3. Financial Sector

[Focus of Discussion]

Regulatory reforms are needed for maximizing the potential of private companies and individuals and thereby revitalizing the Japanese economy and society. In the financial services sector, despite a number of reforms that have already been made since the Japanese Financial Big Bang, further measures should be taken to facilitate the smooth supply of funds to growth industries and businesses. In the indirect finance sector, it is expected that a change "from *ex-ante-facto* regulations to *ex-post-facto* monitoring" in supervisory administration and an introduction of competition principles would make financial services more convenient for users, in turn leading to sounder management of financial institutions. As for the capital market, it is important to continuously promote the shift from indirect finance to direct finance through structural reform of the securities market.

[Specific Measures]

1 Arranging the infrastructure for the development of financial services industry

(1) Relaxation of trust property limitations under the Trust Business Law [To be reviewed and concluded within FY 2003; to be implemented in successive steps]

The Trust Business Law (Law 65, 1922) limits the scope of trust property to money, securities, money claims, movable property, land and fixtures, superficies, and leaseholds.

However, since intellectual property rights, such as patent rights and copyrights, have come to gain greater economic importance as industrial structure changes proceed, inclusion of them in property trust under the Law could broaden the use of the trust system.

Therefore, whether or not intellectual property rights, such as patent rights and copyrights, should be added to the category of property rights that can be placed in trust under the Law should be reviewed and concluded.

(2) Review of trust business regulations (allowing general business corporations < non-financial institutions > to establish trust companies) [To be reviewed in FY2003]

Under the Trust Business Law, a general business corporation (non-financial

institutions), if it obtains a license, can establish a trust company and engage in trust business. However, licensing standards, soundness standards of trust companies, and disclosure provisions, etc. have yet to be arranged by the Law. For this reason, only financial institutions (trust banks) are concurrently engaged in the trust business under the Law that prescribes financial institution's concurrent engagement in trust business, and currently, no trust company has been established based on the Trust Business Law.

On the other hand, there is a strong need to establish trust companies under the existing circumstances.

Therefore, a review should be undertaken on lifting bans on trust companies by establishing entry standards and a code of conduct. On the other hand, while trust banks are allowed to open trust agencies at financial institutions and Shoko Chukin Bank, a study should be undertaken on permitting trust companies to also do this.

(3) Improvement of the marketability of straight bonds in connection with the lifting of the issuance ban by ordinary banks [To be reviewed in FY2003]

Although the ban on issuing straight bonds by ordinary banks was lifted in 1999, there are differences in marketability between these straight bonds and bank debentures issued by long-term credit banks. For example, unlike bank debentures issued by long-term credit banks, etc., straight bonds issued by ordinary banks are not allowed so-called the "best-effort issues". Promoting the marketability of straight bonds is expected to lead to the diversification of investment of personal financial assets.

Therefore, a review should be undertaken on improving the marketability of straight bonds issued by ordinary banks, while taking into account the standpoint of putting the issue systems for bank bonds and bank debentures on an equal footing.

(4) Lifting of bans on prepaid business on the Internet by bank subsidiaries and clarification of the handling of electronic money [Study to be undertaken and concluded in FY2003]

The business of issuing and selling prepaid cards specified in the Law Concerning Prepaid Cards (Law 92, 1989) is within the business scope of bank subsidiaries. With the progress of information technology, prepaid card business on the Internet has emerged, where cards or electronic means are not used to record information about amounts of money. Under the existing laws, bank subsidiaries are not allowed to engage in the business of settling merchandise transactions on the Internet. However, this business is similar to the bank transfer or credit card business

and therefore should be approved as a finance-related business.

Although off-line debit and electronic money businesses are not enumerated as operations ancillary to banking, they are similar to the banking activity of accepting deposits.

Therefore, a study should be undertaken and concluded on approving prepaid business on the Internet by bank subsidiaries as a finance-related business. Also, a study should be undertaken and concluded on including off-line debit and electronic money businesses in ancillary operations under the Banking Law.

