1. REGULATORY FRAMEWORK

1.1. Principal Regulators and Regulatory Philosophy

1.1.1. Principal Regulators

The principal regulator of the Japanese securities markets is the Japanese Ministry of Finance ("MOF"). With regard to listed securities, the Japanese stock exchanges play an important regulatory role. The Japan Securities Dealer Association ("JSDA"), a self-regulatory securities industry trade association, has a significant function in shaping securities market practices, overseeing the Japanese over-the-
counter markets and communicating MOF's policies to the industry. The Japanese Ministry of International Trade and Industry and the Ministry of Agriculture have responsibility for certain non-financial commodities-linked products. As overseer and interpreter of the Japanese Commercial Code, the Japanese Ministry of Justice has influence over certain securities-related issues. With specific regard to private placements, important influences on the market are policies and practices established, in informal consultation with MOF, by the Japanese banks that act as trustee/placement agents in the Japanese private placement market.

1.1.2. Regulatory Philosophy

The Japanese system of securities regulation places a comparatively strong emphasis on retail investor protection, with the result that a variety of qualitative restrictions and limitations on the classes of eligible investors and on the types of instruments that may be offered, as well as disclosure requirements, are used to regulate offerings. The "discipline of the marketplace" is supplemented by the grant of considerable discretionary authority to regulators who tend to favor a cautious, incrementalist approach to change and a substantive evaluation of the strength and safety of issuers and their securities.

Because Japan has a Glass-Steagall-like separation of the banking and securities industries, the struggle for competitive advantage and the resulting friction between the banking and securities industries concerning the limits of their respective spheres of activity also play an extremely important part in molding market philosophy, rules and practices. The competition between the banking and securities industries has significantly affected private placement rules and policies.

1.2. Principal Statutes

1.2.1. The SEL

For purposes of analyzing the legal issues relevant to private placements in Japan, the Japanese Securities Exchange Law (the "SEL") and the ordinances, regulations, rules, guidelines and policy statements thereunder or relating thereto are of central significance. In broad terms, the
Japanese securities laws are substantially modeled on the U.S. securities laws. With regard to private placements, however, the Japanese system of regulation bears only a distant resemblance to the current U.S. system. This difference in approach has been caused, in part, by MOF's desire to keep private placements of debt from undermining the development of Japan's heretofore small and underused public primary market for corporate debt securities.

1.2.2. The FECL

For non-Japanese issuers and for placements having some other international aspect, the Foreign Exchange and Foreign Trade Control Law (the "FECL")—which, like foreign exchange control laws in some European countries, serves policy objectives well beyond those of simple foreign exchange control—can be important.3

1.2.3. The Commercial Code

The Japanese Commercial Code is significant in that it determines what instruments Japanese issuers are permitted to issue, and taken in conjunction with the definition of a "security" in the SEL, often indirectly affects what foreign instruments may be introduced into Japan.4

1.2.4. Other Statutes

There are other statutes that may have a bearing on private placements (such as the law concerning the recordation of bonds and the tax laws), but it is unnecessary to go into them for purposes of this Article. Offerings of interests in open-end investment funds are governed by a special regulatory regime. Market practices and perceptions of MOF policies can be relevant in the legal analysis of instruments that do not fit within established regulatory niches.

3 See infra sections 3.1.3., 3.1.4. and 4.2.
4 See infra section 5.2.
2. PUBLIC OFFERINGS

2.1. Registration Requirement for Public Offerings

The SEL, which as suggested above was modeled to a substantial degree on U.S. securities statutes, provides that:

No one shall make public offerings of new or outstanding securities without the issuer of such securities filing with the Minister of Finance a registration statement of such public offering of new or outstanding securities [subject to certain disclosure exceptions, "qualified institutional investors" exceptions, and de minimis exceptions].

The required registration statement is a lengthy document which, in terms of its contents, resembles a U.S. securities registration statement, although some of the disclosure items differ.

