifically, the FSFL permits a foreign securities firm, through its branch office in Japan, to engage in securities business subject to obtaining a license from Japan's Minister of Finance. In order to obtain this license, a foreign securities firm must be comparable to a Japanese joint stock company and satisfy certain minimum requirements.

Failure to obtain a license, however, does not preclude a foreign firm from engaging in Japanese securities activities. Upon prior notification to the Finance Minister, an unlicensed foreign firm may maintain an office in Japan and engage in such securities-related activities as giving investment advice and managing an investment trust. However, the unlicensed foreign securities firm must be careful not to enter the securities business, as violation of the licensing requirement constitutes a crimi-

68. See SEL, supra note 1, art. 58; supra note 44 and accompanying text.
69. See ISR, supra note 1, Recent Developments Booklet, at 5.
70. Id.
71. See Int'l Capital Mkts, supra note 2, § 11.03[1](3) (citing Gaikoku Shokengyosha ni kansura Horitsu, Law No. 5 of 1971 [hereinafter FSFL]).
72. See ISR, supra note 1, Booklet One, at 118-30.
73. See SEL, supra note 1, arts. 28 to 66; SEL Order, supra note 19, arts. 15 to 18; supra notes 29-69 and accompanying text.
74. See Int'l Capital Mkts, supra note 2, § 11.03[1](2) (citing FSFL, supra note 71, art. 3).
75. See ISR, supra note 1, Booklet One, at 119 (citing FSFL, supra note 71, art. 6).
76. The foreign securities firm or its parent company must have three years minimum experience, meet the amount of paid up capital requirement, and must not engage in non-securities businesses such as banking, either directly or indirectly, through affiliated companies. See ISR, supra note 1, Booklet One, at 119 (citing FSFL, supra note 71, art. 6).
77. See ISR, supra note 1, Booklet One, at 121.
78. See Int'l Capital Mkts, supra note 4, § 11.22 (citing FSFL, supra note 71, art. 31).
In addition to the SEL and FSFL, the Securities Investment Trust Law ("SITL") provides sources of securities regulations for the management of investment trusts. The SITL was enacted to provide investors with a facility for making investments in securities by entrusting their funds to trust banks for management by management companies.

In order to become a management company for a securities investment trust, a firm must be a joint stock company having a paid-in capital of at least fifty million yen, or $377,000. Furthermore, the company must obtain a license from the Finance Minister in order to issue directions for the operation of trust funds. When deciding whether to grant the license, the Finance Minister examines whether the firm is qualified to be a management company "in light of its personnel and capabilities in relation to investment," whether the firm is in a good position to receive a sufficient profit as a management company, and whether the business proposed for performance by the firm is "necessary and appropriate in view of the conditions of securities investment trust and security markets."

According to a 1950 amendment to the SEL, a certified public accountant must audit the balance sheet and other financial statements of a securities company. These statements must be disclosed in a securities report and registration statement filed pursuant to the SEL. The Certified Public Accountants Law ("CPAL") prescribes requirements for the qualification, examination, and supervision of accountants; for the authorization and for organization of accounting corporations; and the organization, compulsory membership in, and supervision of the Japanese Institute of Certified Public Accountants.

A foreign accountant who has qualifications similar to a Japanese certified public accountant and who has received permission from the Minister of Finance may become a foreign certified public accountant. Permission will be granted, however, only if he or she possesses sufficient...
knowledge of Japanese accounting laws and regulations. In addition, permission is granted, however, only if he or she is eligible to become a foreign certified public accountant under the rules of the Japanese Institute of Certified Public Accountants.

C. Implementation and Enforcement of Regulations

The securities regulations enumerated in the previously mentioned statutes are not effective unless they are implemented and enforced by the regulatory authorities. Implementation requires affirmative acts by the Ministry of Finance to pass the appropriate legislation. Enforcement, in turn, requires affirmative acts by the Public Prosecutor's Office through criminal prosecutions and by the Ministry of Finance through its administrative proceedings. Finally, in the event that neither of these agencies succeeds, an individual investor may enforce the securities regulations by seeking private remedial relief under Japan's Commercial and/or Civil Codes.

Many of the laws and regulations set forth in the regulatory statutes, including the SEL and Commercial and Civil Codes, are not self-executing; rather, they are effective only when implemented by cabinet rules and/or ministerial ordinances. As Japanese law commands, "[c]abinet rules, which provide rules in areas delegated by the statute, must be passed by the cabinet, signed by the ministers concerned and the Prime Minister, . . . and promulgated by the Emperor." Ministerial rules, however, are "signed and promulgated by the minister(s) concerned with providing rules in areas delegated by the statute or by cabinet rules." In addition, the Director of the Securities Bureau has issued a number of releases indicating how the statutes and rules are to be interpreted. Furthermore, business correspondences issued from various divisions in the Securities Bureau to their regional officers may also be publicly released.

Chapter IX of the SEL gives an explicit list of all punishable acts under the statute. The penal law specifically provides for punishment of willful acts. However, the courts have interpreted the law to include

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90. See id.
91. See id. (citing CPAL, supra note 87, art. 16-2; see also id. at 80-82 (discussing qualifications for becoming a Certified Public Accountant).
92. See Int'l Capital Mkts, supra note 2, § 11.04[1](5).
93. See id. § 11.20
94. See id. §§ 11.03[2], 11.11.
95. See, e.g., SEL order, supra note 19, at 89-113 (providing an example of a cabinet order which is necessary to implement the regulations under the SEL, supra note 1).
96. Int'l Capital Mkts, supra note 2, § 11.03[1](5) (citing Kenpó (Constitution of Japan)(1946), arts. 7(1), 74).
97. Id. (citing Kokkagyoseisoshikiho, Law No. 120 of 1948, art. 12).
98. See id.
99. See id. Although releases and business correspondences are intended to be used as guidance for the regulatory authorities and do not constitute direct sources of law, in practice securities administration is carried out in accordance with them. See id.
reckless offenses if implied by the statute. Sanctions range from a civil fine of five thousand yen (thirty-eight dollars) or less to a penal fine of up to three million yen and may include imprisonment with hard labor for up to three years.