(5) Regulatory reform to make reorganization and functional division of insurance companies

① Expansion of businesses that can concurrently be engaged with "proxy of business operations or procuration of back-office operations related to the Insurance Businss Law" conducted by subsidiaries of insurance companies [To be studied and concluded in FY2003]

Under Clause 2, Article 56 of the Enforcement Regulations of the Insurance Business Law (Ministry of Finance ordinance No.5 1996), finance-related operations such as the "proxy of business operations or procuration of back-office operations related to the Insurance Businss Law" are enumerated. However, from the standpoint of the law's purpose of restricting the business operations of insurance companies and controlling risks as a group, subsidiaries of insurance companies engaged in the "proxy of business operations or procuration of back-office operations related to the Insurance Businss Law" are not allowed to concurrently engage in businesses other than "soliciting insurance contracts (Item 2, Clause 1, Article 56 of the Enforcement Regulations of the Insurance Business Law)," "investigation of events insured against (Item 3, ib.)," "training of insurance sales staff (Item 4, ib.)," and "operations ancillary to insurance companies as stipulated in Clause 1, Article 98 of the Insurance Business Law (Item 5, ib.). Therefore, insurance companies divide their subsidiaries into small units, making operation inefficient.

After individually investigating the relevancy and affinity to the core business and risks and obtacles to the execution of the core business, a study should be undertaken and conclusion be made on expanding the scope of businesses concurrently conducted along with the "proxy of business operations or procuration of back-office operations related to the Insurance Businss Law" by subsidiaries of insurance companies, so that such subsidiaries can engage in such businesses as "investigation,

analysis, and advice to prevent or lessen risks or damage (Item 8, ib.)," "investigation, analysis, and advice concerning health, welfare, and medical care (Item 9, ib.)," "reporting to an agency on events insured against, consulting on insurance contracts (Item 11, ib.)," and "referral/introduction of auto repair shops (Item 12, ib.)."

②Expanding income sources of subordinate businesses subsidiaries under income dependency regulation [To be reviewed in FY2003]

It is stipulated that more than 50% of the total income of a subordinate business subsidiary of an insurance company should be from parents and subsidiaries.

However, in light of increasing moves toward consolidated accounting in corporate group management, limiting income sources in such a way is not desirable from the standpoint of enhancing management efficiency.

Insurance companies have two types of sales channels, that is official sales staffs of insurance companies and insurance agents that are not officials of insurance companies. While the former is counted as an income source for the subdiairies, the latter is not.

On the other hand, with regard to companies engaged in subordinate businesses such as welfare, goods purchase, printing, and bookbinding, the Insurance Business Law (Law 105, 1995) stipulates that only those that are virtually an integral part of the parent company can be approved as subsidiaries from the standpoint of the law's purpose of prohibiting insurance companies from dealing with other operations and controlling risks as a group.

Therefore, a review should be undertaken on expanding the scope of the income sources of subordnate businesses subsidiaries to incorporated subsidiaries and affiliated corporations and on including insurance agents in such income sources, while paying attention to integrity with parent companies.

③ Review of transfer unit for transferring insurance contracts [Study to be commenced in FY2002 and conclusion to be reached in FY2003]

Article 135 of the Insurance Business Law stipulates that when an insurance company transfers insurance contracts to another insurance company under contract, all of the insurance contracts with the same calculation base for responsibility reserves must be transferred comprehensively, that is, contracts having the same guaranteed interest rate, expected mortality rate, etc. in the case of life insurance and contracts having the same expected loss ratio, etc. in the case of non-life insurance.