2.2. "Public Offerings" Defined

As amended in the summer of 1992, the SEL defines a "public offering of new securities" to be "the solicitation to purchase newly issued securities (including conduct determined as equivalent by MOF ordinance), of many and unspecific persons (but not including the solicitation of "qualified institutional investors" as determined by ordinance) [subject to exceptions where by ordinance it is determined that the securities are unlikely to be transferred to entities other than "qualified institutional investors" or the securities are unlikely to be transferred to many entities]." A "public offering of outstanding securities" is defined as "the offer to many and unspecific persons [as determined by ordinance] to sell, or the solicitation to many and unspecific persons [as determined by ordinance] for subscription to buy, any already issued securities." Unlike in the United States, therefore, secondary offerings by non-affiliates that come within this definition require registration under the SEL.

Securities and Exchange Law of Japan ("SEL"), art. 4(1).
* Id. art. 2(3).
7 Id. art. 2(4).
2.3. "Many and Unspecified Persons"

A 1971 internal MOF circular suggested that an offering to "many and unspecified persons" shall be considered to have occurred when the relevant solicitation or offer is made to "approximately fifty or more" persons. A 1989 JSDA release concerning the offering within Japan of securities originally issued in foreign markets stated that the JSDA had received a MOF directive instructing that public offering disclosure requirements will not apply:

(a) [in] the case where the same security is sold on the same day and the number of persons solicited is less than fifty and (b) [in] the case where the same security is sold over a period of several days, the number of persons solicited on any single day is less than fifty, the securities are sold at prices which [are] based on market conditions that from day to day are not uniform, and the settlement dates for sales on different dates are not the same.

These guidelines are now often expressed by market participants in terms of there being a private placement exemption from the SEL registration requirements for offerings of securities made to no more than forty-nine offerees on like terms and conditions in a single day. Because the market for privately placed securities tends to consist of a limited number of institutional investors, there seem to be few problems with coming well within the scope of the "rule." It should be noted, however, that an offering exclusively to "qualified institutional investors" is excluded from the "public offering" definition set forth above independently of whether the "many and unspecified persons" test is satisfied.

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8 See Internal Circular concerning Disclosure of Corporate Information (Sept. 6, 1971 Kura Sho 2272).
9 Gaikoku Shijo Hakho Shoken no Waga Kuni ni Okeru Boshutou no Toriatsukai ni Tsuite (Concerning Procedures for the Placement within Japan of Securities Offered in Foreign Markets), JSDA Circular, Vol. 1989, No. 14, issued June 30, 1989. MOF is expected to formalize the fifty-offeree rule in a ministerial ordinance that is scheduled to be issued in April 1993.
2.4. Attraction of Offshore Offerings for Japanese Issuers

High transaction costs and various regulatory hindrances have for some time stunted the domestic Japanese market for public offerings of Japanese issuers, particularly corporate debt securities. For example, with corporate debt securities, the so-called commission bank system, which requires that a Japanese bank be appointed to perform certain functions in connection with an offering and be paid a commission, is a cost deterrent to offerings in the Japanese market; this system does not obtain in the Euromarket. Over the past decade, Japanese issuers have often tended to turn to the Euromarkets for debt and equity-linked financings, where transaction costs are smaller and securities can be quickly brought to market with a relatively modest amount of paperwork, and where Japanese investors have been active purchasers. This flight by issuers to London has threatened to result in a “hollowing out” of the Japanese primary securities market (particularly with respect to debt and debt/equity warrant offerings), which has been of concern to proponents of a strong Japanese domestic capital market.

2.5. Japanese Public Offerings of Foreign Securities

2.5.1. Listed Public Equity Offerings

Generally, only large, well-established foreign corporations will qualify to list their shares on the Tokyo Stock Exchange (the “TSE”). As a threshold matter, a foreign company must meet the minimum eligibility requirements for listing, which include: (i) total shareholders’ equity of ¥10 billion (approximately $75 million); (ii) earnings before income tax of at least ¥2 billion (approximately $15 million) for each of the fiscal years ending within three calendar years immediately preceding the listing application; and (iii) “good prospects” that the company will have at least 1,000 shareholders resident in Japan. An eligible company will spend substantial amounts of time and money preparing for a listing, as well as thereafter

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10 At present, foreign shares cannot be listed on other Japanese stock exchanges.
preparing Japanese language annual reports and periodic reporting materials. Because the retail market for foreign securities in Japan is still relatively small, and since the limited liquidity for foreign securities and fixed trading commissions in Japan tend to lead to flowback (the return of securities to their home market), some critics have questioned whether a listing in Japan is worth the trouble for foreign companies. Still, many foreign companies (more than 100) have chosen to list their shares on the TSE. To the present time, this listing has always been accomplished without a concurrent public offering.