Indictment of a criminal suit is under the jurisdiction of the public prosecutors. The Minister of Finance, however, must notify the public prosecutor's office of all conduct which he suspects is a criminal violation of the securities laws. The Ministry's options for prosecuting defendants for violations of the SEL are not, however, limited to actions taken by the Public Prosecutor's Office. The Minister of Finance may apply to the court for an injunction to prevent the continued illegal activity on behalf of the public interest or for the protection of investors, although this has never been done. In addition to criminal proceedings against a defendant, the Finance Minister and his Ministry have "broad control power over a variety of persons" and may issue orders through its administrative proceedings against persons engaged in securities transactions. The Minister, however, must give all defendants notice and an opportunity to be heard before any actions may be taken against a defendant in the administrative proceedings. Although an opportunity to be heard is a necessary prerequisite for any actions to be taken, the Finance Minister may dispense with this notice and opportunity requirement if the defendant disregards the notice for no legitimate reason.

In addition, there are sources of regulatory law that are administered not by the Minister of Finance, but by the Minister of Justice, through the Commercial and Civil Codes. The Commercial and Civil Codes provide private remedial relief to individuals injured by violations of the SEL.

100. See Int'l Capital Mkts, supra note 2, § 11.20[1].
101. SEL, supra note 1, arts. 197 to 210.
102. See Int'l Capital Mkts, supra note 2, § 11.20 (citing Keisohó (Criminal Procedure Law No. 131 of 1948), art. 247).
103. See id. (citing Keisohó (Code of Criminal Procedure Law No. 131 of 1948) art. 239).
104. See Int'l Capital Mkts, supra note 2, § 11.20[1].
105. Id. § 11.20[2].
106. Id.
107. See SEL, supra note 1, art. 182; Int'l Capital Mkts, supra note 2, § 11.20.
108. See supra notes 2-3 and accompanying text.
109. Japan has a unitary system of jurisdiction and as a result no problems of jurisdiction exist. See Int'l Capital Mkts, supra note 2, § 11.21. Venue is determined by the general principles applicable to the proceedings initiated by both the government or an individual plaintiff. See id. Venue is established in the district in which the defendant has his domicile, residence, or office. See id. (citing Minsohó (Code of Civil Procedure), Law No. 29 of 1890 arts. 2, 9). If a defendant has no domicile in Japan or his domicile is unknown, venue is established in the district where the defendant's assets are located. See id. (citing Minsohó art. 8). If the action is based upon tort law, venue may also be established in the district where the wrong occurred. See id. (citing Minsohó art. 15).

If the suit is against a foreign defendant, service may be made by a Japanese govern-
Under the Commercial Code, directors of a corporation are jointly and severally liable for damages sustained by third parties if they have willfully or with gross negligence engaged in misconduct in discharging their duties. In addition, directors who make an untrue statement of a material fact in a stock or debenture subscription form, warrant, or financial statements, or who make a false public announcement, are also jointly and severally liable.

An individual shareholder of a company can bring a derivative suit on behalf of the corporation against all the directors and supervisors who participated in the misconduct. Upon the request of the defendant-directors, however, the court can order the shareholder to post security for costs of the proceedings. In addition, a shareholder who prevails "has a right to force the company to pay him a reasonable amount, not exceeding the attorney fees." However, "a bad faith shareholder who has lost a derivative suit may be liable for damages to the company."

If an injured plaintiff cannot sue under any of the specific provisions of the Commercial Code, he or she may resort to the general tort provisions in the Civil Code. In order for the general tort provision to be applicable, the plaintiff must prove the illegality of the defendant's conduct, willfulness or negligence, causation, and the amount of loss. When an employee of the corporation participates in illegal conduct, the plaintiff can sue the corporation, the employee's supervising director, and the employee himself.

II. JAPANESE REGULATORY AUTHORITIES

Japanese securities laws and regulations are enforced and regulated by three groups of regulatory authorities and organizations. The first group
includes public regulatory authorities such as the Minister of Finance, the Ministry of Finance, and the Securities Bureau. The second group consists of self-regulatory organizations including the Securities Exchange, the Securities Dealer’s Association, and the Securities Investment Trust Association. The third and final group consists of advisory councils such as the Securities and Exchange Council and the Financial Accounting Council.

A. Public Regulatory Authorities

The Minister of Finance, located in Tokyo, has the responsibility of administering and enforcing the securities laws.\textsuperscript{120} He is appointed, and can be removed, by Japan’s Prime Minister, who in turn is appointed by the Diet.\textsuperscript{121} The Finance Minister receives his rule-making authority directly from the SEL.\textsuperscript{122}

The Finance Minister’s secretariat is the Ministry of Finance, an administrative body created in 1949.\textsuperscript{123} The Ministry of Finance is divided into seven internal bureaus.\textsuperscript{124} One such bureau is the Securities Bureau, created to help the Ministry of Finance regulate securities businesses and their transactions.\textsuperscript{125} The Securities Bureau acts much like the United States Securities and Exchange Commission (“SEC”). Unlike the SEC, however, the Securities Bureau is not an independent regulatory agency.\textsuperscript{126} The Securities Bureau, acting on behalf of the Finance Minister, is responsible for granting licenses for securities exchanges, for securities businesses, and for securities investment trusts, as well as for supervising these organizations and their business associations.\textsuperscript{127}

The Bureau must also examine the securities registration, establish corporate accounting standards, supervise certified public accountants, and audit corporations and the Japanese Association of Certified Public Accountants.\textsuperscript{128} In addition, “[t]he Bureau’s staff processes numerous filings under the securities laws, including registration of securities, periodic reports [and] proxy soliciting materials.”\textsuperscript{129} Furthermore, the Bureau has extensive authority through its “administrative and rule making powers,”\textsuperscript{130} though not nearly as much as has the SEC in the United