It is pointed out that this stipulation may create, as a result, an obstacle to

settling failed insurance companies, when almost all insurance companies operate on a national scale and offer a full lineup of products and services. For example, the stipulation makes it impossible for insurance companies to spin off their operations into specialized companies serving specific customer segments, such as corporations and households, and to reorganize insurance companies on a regional basis. In the case of an insurance company's failure, the stipulation is unable to deal with requests from sponsors (companies wishing to rescue the failed company) for a partial transfer of insurance contracts held by the failed company, consequently delaying the disposal of the failure.

When allowing a partial transfer with regard to insurance contracts having the same calculation base for responsibility reserves, it is necessary to divide the responsibility reserves equitably in order to ensure impartial treatment of policyholders (policyholders whose contracts are to be transferred and those whose contracts are not to be transferred), protection of policyholders, and the sound management of insurance company operations. Meanwhile, with regard to the division of responsibility reserves, some argue that impartial treatment and protection of policyholders as well as the sound management of operations of the insurance company can be secured by referring to the required procedures at present for resolutions, objections, etc. at a general meeting of shareholders or policyholders.

Therefore, with regard to the requirement in the case of insurance contract transfer, which stipulates that all contracts with the same calculation base for responsibility reserves should be transferred comprehensively, a study should be undertaken and conclusion be made on making a partial transfer possible, while paying attention to the equitable division of responsibility reserves.

④ Reviewing the method for consignment to insurance sales staff, etc. [To be reviewed and concluded in FY2003]

Under the current insurance solicitation system, insurance sales staff and insurance agents are directly consigned by an insurance company and act as representatives or intermediaries to conclude insurance contracts for the insurance company they belong to. Therefore, when an insurance company wants to enhance the efficiency of its operations by outsourcing dealership operations, such as sales promotions and agent management now being undertaken by individual outlets of the insurance company, to a large insurance agent (sole agent), the insurance agents under the management of the sole agent that is entrusted with dealership operations cannot conclude a sub-agent consignment contract for insurance solicitation via the sole agent.

On this point, some argue that the efficiency of outsourcing dealership operations will be enhanced by allowing conclusion of sub-agent consignment contracts for insurance solicitation via the sole agent as it clarifies the appointment and managerial responsibility for agents under the umbrella of sole agents and separates the functions of insurance companies.

On the other hand, in order to make it possible to outsource the operations of concluding consignment contracts with agents for insurance solicitation, which has so far been concluded directly with the insurance company, and the management of agents, it is necessary to ensure appropriate implementation of operations concerning insurance solicitation and protection of policyholders.

Therefore, the method for consignment to insurance sales staff, etc. should be reviewed after clarifying the responsibility of affiliated insurance companies concerning insurance solicitation, the scope of businesses allowed to sole agents, measures for the appropriate implementation of operations concerning insurance solicitation, and protection of policyholders.

(6) Review of policyholder protection system concerning non-life insurance [To be studied in FY2003]

The policyholder protection system stipulated in the current Insurance Business Law is designed, in the case of an insurance company bankruptcy, to protect policyholders by ensuring the continuity of insurance contracts by compensating a certain percentage of responsibility reserves (reserves for payment of insurance money, etc.). The same system is adopted for life insurance and non-life insurance.

However, it is pointed out that, in the case of automobile and some other non-life insurances, since the insurance term is usually one year and the problem of insurance repurchase due to age or the medical history of insured persons is less likely to occur compared with life insurance, it is better to place emphasis on ensuring insurance benefits, for example, by guaranteeing a 100% payment of insurance benefits for a certain period after the failure of the insurance company, than to place emphasis on the continuation of the insurance contract.

On the other hand, it is also pointed out that since non-life insurance companies also deal in long-term insurance, such as medical care and nursing care insurances that are difficult to repurchase, as well as savings insurance, it is necessary to maintain the current policyholder protection system by taking into consideration the characteristics of those insurances and the protection of policyholders.

When reviewing the system, it is also necessary not to diminish overall

policyholder protection and to give due consideration to financial assistance sponsors.