2.5.2. Public Debt Offerings

Foreign sovereign and high-grade corporate issuers have long been able to issue straight bonds in Japan, and foreign companies that are listed on the Tokyo Stock Exchange have also been permitted to issue convertible bonds since May 1989. Relatively few non-sovereign foreign issuers have chosen to enter the debt market. Although Japan-licensed securities firms have the exclusive right under the SEL to underwrite the public issuance of corporate debt, issuers are required to retain a bank to act as a commission agent, which requires the payment of commission agent fees. Moreover, public offering disclosure requirements apply. In addition, unless quality and rating standards are satisfied, publicly issued bonds must be collateralized, adding additional expense and restrictions. MOF has taken steps to attract foreign issuers, such as lowering ratings standards, approving the issuance of bonds with maturities of less than four years and introducing a variant of a shelf registration system. For private issuers, however, these measures generally have not overcome the cost and other disadvantages of launching a public debt issue in Japan.

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13 These fees can be in the area of approximately 0.135% of principal at issuance and 0.05% annually thereafter. Fee rates vary considerably based on a variety of circumstances. Bankers with whom the authors spoke would not disclose the full rate schedule, perhaps because it may be too complex to follow without lengthy study.
14 See SEL, art. 4(1).
2.5.3. Unlisted Registered Public Equity Offerings

Since June 1989, when new rules eliminated the listing requirement for publicly offered foreign stock, foreign issuers of common stock have had a relatively efficient means of achieving a wide distribution in Japan, particularly in connection with a global offering. To qualify for an unlisted public offering, the company's stock must be listed on a "designated exchange" (a group that includes most of the prominent international exchanges) and the company's earnings per share must be 20% of the share's nominal value prior to the offering. Different standards apply to newly privatized companies. Issuers that engage in unlisted registered offerings must file a Japanese-language securities registration statement with MOF. The registration statement must be declared effective pursuant to the SEL before the offering. Thereafter, issuers become subject to the SEL's continuous reporting requirements. Certain FECL-related requirements must also be satisfied in connection with a primary offering of shares in Japan.15

3. PRIVATE PLACEMENTS UPON INITIAL ISSUANCE

The rules governing the private placement of securities in Japan upon initial issuance (as opposed to private placements of outstanding securities) tend to be restrictive and rather complex. In examining the Japanese regulatory regime for private placements, this discussion focuses on its application to non-Japanese issuers, because this is the area in which the readers of this survey are likely to have a practical interest. This section, however, also addresses the restrictions on Japanese issuers of debt, because this market has become rather active over the past three years.

15 A number of non-Japanese issuers have taken advantage of the unlisted public offering option, including PolyGram N.V., Coastal Corp., U.K. Water, U.S. West and Telmex, but to this time, to the authors' knowledge, unlisted public offerings have only been used in connection with international offerings for which offering documents were otherwise being prepared.
3.1. The Direct Private Placement of Newly Issued Equity Securities by an Issuer Not Resident in Japan

3.1.1. General

With respect to private placements of equity by foreign issuers with Japanese investors, only the most credit-worthy companies receive the required MOF approval, which, if forthcoming, takes approximately one month to obtain. The criteria that MOF uses in evaluating whether an issuer is fit to offer securities in Japan are not publicly available, although it appears that having a listing on a stock exchange in an OECD country and a record of paying dividends for at least the past three years is helpful, as is having some form of business operations in Japan. Privately-placed securities are generally subject to a two-year bar on resales and may only be purchased by institutional investors.

3.1.2. SEL Requirements

Once a foreign issuer has received approval for a proposed private placement, the issuer is required to file a Securities Notification with MOF or, if the issuer is already subject to continuing reporting requirements under the SEL, a Current Report is required. These SEL filings must be submitted only in the case of a placement of newly-issued shares, and only where the aggregate issue price is ¥500 million or more. The filing of a Securities Notification does not trigger the application of the SEL's continuous disclosure requirements. In the course of a private placement, it is a common practice in Japan for a foreign issuer to prepare and distribute a placement memorandum in the same manner as would an issuer in the United States or the Euromarket.