\textsuperscript{120} See Int’l Capital Mkt, supra note 2, § 11.02[1].
\textsuperscript{121} See id. § 11.02[2] (citing Kenpó arts. 67, 68).
\textsuperscript{122} See ISR, supra note 1, Booklet One, at 26.
\textsuperscript{123} Int’l Capital Mkt, supra note 2, § 11.02[1] (citing Okurasho Setchiho, Law No. 144 of 1949, art. 11).
\textsuperscript{124} ISR, supra note 1, Booklet One, at 26 (citing MOF Order, art. 1).
\textsuperscript{125} Int’l Capital Mkt, supra note 2, § 11.02[1].
\textsuperscript{126} See id. The Securities Bureau is simply a division of the Ministry of Finance acting under the Finance Minister. See id.
\textsuperscript{127} See ISR, supra note 1, Booklet One, at 26 (citing MOF Order, art. 9).
\textsuperscript{128} See id. (citing MOF Order art. 9).
\textsuperscript{129} Int’l Capital Mkt, supra note 2, § 11.02[1].
\textsuperscript{130} ISR, supra note 1, Booklet One, at 27. The Bureau, in the name of the finance minister, enforces the securities laws by “conducting investigations which may lead to administrative proceedings, civil actions for injunctive relief, or notification to the public
B. Self-Regulatory Organizations

There are three self-regulatory organizations in Japan: the Securities Exchanges, the Securities Dealer's Association, and the Securities Investment Trust Association. Each authority has extensive regulations and rules of conduct that bind its members.

There are eight securities exchanges in Japan. The Tokyo Stock Exchange is the largest, which in 1977 accounted for over eighty percent of the volume of shares traded on all exchanges. The Osaka Stock Exchange is the second largest, which in 1977 accounted for over twelve percent of the total volume. Six small exchanges account for the remainder of the market.

Each securities exchange must be licensed by the Minister of Finance, who reviews the application and examines its rules, organization, and location. Moreover, only Japanese and foreign securities companies that are licensed pursuant to the SEL can become members of the securities exchange.

In addition, the Securities Exchange Law requires a securities exchange to have a constitution, regulations for securities business transactions, and regulations for entrustment contracts. A constitution must establish rules for membership, organization, administration, and listing of securities. Business regulations must control the sale and purchase of securities on the exchange. Finally, entrustment contract regulations must address transactions between a member and its customers.

If a securities exchange fails to take disciplinary actions against a member who has violated the SEL or the rules of the exchange, the Minister of Finance may revoke the exchange's license, suspend its operations, or order it to dismiss one or more of its officers.

In addition to membership on the securities exchanges, both Japanese and foreign securities companies are also members of the Securities

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footnotes:

131. See generally ISR, supra note 1, Booklet One, at 27-31 (discussing self-regulatory organizations).
132. See id.
133. See Int'l Capital Mkts, supra note 2, § 11.02[1].
134. See id. (citing Okurasho Shakenkyoku Nempo, Table 76, at 104).
135. See SEL, supra note 1, art. 81.
136. See id. arts. 81 to 83.
137. See id. arts. 81, 90; SEL Order, supra note 19, art. 18-2.
138. See SEL, supra note 1, arts. 82, 88, 108, 130.
139. See id. art. 88.
140. See id. art. 108.
141. See id. art. 130, ¶ 2.
142. See id. art. 155.
Dealer's Association, although this membership is not compulsory.\textsuperscript{143} The Association, is an organization formed pursuant to the SEL\textsuperscript{144} for the purposes of ensuring fairness in securities dealing and maintaining protection of investors.\textsuperscript{145} To achieve this goal, the Association ensures its members' compliance with the securities laws and regulations, oversees the conduct and assets of its members, educates the officers and employees of members, and conducts exams of securities salesmen.\textsuperscript{146} The Association, pursuant to the SEL, must also register with the Ministry of Finance and have a constitution, rules of fair practice, and a uniform practice code, all of which bind its members.\textsuperscript{147}

As with the Securities Exchanges and Dealer's Association, the Securities Investment Trust Association is a self-regulatory organization whose members are the management and securities companies which engage in the sale and purchase of securities investment trusts.\textsuperscript{148} The Securities Investment Trust Association is a corporate entity formed pursuant to the provisions of the SITL.\textsuperscript{149} This Association was created by the securities investment management companies for the purpose of promoting the protection of investors and the sound development of securities investment trusts.\textsuperscript{150} It has rule-making power under the supervision of the Ministry of Finance, which reserves the power to approve or disapprove the rules of conduct of the association and to issue necessary orders.\textsuperscript{151}

C. Advisory Councils

The final group of regulatory authorities consists of advisory councils. Their role is to research various problems that arise in the securities business and to recommend reforms to the Ministry of Finance.\textsuperscript{152} The most influential advisory council is the Securities and Exchange Council. It acts as an advisory council to the Ministry of Finance and is created pursuant to the SEL.\textsuperscript{153} The purpose of the Securities Exchange Council is to research issues relating to the issuance, sale, and purchase of securities.\textsuperscript{154} The members of the Council are chosen from among the leaders

\begin{itemize}
  \item \textsuperscript{143} See generally ISR, supra note 1, Booklet One, at 28-30 (discussing organization and responsibilities of the Securities Dealer's Association); Int'l Capital Mkts, supra note 2, § 11.02[2](6) (same).
  \item \textsuperscript{144} See SEL, supra note 1, art. 67.
  \item \textsuperscript{145} See ISR, supra note 1, Booklet One, at 29.
  \item \textsuperscript{146} See id.
  \item \textsuperscript{147} See id. at 29-30 (citing Articles of Association art. 5).
  \item \textsuperscript{148} See generally id. Booklet One, at 30-31 (discussing the organization and responsibilities of the Securities Investment Trust Association).
  \item \textsuperscript{149} See id. Booklet One, at 30 (citing SITL, supra note 80, art. 24-2).
  \item \textsuperscript{150} See id. at 30-31.
  \item \textsuperscript{151} See id.
  \item \textsuperscript{152} See generally id. Booklet One, at 32 (discussing the organization and responsibilities of the Advisory Councils); Int'l Capital Mkts, supra note 2, § 11.02[5] (same).
  \item \textsuperscript{153} See SEL, supra note 1, art. 165.
  \item \textsuperscript{154} See ISR, supra note 1, Booklet One, at 32.
\end{itemize}
in the securities, banking, insurance, and other industries for a term of two years.\textsuperscript{155}