Therefore, a study should be undertaken on reviewing the policyholder protection system concerning non-life insurance, while taking into account the characteristics of non-life insurance and the aim of safety net; protecting policyholders.

2 Improving systems to promote asset liquidation

(1) Flexibility and simplification of the documentation of asset liquidation plans and the attached documents on the business commencement report [To be reviewed in FY2003]

The Law Concerning Liquidation of Assets (Law 105, 1998) stipulates that plans for asset liquidation shall be documented in detail and the necessary documents shall be attached to a business commencement report.

With regard to the contents of documents on asset liquidation plans, there are detailed provisions. As for "contents of qualified corporate bonds," it is required to state the interest rate on qualified corporate bonds to be issued in the future and this matter cannot be left undecided. For this reason, corporations are forced to take the cumbersome steps of first stating a provisional figure at the time of reporting and then go through the procedure of altering the figure later.

As for attached documents for a business commencement report, in the case of acquiring qualified assets as a result of development, the contract or subscription contract on the development in question must be attached and it is treated as the contract document for practical purposes. Since the reporting of business commencement may be made before the transfer of land, it is practically impossible to specify the counter-party and the coverage of the contract to be concluded in the future. However, if acquiring qualified assets is ensured, such a contract, regardless of its type, can be used as a attached document for the of business commencement report.

When a special purpose company (SPC) engages in businesses related to liquidation of assets, many documents have to be submitted, including a business commencement report, articles of incorporation, an asset liquidation plan, and a take-over contract of qualified asset. Since strict rules are applied to changes after the submission, instances where lawyers have inquired the documentation of local finance bureaus before the submission have been increasing.

Under such circumstances, in order to promote asset liquidation, it is important to simplify procedures, while paying due consideration to investor protection.

Therefore, with regard to plans for asset liquidation and attached documents

on business commencement, a review should be undertaken on promoting their flexibility and simplification from the above standpoint. In addition, necessary specific measures should be reviewed so that reporting procedures can be implemented promptly and smoothly.

(2) Expanding lenders to special purpose companies [To be studied in FY2003]

The Law Concerning Liquidation of Assets limits possible lenders to a special purpose company to banks and qualified institutional investors who have been designated as having specialized knowledge and experience concerning securities investment. With respect to this, the "Status of Responses of Ministries and Agencies to Opinions/Requests at Home and Abroad Concerning Regulatory Reform" (June 2002) says that "(since borrowing by a special purpose company) is different from specific corporate bonds and is not covered by investor protection measures provided under the Securities and Transaction Law, the restriction on borrowing is necessary." However, it will not cause any harmful effects to include financing operators having a certain level of decision-making capability in the list of qualified institutional investors or accord such financing operators the same treatment as that accorded a qualified institutional investor.

Therefore, a study should be undertaken on expanding the range of lenders to special purpose companies.

(3) Easing the document-issuing obligation at the time of credit transfer from financing operators [To be reviewed in FY2003]

Clause 2, Article 24 of the Consumer Financing Control Law (Law 32, 1983) stipulates that, at the time of credit transfer, the transferee shall issue a document specifying the contents of the contract to the obligor, by applying Article 17 of the Law *mutatis mutandis*. This document-issuing obligation is designed to prevent trouble over the contents of contracts and protect obligors by specifying the contents of contracts every time a credit is transferred and has been in place since the enactment of the Law.

Meanwhile, the "Three-Year Program for Promoting Regulatory Reform (Revised)" states that a fact-finding investigation will be conducted in FY2002 with regard to restrictions on financing operators. Of three investigation items, we request examination of this case in particular because it is a necessary measure for promoting liquidation of receivables.

Therefore, a review should be undertaken on the possibility of easing the document-issuing obligation at the time of credit-transfer from financing operators,

based on the results of the fact-finding investigation.