3.1.3. FECL Requirements

Under the FECL, when an issuer not having its main office in Japan contemplates the issuance or offering of equity shares in Japan, it must within two months and no later than twenty days before the issuance or offering of shares file a notification

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16 SEL, art. 24-5(2).
17 Id. art. 4(1).
with MOF through the Bank of Japan describing the nature of the shares, the proposed issue date, and certain other matters relating to the transaction. A prospective issuer that has filed the required notification may not carry out the issuance or offering plan, unless otherwise permitted by MOF, for a period of twenty days after the receipt of the notification by MOF. Within the twenty-day waiting period, MOF may recommend revision or suspension of the plan if MOF perceives that it would have an unfavorable effect on Japan. After the closing, the issuer is required to file a brief report concerning the closing with MOF.

3.1.4. Informal Pre-Clearance

To the authors' knowledge, MOF has not made any formal recommendations or orders with respect to private placements or equity by non-Japanese residents because in practice there exists an informal system of consultation and pre-clearance by MOF. This customarily takes place at least one week before the filing of the requisite formal notification under the FECL. Based on this review, MOF may informally suggest modifications to or the suspension of the offering plan, or may advise the issuer to proceed with the filing of the requisite notification under the FECL. As a result of this process, the offering is, in effect, “pre-cleared” and the actual filing under the FECL is a mere formality. The statutory waiting period under the FECL, therefore, is often shortened by MOF to as little as one week. It is important to note that if securities come into Japan through a secondary market transaction, a FECL filing by the purchasers may be required in lieu of a filing by the issuer. With regard to voting securities, there are certain other FECL limitations intended to prohibit or restrict Japanese equity investment overseas in certain sensitive industries (e.g., armaments or narcotics) and there are antimonopoly limitations on the ability of banks and insurance companies to acquire holdings of an issuer’s voting securities

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18 FECL, arts. 22, 23.
19 Id. art. 23(1).
20 Id. art. 23(2).
21 See infra section 4.
22 FECL, art. 22.
in excess of certain percentage limitations.\textsuperscript{23}

3.2. Procedures for a Direct Private Placement of Newly Issued Straight Debt Securities by an Issuer Not Resident in Japan

3.2.1. Non-Sovereign Issuers

Japanese counsel and participants in the private placement market have advised that MOF's policy, at least until August 1992, had been to "discourage" non-Japanese private issuers from making direct private placements within Japan of debt securities upon initial issuance. In practical terms, except in unusual circumstances, direct private placements of debt appear to have been limited to sovereigns, sovereign-related entities, and international organizations.\textsuperscript{24} Starting on August 1, 1992, qualifications for both non-sovereign issuers and sovereign issuers to make direct private placements were, at least formally, relaxed. It has yet to be seen whether this formal change indicates a shift in MOF's attitudes toward private placements of debt by foreign non-sovereign issuers, or whether MOF intends to continue "discouraging" such issues in spite of the formal changes.

3.2.2. Sovereigns, Sovereign-Related Entities and International Organizations

The private placement of non-yen-denominated foreign bonds was formerly restricted to the World Bank, but there appears to have been a relaxation of this restriction in recent times, at least with respect to convertible bonds.

For both yen-denominated foreign bonds and foreign currency-denominated bonds, limits are set on the size of an issue based on the credit rating of the issuer.\textsuperscript{25} The prices and coupons of the bonds are determined in accordance with a schedule calculated with reference to a so-called "base rate." The "base rate" is the lower of the long-term prime lending rate and the yield to maturity (by simple computation) of the most recent issue of ten-year Japanese Government Bonds

\textsuperscript{23} See, e.g., FECL, art. 22; Antimonopoly Law, art. 11(1).

\textsuperscript{24} But see discussion of secondary market transactions \textit{infra} section 4.