The Financial Accounting Council is another advisory council to the Ministry of Finance.\textsuperscript{157} Its primary purpose is to establish financial accounting standards for business corporations.\textsuperscript{158} Membership on the Council is contingent upon appointment by the Minister of Finance for a two year term and is limited to forty part-time members.\textsuperscript{159}

III. PROBLEMS OF ENFORCEMENT

Although Japanese securities laws, regulations, and regulatory authorities are highly developed, many problems of market manipulation, dishonesty, and unfair dealings still frequently arise.\textsuperscript{160} Most problems, on close analysis, appear to stem from the Ministry of Finance's failure to effectively enforce the securities regulations.\textsuperscript{161}

The Ministry of Finance's ideological approach to securities regulation is closely intertwined with its ethical and political ideologies.\textsuperscript{162} As a result, information relating to illegal activities or misconduct by parties engaged in the securities industry usually does not enter the public domain.\textsuperscript{163} The lack of litigation against fraudulent securities activities cannot be attributed to a failure to expose misconduct and illegal activities to the Ministry of Finance.\textsuperscript{164} Indeed, these activities are exposed to the Finance Ministry, but the public remains unaware of the extent of these ongoing practices because the Ministry's method of addressing these activities is to reprimand the guilty parties behind closed doors and without any public record.\textsuperscript{165} In fact, one commentator was shocked by

\textsuperscript{155} See id.

\textsuperscript{156} See SEL, supra note 1, arts. 166 to 167.

\textsuperscript{157} See ISR, supra note 1, Booklet One, at 32.

\textsuperscript{158} See id.; Int'l Capital Mkts, supra note 2, § 11.02[2](5)(b).

\textsuperscript{159} See Int'l Capital Mkts, supra note 2, § 11.02[2](5)(b).

\textsuperscript{160} See, e.g., infra note 168 accompanying text (discussing a prime example of continuing fraudulent activities).

\textsuperscript{161} See Special Report: International Regulatory Outlook '90, Int'l Sec. Reg. Rep., January 3, 1990. Some critics argue that the securities laws are not highly developed but are simply "vague laws rife with loop holes," and that it is for this reason that regulatory problems exist. See Yates, Reform Far Off For Japan Markets, Chi. Trib., Aug. 4, 1991, § 1, at 1, col. 1. Although this argument has merit, one may also argue that the Ministry of Finance can use these ambiguities for its advantage, and thus police even more activities, but it simply chooses not to. In addition, if enforcement problems exist because of these ambiguities then it is up to the Ministry of Finance to propose clearer legislation rather than sit back and use the ambiguities to justify its inaction.

\textsuperscript{162} See infra notes 184-89 and accompanying text.


\textsuperscript{164} See supra notes 60-69 and accompanying text.

\textsuperscript{165} The Ministry of Finance was aware of the client compensation scandal approximately one year before it was exposed by the media. See Nickerson, Japan Feeling Backlash From Stock Scandal, Boston Globe, June 30, 1991, at 65, col. 2.

\textsuperscript{166} As one commentator noted, "The rule in Japan appears to be: Hide abuses whenever possible. If they become public, acknowledge them, express regret, sacrifice a few
the recently uncovered securities scandal not because of the exposed activity, but because the activity was actually exposed to the public.\textsuperscript{167}

A. Examples of Enforcement Problems

The August 1991 client compensation scandal is a particularly effective example of Japan’s enforcement problems because this scandal illustrated the underlying causes of the enforcement problems: the practice of Amukadari, Japan’s ideology towards securities regulation; and the Ministry of Finance’s methods of administrative guidance.

The August 1991 scandal is a prime example of the Ministry of Finance’s ineffectiveness in enforcing Japanese securities regulations. This scandal involved client compensation for trading losses by the four largest brokerage houses in the country: Nomura, Nikko, Daiwa and Yamaichi.\textsuperscript{168} Since then, according to an industry reporter the “largest seventeen brokerage houses have so far admitted to paying a total of 171.9 billion yen, [or 1.1 billion dollars], in compensation to 608 organizations and nine individuals.”\textsuperscript{169}

August 1991, however, was not the first time that the Ministry of Finance had known of these practices. In August 1990 more than ten Japanese securities houses, including Daiwa and Yamaichi, were hit with tax penalties totalling seven billion yen, or forty-seven million dollars, for declaring compensations made to large corporate clients as non-taxable


\textsuperscript{168} Public exposure of the scandal has also led to an investigation by the Ministry of Finance into the activities of Nomura Securities. It has been discovered that Nomura, along with Nikko, has “reportedly offered over $100 million each in financing to Susumu Ishii, reputedly the retired godfather of one of Japan’s most notorious crime syndicates.” Impoco, \textit{Pulling Strings in Japan’s Market}, U.S. News & World Rep., Aug. 12, 1991, at 38; see also \textit{Trapped in the Rubble}, Economist, June 29, 1991, at 65 (discussing the roles of Nomura and Nikko in the securities scandal). In addition, Nomura has been accused of manipulating stock by artificially boosting the value of shares in Tokyu Railways Co. after Susumu Ishii had invested heavily in the stocks. See \textit{id.}

\textsuperscript{169} Gangster affiliations with securities is no surprise to those who participate in Japan’s securities markets. “Rumors about gangster contacts have long swirled around almost every big financial group in Japan.” \textit{id.} at 65. More specifically, these kinds of practices have allegedly been part of an ordinary course of business for Nomura, as well as a contributing factor for its success in the securities industry. \textit{See generally} Alletzhauser, \textit{The House Of Nomura: The Inside Story Of The Legendary Japanese Financial Dynasty} (HarperPerennial, 1991) (exploring the rise of power of Nomura Securities). Gangster affiliations in the securities industry exist because of “the constant need for organized crime to launder money.” \textit{Trapped in the Rubble}, Economist, June 29, 1991, at 65; see also \textit{Note, Putting Starch in European Efforts to Combat Money Laundering}, in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. S429, (1992) (discussing money laundering in financial markets). In light of this historical gangster affiliation, the Ministry of Finance’s investigation and subsequent sanctions against the parties involved appear only to be a ploy to turn the critical eye off itself and onto the securities firms.
business expenses.  