(4) Review of auction system for self-foreclosure companies [To be reviewed in FY2003]

Auction objects of self-foreclosure companies are limited to collateral related to loans extended by the parent bank, that is to say, objects whose auction is expected to provide dividends to the parent bank. It had also been stipulated that a self-foreclosure company had to be a wholly owned company of the parent bank but that provision was deleted as a result of revisions to the Guideline on Article 11 of the Antimonopoly Law and the Guideline on Bank-related Affairs.

However, in order to promote disposal of non-performing loans, it would be better to study measures to increase options for the auction of self-foreclosure companies, after clarifying the purpose of the regulation.

Therefore, after taking into account the provision prohibiting banks from enaging in other businesses and the regulation's purpose of limiting the acquisition of real estate collateral by a self-foreclosure company to only those cases when such an acquisition is really necessary for the parent bank to collect receivables and when no other bidders are found, while paying attention to the real estate market and the viewpoints of ensuring the financial soundness of banks, etc., a review should be undertaken on expanding the scope of auction objects to not only those that are expected to produce dividends to the parent bank but also to those that are expected to produce dividends to subsidiaries and affiliated companies. As for investment conditions, in light of revisions to the Guideline on Article 11 of the Antimonopoly Law and the Guideline on Bank-related Affairs, the competent authorities should review to clarify their understanding with regard to allowing investment in self-foreclosure companies by the parent company (holding company) of the parent bank in question and group companies.

(5) Improvement of bankruptcy law [To be reviewed and concluded in FY2003]

With regard to the provision limiting the validity of the disposal of rent receivables and the nonadmission system on the sale of assets such as real estate at a fair price, a study should be undertaken on the basis of the "Interim Report on the Review of the Bankruptcy Law, etc." and concluded.

(6) Introduction of escrow system [To be studied in FY2003]

Amid the expansion of markets of financial asset and real estate, market

participants are diversifying. In order to further promote asset liquidation by increasing the number of market participants, some argue that Japan should introduce an escrow system by referring to similar systems in other countries. On the other hand, there are opinions that the existing laws do not prohibit the adoption of the escrow system under contract between the parties concerned and that the need for such a system does not exist with regard to real estate.

Therefore, a fact-finding investigation should be conducted on the needs for the escrow system in Japan and the necessary measures should be studied.

3 Arranging the Bases for Securities Markets

(1) Increasing qualified corporations to use the issue registration system [To be reviewed and concluded in FY2002]

Under the issue registration system, if an issuer submits beforehand issue registration papers describing the kind of securities to be issued, the planned issue period and amount, etc., the issuer is allowed to sell securities to investors by simply submitting an issue registration supplementary paper describing only the issue terms at the start of subscription or offering.

In order to be eligible to use this system, a company has to meet both the continuous disclosure requirement (financial statements are submitted continuously for one year) and the publicity requirement (company information has already been widely provided to the public): these requirements are applied correspondingly to the reference system of financial statement. The specific requirement for the publicity requirement is that the company has to be either a listed company or an OTC company and that its three-year average market capitalization is 25 billion yen or more.

Although the investor protection purpose of the disclosure system has to be fully taken into account, it is necessary, from the viewpoint of policy implementation, in light of the current economic situation and the corporate reorganization, to expand the range of companies eliglible to use the system designed to facilitate flexible and swift fund raising by corporations.

Therefore, the number of companies eligible to use the system should be increased, while comprehensively considering the purpose of the disclosure system to protect investors.

A study should be undertaken on allowing the following groups to use the system and concluded:

① non-listed or unregistered foreign companies in the same manner as non-listed

or unregistered domestic companies, and

② new holding companies that came into being after acquiring companies that had been eligible to use the system.

(2) Review of the issue registration system for corporate bonds

① Shortening the validity suspension period of issue registration in the issue registration system for corporate bonds [To be reviewed and concluded in FY2002]

The issue registration system is premised that investors refer to continuously diclosed information. Therefore, when a corporation which has registered for issuance (issue registrant) submits new reference information, a validity suspension period is created. Investors, in their turn, make investment decision during the period. When, for example, new financial statements are submitted, a four-day validity suspension period will be created to give investors time to contemplate their investment decision.