\textsuperscript{25} MOF Press Release (July 16, 1992).
plus a certain number of basis points. In general, as an issuer's credit rating increases, the number of basis points, if any, that are tacked on to the base rate decreases. Unrated institutions may qualify if they have issued or guaranteed a bond, or have borrowed under or guaranteed a syndicated loan, in a major financial market within the past five years, or if they are the public agencies of a country that has "any rating."\textsuperscript{26}

Japanese financial institutions that are qualified to arrange private placements (such as banks and securities companies) generally arrange for the requisite Japanese regulatory clearances and filings in conjunction with counsel. It is customary to prepare a private placement memorandum in conjunction with the placement. The SEL and the FECL filing requirements discussed above with respect to the private placement of foreign equity securities also apply to foreign debt securities.\textsuperscript{27}

The privately placed bonds are subject to a two-year prohibition on resale (which obviously creates some foreign exchange risk for the Japanese purchasers of non-yen-denominated bonds). They may be sold only to and among sophisticated institutional investors, and any resale must be to one purchaser and in one full lot. MOF has in the past indicated that the number of purchasers of yen-denominated foreign bonds should be kept to as few as possible (e.g., ten to fifteen purchasers). Japanese purchasers must submit to MOF a "Confirmation of Investment Intent"\textsuperscript{28} confirming acceptance of these restrictions. Participants in the private placement market have advised the authors that MOF is expected to issue an ordinance in late 1992 or early 1993 to relax the formal restrictions on privately placed bonds irrespective of the nature of the issuer. In particular, either the two-year prohibition on resale will be eliminated or the "sophisticated institutional investors" requirement will be relaxed. A third possibility is that the ordinance will call for two classes of private placements: one that eliminates the two-year prohibition on resale but maintains a strict definition of eligible

\textsuperscript{26} It seems likely that the ratings must be from a major ratings institution in Japan or the United States.
\textsuperscript{27} See supra sections 3.1.2. and 3.1.3.
\textsuperscript{28} See infra section 3.3.
investors and one that maintains the two-year holding period but relaxes the "sophisticated institutional investors" standard.

3.2.3. Zero Coupon Debt, Etc.

Certain tax and additional regulatory issues may be relevant to the introduction into Japan (whether upon initial issuance or in secondary market transactions) of zero coupon notes, indexed bonds, and other debt instruments that are not fixed-coupon straight debt securities.

3.3. Procedures for a Direct Private Placement of Newly Issued Straight Debt (shibosai) by a Japanese Resident Issuer

To qualify to issue bonds in a private placement, a Japanese non-governmental issuer must, as a practical matter, meet certain strict eligibility requirements that vary with the size of the issuer (basically, the higher the level of shareholders' equity, the more liberal the standards). Among the tests used in the eligibility matrix are the issuer's amount of shareholders' equity; the issuer's ratio of dividends to capital; the issuer's ratio of capital to shareholders' equity; the issuer's ratio of shareholders' equity to total assets; the issuer's ratio of operating income, interest income, and dividend income to total assets; and the issuer's interest coverage ratio. An issue's size (no more than two times net assets, and no less than 100 million yen but less than 10 billion yen), its price and coupon (determined by reference to the yield on newly issued Japanese Government Bonds), and its term and structure (amortizing versus bullet principal payments) are all prescribed. The bonds must be fully collateralized by a first mortgage on immovable assets of the issuer, unless the issuer satisfies the eligibility standards for a public offering of uncollateralized bonds. The lead bank in the placement will usually act as the recording agent (whose function is to provide formal notification to the Government of the placement) and as the paying agent. It will also act as one of the commissioned banks (possibly the only one) and possibly as a purchaser. For each type of service provided, the lead bank will collect fees that are established percentages of the issue amount, some upon initial issuance and some over time. For so-called large-lot placements (not less than 2 billion yen
but less than 10 billion yen), an arranger or arrangers (which may be a bank, a securities company or a life insurance company) must also be involved. Purchasers of privately placed bonds are limited to institutional investors. MOF informally requires that such purchasers submit to MOF a “Confirmation of Investment Intent” in which (1) the purchasers confirm that they know that the offering does not provide them with the protection of the disclosure filings required for a public offering; (2) the purchasers confirm that they are purchasing with no intent to resell, and that they will not, without MOF’s permission, resell the bonds unless (i) two years have lapsed since the time of the initial purchase, (ii) the subsequent purchaser is a single institutional investor, and (iii) all of the bonds acquired will be resold in a single lot; and (3) the purchasers agree to deliver to MOF within one week of resale a “Confirmation of Investment Intent” in like form from the subsequent purchaser. The strict two-year prohibition on resale and the limited class of eligible purchasers make it clear that the domestic Japanese private placement market is in substance an extension of the syndicated lending market. Japanese banks have not been permitted to sell loans from their loan portfolios. Therefore, putting a loan in the form of a private placement of debt securities has had the advantage of making the debt transferable to a limited degree once two years have lapsed. There are percentage limitations on how much of an issue a single arranger/purchaser may buy, and there are limitations on how much and how often debt may be issued in private placements by an issuer.