Client compensation, if used to attract clients, is prohibited by SEL Article 50. Article 50, entitled Prohibited Activities, states in pertinent part:

> It shall be unlawful for any securities company, its officers or employees to commit any of in [sic] the following acts: . . .
> (2) To solicit buying, selling or other transactions of securities by undertaking to a customer to absorb the loss, in whole or in part, to be incurred with respect to such securities.\(^\text{171}\)

The problem with Article 50, however, is that it prohibits a brokerage house from promising to reimburse an investor in advance for losses suffered in the market, but does not prohibit a broker from compensating a client after the fact.\(^\text{172}\) Indeed, the Finance Ministry regulators have attempted to justify their inaction in the client compensation scandal by arguing that reimbursements are “illegal only if promised when the orders . . . were solicited.”\(^\text{173}\)

Under Article 50, the Ministry of Finance’s argument may be valid, because the Article is limited to acts used to solicit securities sales.\(^\text{174}\) There are, however, other laws which could be used against the brokerage houses, with or without evidence of when the promises were made. These include SEL Article 58, the anti-fraud provision,\(^\text{175}\) and SEL Article 125, which bars false trading activity.\(^\text{176}\) Both of these articles were taken from the United States Securities Exchange Act of 1934 and imple-

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\(^{171}\) See SEL, supra note 1, art. 50.


\(^{173}\) See Stevens, *Japan’s Rigged Financial Market*, N.Y. Times, July 30, 1991, at A19, col. 5. This is a specific example where the Ministry of Finance attempts to exploit the ambiguity of the SEL by sitting back and doing nothing to correct the situation. See supra note 165.

\(^{174}\) See supra note 171 and accompanying text.

\(^{175}\) See supra note 44 and accompanying text. Although this provision does not form the direct basis for civil liability, this should not bar its use by the Ministry of Finance against brokerage houses for violations of the SEL. Paragraph One of Article 58 specifically forbids the use of fraudulent schemes in any securities transactions. See id. One can easily argue that the client compensation practices were schemes aimed only at the brokerage houses’ largest clients, since the practices were not extended to the smaller investors. See Sterngold, *Signs Seen in Japan Scandal of Efforts to Curb Inquiry*, N.Y. Times, July 22, 1991, at D1, col. 1.

\(^{176}\) See supra note 50 and accompanying text. Again, an argument may be advanced that the compensation activities violate this provision. In order to advance such an argument, the Ministry of Finance would have to investigate the manner in which the improper compensation was paid. Reports have persisted that “the payments were made by selling securities to the clients at artificially low prices, then repurchasing the securities later at higher prices.” Sterngold, *Signs Seen in Japan Scandal of Efforts to Curb Inquiry*, N.Y. Times, July 22, 1991, at D1, col. 1. If these allegations are true, this activity seems to be clear evidence of a violation of the statute against manipulative or false trading.
mented in the SEL during the United States occupation after the World War II. These sections make violators criminally punishable with up to three years of hard labor. That neither of these statutes has been suggested as a means of punishing the brokerage houses for their activities is not evidence that Japan lacks the appropriate regulatory laws, but that it simply fails to enforce the laws effectively.

The Ministry of Finance has been "publicly accused of everything from turning a blind eye to downright complicity in the expanding securities scandal." The main criticism leveled against the Ministry of Finance centers on its close relationship with the securities industry, which gives rise to conflicts of interest.

The practice of Amakudari—literally, "descent from heaven"—has been a contributing factor in the conflicts of interest that have arisen. Amakudari refers to a practice that permits the top securities firms to hire retired senior officials from the Ministry of Finance. Because of these employment practices, the Ministry of Finance has shown a willingness to overlook misbehavior of these securities firms.

The practice of Amakudari stems from another problem of securities regulations enforcement in Japan, which rests upon the failure of Japan's political ideologies to evolve into modern times. The Japanese have, in the words of one commentator, a "Confucian understanding of politics," and they "believe that only the highly educated elite have both the knowledge and virtue necessary to govern effectively."

Unlike the United States western democratic tradition, which has "cultivated a healthy distrust of those in power," the Japanese tradition

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177. See Sterngold, Signs Seen in Japan Scandal of Efforts to Curb Inquiry, N.Y. Times, July 22, 1991, at D1, col. 1; supra notes 44, 50 and accompanying text.
178. See Sterngold, supra note 177; supra notes 46, 53 and accompanying text.
180. See id.
182. More than two hundred high ranking officials have "made the descent" in the last five years. Powell, Tokyo's Power Club, Newsweek, July 8, 1991, at 40, 41. In fact, a private credit research agency, Teikoku Databank Ltd., reported on September 13 that "at least 170 former Finance Ministry and Bank of Japan officials are board members of commercial banks and securities houses." Reform Council Proposes Watchdog Committee for Securities Industry, Report From Japan, Inc., Sept. 16, 1991, available in LEXIS, Nexis library, NEWSWIRES File. As a result, former Ministry officials account for one in every twenty seats on bank and brokerage boards. See id.
183. See Reform Council Proposes Watchdog Committee for Securities Industry, Report From Japan, Inc., Sept. 16, 1991, available in LEXIS, Nexis Library, NEWSWIRES File. In fact, not only does this practice result in the Ministry of Finance overlooking certain activities, but it is alleged that the Ministry of Finance is more "reluctant to inspect banking and securities companies because so many former ministry officials work for them." Oishi, Scandal Cleanup Awaited; Reform Proposals on Political Calendar, Nikkei Weekly, Aug. 17, 1991, at 1, col. 6.
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thrives on trust of those in power "in the same way that children trust their parents." Consequently, while the United States system designs entities in order to check the balance of power, the Japanese system results in a concentration of power in the hands of the elite. This ideology has trickled down from those governing the securities industry to the participants themselves. In Japan, "[b]reaking a rule for a client is the ultimate expression of gratitude and it also psychologically binds a customer to a particular [business]." Thus, client compensation in the recent scandal was not only an ongoing activity, but was an expected activity.