Meanwhile, if EDINET (Electronic Disclosure for Investors' NETwork; an electronic disclosure system concerning dislosed information such as financial statements based on the Securities and Transaction Law) is available, investors can get information over the Internet one day after the information was submitted.

Therefore, by taking into account the development of such information technology, a study should be undertaken and measures should be taken to shorten the validity suspension period.

② Easing submission criteria for corrected issue registration papers [To be reviewed and concluded in FY2003]

The submission of corrected issue registration papers becomes necessary when, for example, an issue registrant submits new reference materials or reduces the planned issue amount. In such cases, the validity of the issue registration will be suspended in order to allow investors a contemplation period. However, when the correction involves a matter that is not likely to gravely affect investors' investment decisions, such as "the change in name of a correspondent bank," it is possible to ease the submission criteria.

Therefore, the submision criteria for corrected issue registration papers should be eased with regard to matters that are not likely to gravely affect investors' investment decisions.

(3) Expansion of the scope of qualified institutional investors [To be reviewed and concluded in FY2002]

Qualified institutional investors are currently limited to financial institutions such as banks, and some business corporations. When soliciting investment from qualified institutional investors, the submission of financial statements is not required (so-called "professional private placement"). But the scope of qualified institutional investors is enumerated and venture capitals, venture funds, and experienced wealthy individuals are not included.

However, broadening investor base in the private placement market will lead to the improvement of the fund-raising environment for companies in their early-stage.

Therefore, a review should be undertaken and concluded on expanding the scope of qualified institutional investors to venture capitals, venture funds, and experienced wealthy individuals.

(4) Lowering the minimum capital of securities companies, investment adovisory companies, and investment trust management companies [To be implemented inFY2003]

The minimum capital of securities companies, investment trust management companies, and certified investment advisory companies is currently set at more than 100 million yen, an amount seen as necessary and appropriate to protect public interests and investors. However, if the minimum capital is reduced, it is expected to further promote competition and lead to the divesification of products and services in response to investors' needs.

Therefore, the minimum capital of securities companies, investment trust management companies, and certified investment advisory companies should be reduced by also taking into account the fact that an investor protection framework has been established, such as the separate management of customer assets, establishment of an investor protection fund, and the prohibition of deposit and acceptance of customers' money by investment trust management companies.

(5) Introduction of a securities intermediary system [Bill to be submitted in the 156th session of the Diet (the ordinary session)]

At present, securities companies are not allowed to conduct business activities using agents. However, if the sales channel function of securities companies is expanded, it is expected to promote the participation of diversified market investors.

Therefore, the "Securities Intermediary System", which works as an intermediary between securities companies and customers, should be introduced after ensuring compliance with laws and paying full attention to investor protection, such as

the introduction of a registration system and clarification of responsibility for damages compensation.

(6) Response to the global development of exchanges [Bill to be submitted in the 156th session of the Diet (the ordinary session)]

With financial transactions becoming increasingly globalized due to the development of information and telecommunication technologies, cooperation and tie-ups among exchanges are increasing on an international scale. Under these circumstances, Japan has to urgently tackle the task of enhancing the trading volume of its exchange markets and strengthening competitiveness.

Therefore, the current rules obligating overseas securities dealers to establish a branch office in Japan should be reviewed while paying attention to the prevention of unfair trading, and a system should be established to enable overseas securities dealers to pass orders directly to Japanese exchange markets.

While paying attention to ensuring the fairness, neutrality and reliability of exchanges, the current provision pohibiting stock ownership of more than 5% across the board should be reviewed in order to make tie-ups possible among securities exchanges via holding companies or in other forms, and between securities exchanges and securities futures/financial futures exchanges.