3.4. The Role of Banks in Promoting the Boom in the Japanese Domestic Private Placement Market

With (i) the Bank for International Settlements capital adequacy standards putting pressure on Japanese banks to shrink the asset side of their balance sheets, (ii) the withering of the market for equity-linked Japanese bonds, and (iii) recent

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29 Recent press reports indicate that the Ministry of Justice plans to scrap the Commercial Code limits on the maximum amount of bonds that Japanese corporations are permitted to issue. See, e.g., "Government Plans to Scrap Curbs on Corporate Issues," Japan Economic Newswire (Jan. 22, 1993).
amendments to the Japanese Commercial Code liberalizing the statutory limit on bond issues by Japanese corporate issuers, private placements of bonds within Japan by domestic Japanese issuers have occurred in increasing volume. Banks eager to establish a track record in advance of securities market deregulation and searching for fee income have encouraged their clients to replace bank loans with privately placed bonds.

Private placements have been an area of competitive advantage for the Japanese banks vis-à-vis securities companies. Prior to the summer of 1992, Japanese banks had been prohibited from underwriting debt securities in Japanese public offerings (an activity reserved to securities companies), but they had been permitted to act as "arrangers" for private placements. Typically, a bank acted as both the arranger and the commission bank for a privately placed issue. Amendments to the SEL in the summer of 1992 have loosened limitations on banks acting directly in private placements and now permit banks to establish securities dealer subsidiaries that are expected to be able to underwrite debt securities in the public markets.\textsuperscript{30} Implementing regulations with respect to these amendments will be adopted by MOF. Even before the 1992 changes to the SEL, banks tended to dominate the Japanese market for private placements because of their close ties to issuers and because of their placement power with small issues (banks often being the buyers of the privately placed debt for their own portfolios). The SEL changes can be expected to increase the banks' dominance in the area of private placements. A particular attraction of going forward with a domestic private placement for debt securities, rather than an offering in the Euromarkets, is the ability to place yen-denominated bonds directly with Japanese institutional investors at initial issuance. Under current MOF policies, yen-denominated Eurobonds must be "seasoned" offshore for ninety days before they may be sold into Japan in secondary market transactions; "dual currency" Eurobonds (generally with principal payable in yen and interest payable in some other currency) must be "seasoned" offshore for 180 days, which theoretically exposes underwriters and others who intend to

\textsuperscript{30} SEL, art. 65-3.
sell the bonds into Japan to a certain degree of risk.

4. SECONDARY MARKET TRANSACTIONS

4.1. Secondary Market Route

Because of the rigidities of the system for direct private placements upon initial issuance, many non-Japanese securities that find their way into Japan are issued and held for a certain period (a "seasoning period") outside of Japan and then transferred into Japan by means of secondary market transactions. Similarly, the securities of Japanese issuers (particularly equity warrants) issued in the Euromarkets often find their way back to Japan in secondary market trades. Some participants in the market take the view that the seasoning period for securities that are neither denominated nor settled in yen can be as short as one day (overnight). Accordingly, many issuers have found it comparatively advantageous to reach Japanese investors through the Euromarkets, even though in formal terms this selling structure limits the marketing within Japan (e.g., the distribution of offering documents, roadshows) that may take place in advance of the issuance, since the principle is that no offering or sale of the relevant securities is supposed to occur in Japan until they have been issued overseas. Issues brought into Japan by means of secondary market transactions are not exempt from the SEL registration requirements for public offerings. Therefore, care is usually taken to avoid actions that might cause the secondary market trades to be characterized as a secondary public offering. FECL complications can arise for the purchaser if the acquisition of foreign securities is not considered a portfolio investment. In general, the FECL treatment of foreign securities is complex, with different participants in the market having different views on the accepted regulatory treatments and different appetites for novelty and risk. Therefore, it is desirable to obtain expert advice before introducing unconventional instruments into Japan through secondary market transactions.
4.2. **Yen-Denominated and Dual-Currency-Denominated Securities**