The client compensation scandal demonstrates the need to change this elitist ideology. Client compensation is aimed at benefitting the strong and powerful customers in the securities industry. The idea that the "bureaucracy's first obligation is to the greater good of the economy, as opposed to enforcing the regulations" appears to have influenced the Ministry of Finance in its involvement in the compensation practices. As one analyst has pointed out, had those large clients "lost hundreds of millions when the market crashed, the reverberations would have been felt through the entire economy." While this tradition of politics has been successful in the past, Japan has changed in the last few decades, while the goal of the Japanese leadership has not. The origins of this change lie in the securities firms' "excessive pursuit of profit of the past five years." As one commentator has noted, the "bull market created an atmosphere in which traditional standards evaporated." In fact, Mr. Aida, the current chairman of Nomura, has admitted that "[t]oo much of [Nomura's] energy was centered on pursuing profits. [Nomura] was so successful that [it] became arrogant not just in [its] business but in [its] attitudes to the whole world." Thus, as the Ministry itself recognizes, it can no longer rely on Japan's unwritten code of behavior, but must codify the principles of honesty and fairness into its securities laws and regulations.

An additional factor contributing to repeated violations of the SEL by

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185. Id.
186. See id.
188. See id.
190. See id.
191. Id.
192. See id.
194. Id.
large securities firms is the Ministry of Finance’s preference to enforce its will by “administrative guidance—the supervision of financial companies through a mass of written and unwritten regulations.”\textsuperscript{197} In typical Ministry of Finance practice, top Japanese securities executives make daily “pilgrimages” from their offices to the Ministry of Finance.\textsuperscript{198} They report their activities and new developments to ministry officials, who either approve or disapprove of their activities.\textsuperscript{199} As a result of this practice, it is rarely possible to prove that a particular company broke or bent a particular rule.

There is no doubt that during the post-war decade of reconstruction and rapid growth, administrative guidance played an important role in the Japanese financial industry,\textsuperscript{200} but now “such guidance has outgrown its usefulness and is now even doing harm to the economy by widening the gap between the development of the national economy and individual citizens’ affluence.”\textsuperscript{201} The end result, one critic argues, is that “the public is denied an opportunity to share in information essential to a free market economy.”\textsuperscript{202}

Finally, securities companies often escape prosecution for their practices partly because the Ministry of Finance too often relies upon self-regulating organizations, such as the Securities Exchange\textsuperscript{203} and the Securities Dealer’s Association,\textsuperscript{204} to discipline companies for violations of the regulations. This is problematic because certain violations of the SEL—customer compensation, for example—are not violations of any rules or regulations of the organizations.

B. Impact of Enforcement Problems

The Ministry of Finance’s problems in enforcing the securities regulations have a major impact on two groups of investors: small investors and foreign investors. Indeed, Japan still remains “a closed system with privileges based upon the power to serve the system.”\textsuperscript{205} Japan’s regulatory scheme, therefore, caters to powerful corporate and political inter-

\textsuperscript{197} Wagstyl, Tokyo Finds a Nod and a Wink No Longer Enough, Fin. Times, Aug. 10/11, 1991. “The system is flexible. But it can be vague and unclear. It tends to discriminate in favour of companies and individuals with long experience of dealing with the ministry.” \textit{Id.}


\textsuperscript{199} See \textit{id.}


\textsuperscript{201} \textit{Id.}

\textsuperscript{202} \textit{Id.}

\textsuperscript{203} See \textit{supra} note 131 and accompanying text.

\textsuperscript{204} See \textit{supra} note 143 and accompanying text.

\textsuperscript{205} Wood, \textit{Why Japan Isn’t Ready For Reform}, Chi. Trib., Aug. 2, 1991, § 1, at 19, col. 2. “Foreigners do not serve the system and neither do small investors. Crime syndicates do serve the system so they get help.” \textit{Id.}; see also supra note 168 (discussing crime affiliations in the securities industry).
ests at the expense of small investors, as demonstrated by Nomura’s role in the recent client compensation activities. Although Nomura’s smaller retail customers may protest exclusion from the benefits of these activities, such deals attract large investors to Japan’s market. Such large capital investments “supplied the capital for the firm’s worldwide expansion, which has created thousands of jobs and generated hundreds of millions of yen in taxes.”

Japan’s bias against small investors is not unique in the securities markets of the world. However, Japan’s enforcement problems are clouded by Ministry officials’ beliefs that the benefit of capital flow into the domestic securities system outweighs the costs of bias against small investors. This philosophy governing the securities industry focuses narrowly on Japan’s domestic securities system, and fails to consider the impact of its bias on other foreign securities systems.

Foreign investors are excluded from Japan’s securities market for three primary reasons. First, its system of administrative guidance results in a regulatory system “managed in an informal way that benefits Japanese companies and is generally not comprehensible to outsiders.” Second, Japanese brokerage houses believe that the potential capital gains received from promising special treatment, such as compensation to foreign investors, are not large enough to enable the securities firms to afford “the potential liabilities that come with such guarantees.” Finally, Japanese brokerage houses are leery of offering such inducements to foreign investors because most of the activities that the brokerages could offer would be illegal under the securities laws of the foreign investor’s home country.

In order for Japan to maintain its legitimacy in the “transnational” world of financial services, it needs to restructure its methods of regulating securities laws. Former Prime Minister Kaifu admits that the Japanese securities market is expected to “channel funds effectively not only

207. See supra note 180 and accompanying text.
209. See Rowen, *Scandal, Japanese Style: Looking the Other Way*, Wash. Post, June 30, 1991, at H1, col. 5. Japan simply demonstrates that the “small investor has no business being in anybody’s stock market—Japan’s, New York’s, Hong Kong’s or Taipei’s.” Id. at H6, col.1. “The small investor is not buying ‘a share of America,’ as [the] New York Stock Exchange [advertises]: He or She is shooting craps with high rollers with deep pockets.” Id.
213. See id. at 41-42.
for the Japanese economy, but also for the global economy. . ." To accomplish this, however, Japan's securities industry must regain the confidence of both foreign and small investors.

IV. PROPOSALS FOR CHANGE

Despite the client compensation scandal, the Director of the Finance Ministry's Securities Bureau, Nabuhiko Matsuno, defended the work of his agency. The publicity surrounding the most recent scandal, however, reduces the Ministry of Finance's ability to have the "luxury of conducting business in its normal state of relative obscurity." Public attention in Japan is highly focused on what the Ministry will do. This has forced the Ministry of Finance to consider several proposals for reform.

A. Proposals For Reform

The Ministry of Finance recognizes the need for reform and has proposed the creation of a new regulatory agency that would be under the umbrella of the Ministry of Finance. This new "watchdog" agency, "tentatively called the Financial Fair Trade Commission," would be a "semi-independent board of five to seven members who would be financial experts and possibly lawyers." This agency's primary function would be to investigate violations of the securities regulations. The agency, however, would only be able to recommend penalties to the Fi-

217. Id. at 8.
218. Wada, Financial Watchdog Likely Outside Ministry, Nikkei Weekly, Sept. 14, 1991, at 4, col. 2; see also Reform Council Proposes Watchdog Committee for Securities Industry, Report From Japan, Inc., Sept. 16, 1991, available in LEXIS Nexis Library, NEWSWIRES File ("the investigative committee should have five standing members, each of whom will be either a former Supreme Court Justice, legal officer, public accountant or academic").

One criticism made against the Ministry of Finance's employees is that they are not experts in the field of securities regulations. A commentator has suggested that new education policies should be developed to educate those in the securities industry on financial economics. See Hebner, Financial Markets Demand New Education Policies, Nikkei Weekly, Aug. 31, 1991, at 6, col. 6. "Japanese universities have only 15-20% of the number of finance professors that the average North American university has." Id. Hebner suggests that this has two major consequences. "First, there is relatively little research [conducted] examining Japanese financial institutions." Id. "Second, relatively few university students receive a rigorous training in financial economics." Id. As a result, employees of brokerage houses are unable to think "independently and critically about complex issues" since all of their education comes from the brokerage houses themselves. Id.
The Ministry of Finance recognized the need for anti-compensation laws and proposed an anti-scandal bill that won quick approval by the Diet. The bill bans discretionary account management and prohibits compensation for losses on stock transactions. It also includes a "pledge to consider more fundamental changes" in the SEL. Furthermore, under this bill, a broker could be imprisoned for up to one year and/or be fined a maximum of one million yen (approximately $7,450) for making compensation payments. An investor could be fined half that amount for accepting the payments.

Also, in response to the scandal, "the Ministry of Finance ordered the 'big' four brokerages—Nomura Securities, Daiwa Securities, Nikko Securities, and Yamaichi Securities—to refrain from doing business with corporate clients for four days and advised the companies to punish executives involved in the misdeeds." 

The former Minister of Finance, Kaifu, also recognized that the self-regulatory bodies need to "set up fair and transparent rules in order to avoid a recurrence of the recent brokerage scandals." Proposals for reform include "opening up . . . [the domestic] markets to more participants . . . and increasing the transparency of government administration of the securities market."
Although the Ministry of Finance acknowledges the need for reform, criticisms of the Ministry's proposals have come from the public, from businesses, and from a wide range of politicians. Even if the new regulatory commission were approved by the Diet, it would still be under the umbrella of the Ministry of Finance and "be part of a system staffed by people who accomplish things informally, not through institutional or legal channels." Consequently, the public and some top political and corporate leaders favor a proposal that calls for the creation of a more independent investigative body.

The leading such proposal calls for a Japanese-style Securities Exchange Commission, modeled after the United States Securities Exchange Commission. Under the SEC model, an independent agency would then have full investigative and judicial powers to prosecute violations of the securities laws outside of the Ministry of Finance. It would also prohibit the Ministry of Finance from playing "a dual role as both protector and overseer of securities regulations.

The Japanese-style SEC proposal, however, is not supported by the Ministry of Finance. The most obvious reason, though not acknowledged by the Ministry, is that it would diminish the Ministry's exclusive control over the securities industry. Matsuno has argued that an SEC system would not work because of the differences in each country's securities industry. As evidence, he explains that there are over 12,000 securities companies registered for securities trading in the United States and that, during a year, approximately "200 of these change as a result of the relative ease with which they can enter and leave the business. In such circumstances, an 'SEC responsible for regulating these companies is important'." In Japan, however, there are fewer than 270 registered securities companies, which must satisfy strict license qualifications and cannot freely decide to leave. The Ministry of Finance believes that "it is more efficient and preferable for us to stop malpractice before it

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230. In the beginning, then Prime Minister Kaifu and the Liberal Democratic Party were strong proponents of creating an independent body modeled after the United States SEC. See Japan's Brokers Under Pressure To Adopt Reforms, Bus. Int'l; Bus. Asia, Sept. 2, 1991, available in LEXIS, Nexis Library, NEWSWIRE File. It is unclear, however, whether these supporters are truly supporting the creation of such a body or whether they are doing so simply to salvage their reputations and save face under local and international criticism. See id.
235. See id.
happens, rather than after the fact as the SEC has done in the United States.\textsuperscript{237}

The Japanese Securities Dealer's Association has also recognized the need for reform, and has proposed the most significant reform to date. Proposed measures include conducting more frequent inspections of brokerage operations and increasing the staff in charge of such inspections.\textsuperscript{238} In addition, the Association has announced that it will ban discretionary accounts within the securities industry.\textsuperscript{239} These accounts give brokerages wide discretion in managing clients' investments, and it was losses in such accounts that prompted institutional clients to demand compensation from brokerages.\textsuperscript{240}

In response to the compensation scandal, the Securities Dealer's Association has sought to establish two committees, "the Headquarters for Promotion of Industry Reform, which will advise on policy options to improve investor confidence;" and another committee to include scholars and journalists, "designed to provide opinions from outside the industry."\textsuperscript{241}

The Tokyo Stock Exchange will soon announce that it plans to take certain measures to prevent fraudulent stock dealings.\textsuperscript{242} One plan is to acquire more directors from outside the industry.\textsuperscript{243} It further proposes to punish brokerage houses more severely for irregular trading and strengthen its inspection of stock transactions.\textsuperscript{244}

\textbf{B. Analysis Of The Proposals}

In order for Japan to effectively eliminate its problems of regulatory enforcement, it must initially codify the Finance Ministry's administrative guidance in clear laws and regulations. It must then sever the administration and promotion of the securities industry from the regulation of the industry. In order to accomplish this, the practice of Amukadari must be abolished, thereby eliminating conflicts of interest, and an independent investigative body must be created separate from the Ministry of Finance.