As mentioned above, the seasoning period for yen-denominated or -settled securities is ninety days and the seasoning period for dual currency securities (yen and some other currency) is 180 days.\(^{31}\) In each case, an FECL license with respect to the issuance must be obtained from MOF and the term sheet for the transaction must specify that no placement in Japan is permitted during the relevant seasoning period. MOF takes the view that any offering of securities denominated or settled in yen by a non-Japanese issuer requires a license from MOF, irrespective of where the securities are issued.\(^{32}\)

4.3. **The Relevance of Listing Outside of Japan**

4.3.1. **Ordinary Investors**

Japan-licensed securities firms may generally only deal in instruments that fit into one of the categories stipulated in the SEL definition of a "security."\(^{33}\) In addition, under JSDA rules, such firms may not sell to ordinary investors foreign securities that have been issued by an issuer that does not have a class of debt or equity securities listed on an approved foreign stock exchange or trading system.\(^{34}\) In practice, since most Japanese investors have been required under the FECL to deal exclusively with Japan-licensed securities dealers, they have been limited to acquiring securities of foreign issuers with a security listed on a designated exchange. In November 1990, a change in the rules that permits Japanese residents to place unsolicited orders for securities with offshore securities dealers without prior MOF approval was announced. The practical effects of this change, which by its literal terms is rather limited, are still being gauged, but they do not seem to be very significant.

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\(^{31}\) See supra section 3.4.

\(^{32}\) See FECL, arts. 20(7), 21(1)(2).

\(^{33}\) SEL, arts. 20(8), 43. See discussion infra section 5.1.

\(^{34}\) Most major exchanges and the NASDAQ trading system are on the list of approved exchanges.
4.3.2. Designated Financial Institutions, Etc.

"Designated Financial Institutions" (sometimes called "Designated Institutional Investors" or "Qualified Institutional Investors") are a group that includes most major Japanese institutional investors, with the exception of trading companies and leasing companies. Designated Financial Institutions may acquire foreign securities from Japan-licensed securities companies in secondary market transactions unencumbered by the aforementioned rule concerning listing on a designated exchange. Some categories of such investors may also deal directly with foreign securities firms. Licensed foreign exchange banks, most Japanese life insurance companies, and most trust accounts maintained by Japanese trust banks have acquired a regulatory exemption either by virtue of their status or by their approved application that permits them to acquire foreign securities offshore for their own investment portfolios without filing prior notifications with MOF. On occasion, the licensed foreign exchange banks, at least, may acquire foreign securities upon initial issuance overseas.

5. Narrow Definition of "Securities"

5.1. The SEL Definition

The SEL defines the instruments that are considered "securities" for Japanese regulatory purposes. The definition lists a number of instruments, such as common stock and debentures. With regard to foreign securities, the SEL categorizes as "securities" for purposes of the SEL those "securities or certificates issued by foreign countries or foreign juridical persons which are of the same nature as the securities or certificates [identified in Article 2]." The SEL definition of "securities" does not include a "catch-all" basket that encompasses other instruments with the characteristics of a security. Even obvious investment-like instruments, such as limited partnership interests, are not treated as securities.