The Finance Ministry's proposals for reform are not sufficient to over-

\begin{itemize}
\item \textsuperscript{237} See id.
\item \textsuperscript{238} See Japanese Dealers To Strengthen Self-Regulation, Reuters, Sept. 18, 1991, available in LEXIS, Nexis Library, NEWSWIRES File.
\item \textsuperscript{239} Yates, Reform Far Off for Japan Markets, Chi. Trib., Aug. 4, 1991, § 1, at 4, col. 1.
\item \textsuperscript{240} Id.; see also supra note 221 (discussing discretionary accounts).
\item \textsuperscript{241} Thompson, Bank of Japan Chief Calls for Clear Securities Rules, Fin. Times, July 18, 1991, at 6, col. 1.
\item \textsuperscript{243} See id. This proposal would eliminate the practice of Amukadari. See supra notes 181-88 and accompanying text.
\item \textsuperscript{244} See supra note 242 and accompanying text.
\end{itemize}
come regulatory enforcement problems because they do not address the fundamental causes of the problems; rather, they only address the particular issues involved in the recent client compensation scandals.

The anti-compensation legislation, although useful because it specifically bans client compensation, does not address the fact that the Ministry of Finance had approved the activity after the fact through its "administrative guidance." It also does not address the Ministry's reluctance to prosecute any securities violations. In addition, the penal fines for violating the legislation are not large enough to act as a disincentive unless they are used in conjunction with more criminal prosecutions.

Furthermore, the Ministry's proposal for a semi-independent agency appears to be a smoke screen created in response to public criticism. As it stands, the new agency would simply be in the ambit of the Ministry of Finance. This does not eliminate any of the fundamental problems of enforcement, such as the Ministry's close ties with the industry or the conflicts of interest that arise. In addition, the Ministry has neither the "resources [n]or the inclination" to separate the industry's roles of promotion and regulation and thus put a stop to the illicit practices.

The proposals to create a Japanese-style SEC, however, would effectively separate the roles of promotion and regulation, and would thus be a step toward substantive regulatory reform in Japan. The aim of the proposal is to create an independent body, separate from the Ministry of Finance, which is empowered with the duties of investigating securities misconduct and initiating criminal proceedings against the wrongdoers. The Director of the Securities Bureau, Matsuno, argues that such an agency is not needed because there are fewer securities firms in Japan that need policing. The mere fact that there are fewer brokerage firms

245. See supra note 64 and accompanying text.

246. The fines proposed are minimal in relation to the potential profits earned by engaging in such activities and thus, are not a disincentive to the parties involved.

247. In fact, since it is the Ministry of Finance that selects the members for the agency the result could lead to further instances of conflicts of interest. See supra note 218.


249. Contrary to the Ministry of Finance's arguments, the goal of this proposal should not be to adopt the United States SEC as it stands because it too has its own inherent regulatory problems. See, e.g., Note, Increasing United States Investment in Foreign Securities: An Evaluation of SEC Rule 144A in Annual Survey of Financial Institutions and Regulation, Transnational Financial Services in the 1990s, 60 Fordham L. Rev. 8179, (1992) (discussing problems of over regulation by the United States SEC). The goal should be to adopt the idea of an independent regulatory model and adapt it to meet the needs of Japan's regulatory system.

250. See supra note 234 and accompanying text.
participating in the securities industry in Japan, however, does not mean that the volume of incoming capital and the opportunity for abuse is any less. In fact, because the capital flow is concentrated in four main brokerage houses—Nomura, Nikko, Daiwa, and Yamaichi—the opportunity for abuse is equal to, if not greater than, that found in the United States. Therefore, the number of Japanese firms is not indicative of the strength or influence of the Japanese Dealers.

Matsuno also argues that there is no need for an SEC-type regulatory body because of Japan’s strict licensing requirements. However, it is precisely these licensing requirements that have caused firms to engage in activities such as client compensation. The licensings make it extremely difficult for firms to enter the securities business, and as a result competition among the existing brokers is limited, thus leading them to compete in other ways such as offering client compensation.

The implementation of a Japanese-style SEC would eliminate this lack of competition. By using a system of registration, as in the United States, the securities market would be open to more companies interested in participating in the securities industry, thereby increasing the competition among brokers.

CONCLUSION

Japan’s regulatory enforcement problems are the direct result of, first, the close relationship between the Ministry of Finance and the securities companies it regulates and, second, the Ministry’s obscure manner of regulation through administrative guidance. In order to have an effective domestic securities industry, and in order to respond to the growing public pressures that resulted from the recent scandal, changes must take place in the enforcement of the securities regulations by the regulatory authorities, especially by the Minister of Finance. Meeting the needs of a domestic securities industry should not be the only goal of the Minister.

251. There are over two hundred Japanese firms, of which twenty-five have offices in London and fourteen have offices in the United States compared to over twelve thousand broker-dealers in the United States, only twenty three of which are foreign dealers. See Int’l Capital Mkts, supra note 2, § 1.05[2] (citing 1987 SEC, Ann. Rep. 112).

252. See id. Four of the six largest and nine of the twenty-five largest securities firms in the world are Japanese firms. See id. In 1987, the four largest Japanese firms had a net income of approximately six billion dollars compared to a net income of seven hundred million dollars for the three largest United States firms. See id.

253. See supra note 235 and accompanying text.


255. The number of securities firms decreased tremendously as a result of the enactment of the licensing requirements. In 1963, before the enactment of the requirements, there were 597 firms in Japan’s securities industry. In 1968, after enactment of the requirement to have a license rather than a registration, the number was reduced to 277. This reduction was “a result of mergers and dissolution of weak firms which found it difficult to meet licensing standards.” Int’l Capital Mkts, supra note 4, § 11.04[4]

of Finance and his Ministry. In order to maintain its legitimacy as a competitive securities market in a transnational financial world, Japan must ensure that the political ideology of the Ministry of Finance is reformed.

The best way to achieve these goals is to create an independent regulatory agency, separate from the Ministry of Finance, modeled after the SEC in the United States. By establishing such an agency, the administration and promotion of the securities industry will be separate from the regulation of the industry, thus removing a major barrier to the effective enforcement of securities laws and regulations in Japan.