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36 These include banks and trust banks authorized by MOF to engage in a foreign exchange business and to carry out correspondent arrangements with foreign financial institutions.
37 SEL, art. 2(1).
38 Id. art. 2(8).
under the SEL. Investment instruments that are considered securities in other jurisdictions but that do not fit within the list of instruments designated in the SEL as “securities” tend to be subject to regulatory uncertainty that can be difficult to resolve because of the clash between the Japanese banks and the Japanese securities companies over the scope of their businesses. If an instrument is not a “security,” (i) Japan-licensed securities dealers may not be able to trade the product; (ii) the internal regulations of certain regulated Japanese investors may restrict the purchase of the non-security, except for certain limited purposes; (iii) the Japanese tax treatment may be difficult to predict; (iv) different exchange control rules may apply; and (v) other uncertainties may arise. There was widespread expectation that the amendments to the SEL adopted in the summer of 1992 would include significant revisions to the definition of “securities” under the Japanese securities laws. The expected revisions would have lengthened the current “positive list” by adding a number of instruments and, more importantly, would have added a “catch-all” provision under which instruments with “security-like” characteristics would have been treated as securities under the SEL. A principal objective of the catch-all provision would have been to stimulate in Japan the development of an asset-backed securities market by bringing such instruments within the definition of “securities” under the SEL. However, as a result of an apparent jurisdictional battle among MOF, the Ministry of International Trade and Industry (“MITI”) and the other ministries, MOF’s proposals were dramatically cut back. MITI is responsible for the regulation of many of the entities that generate assets likely to be securitized, such as trading companies, as well as other companies, such as non-bank financial institutions, that are potential participants in a possible asset-backed market. The Ministry of Construction also sought jurisdiction in respect to certain mortgage-backed vehicles. The amendments to the SEL that were adopted include only a modestly increased “positive list,” which adds to the definition of “securities” commercial paper, foreign certificates of deposit, foreign-
originated credit card receivable-backed securities, and foreign-government-backed mortgage pass-throughs. No broad catch-all provision was added. Securities could be added to the definition, either by MOF or by MOF in combination with other ministries, depending on the nature of the issuer, the instrument, and the targeted investors. This potential involvement by other ministries in what has been to date the province of MOF might even be viewed as a step backwards, since the bureaucratic consensus to approve most new products would have to be reached not only among the different bureaus of MOF, but also among the various other interested ministries. In addition, only instruments with elements of transferability or negotiability under Japanese law will be classifiable as securities. The failure to adopt a broad comprehensive definition of securities raises questions about the nature and pace of the development of securitization in Japan. Requiring each new product to be added to the positive list by MOF or inter-ministerial action leaves the situation much the same as it was before. The failure to change the definition of securities also leaves legal investment restrictions in place on certain Japanese institutional investors.

5.2. The Japanese Commercial Code—Restrictions on Japanese Issuers

Although MOF may on occasion bend definitional guidelines to allow an innovative foreign product into the Japanese market on a secondary market transaction basis, Japanese issuers face an additional hurdle to issuing novel products either in or outside Japan. The Japanese Commercial Code, which provides the authority for Japanese corporations to issue securities, authorizes only a narrow list of permissible instruments. For example, a Japanese issuer may issue warrants for its own new stock, because the Commercial Code permits the issuance of “subscription warrants.” The Japanese issuer has no power, however, to issue a warrant on any other company’s stock or a stock index-linked warrant,

39 SEL, art. 2(1), 2(2).
40 See discussion supra section 5.1.
42 Id. art. 341-8(1).
because these instruments are not identified as "securities" in the Commercial Code. This disability can have an effect on the range of foreign securities that may be introduced into Japan because of the way "securities" are defined in section 2(8) of the SEL. Even certain products that MOF might for SEL/FECL purposes view as a security or as an instrument that may be introduced into Japan might be off limits to issuance by Japanese corporations because of the limitations of the Commercial Code, which is administered by the Ministry of Justice.

6. REFORM

Many observers agree that the irrational and obscure tangle of rules and guidelines concerning the private offering of securities in Japan is in need of reform, but because the issue is wrapped up in the debate over the structure of the Japanese financial system, it will likely take some time before reform can be accomplished. As indicated above, MOF may be moving toward loosening the effective prohibition on private placements of debt securities by non-Japanese issuers, permitting private placements to be made to a broader class of investors, and toward replacing the two-year lock-up with less draconian resale restrictions. In the meantime, for foreign non-sovereign issuers, the unlisted public offering procedure can be of utility in planning global securities offerings of equity, and it appears that participants in the market will continue to find secondary market transactions to be a useful method of introducing securities issued outside of Japan to Japanese investors.

43 See supra section 5.1.