

The financial markets in Japan 2009 and outlook for 2010

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Speedread

This article highlights the most significant developments related to the financial markets in Japan in 2009, as well as looking forward to those to come in 2010.

The economy and financial markets in 2009

As with the economies of many other countries, the Japanese economy was heavily impacted by the global financial crisis. Compared to 2008, quarterly real gross domestic product (GDP) of Japan in 2009 was:

-8.9% for the first quarter.

-5.8% for the second quarter

-5.1% for the third quarter figures.

(The final quarter will be announced in February 2010).

The Nikkei Stock Average, which ranged between approximately 12,500 to 14,500 in 2008 before the bankruptcy of Lehman Brothers, fell sharply to the 8,500 level on news of the insolvency and stayed inside a range of 7,000 to over 9000 in the first half of 2009.

In January 2009, the Bank of Japan introduced two measures to stabilise the economy:

A special operation to facilitate corporate financing which enabled financial institutions to obtain funds with no explicit ceiling on the total funds available but with interest rates lower than corresponding market interest rates.

Outright purchases of commercial paper (CP).

The economy and financial markets of Japan are now emerging from the crisis, and commentators expect growth in 2010. The Nikkei Average in the second half of 2009 stayed continuously over 9000 and sometimes moved above 10,000. By January 2010, it moved continuously above 10,000 and reached 10,798, higher than any end of month in 2009.

The Bank of Japan:

Ended the special operation to facilitate corporate financing at the end of 2009.

Will end outright purchases of CP by the end of March 2010.

According to the official forecasts announced in December 2009, the annual real GDP in 2010 will increase by 1.4% from that of 2009 (though negative growth is still expected).

Major developments in the financial and corporate sectors in 2009

Financial sector. The following major developments took place in the financial sector:

Amendments to the Financial Instruments Law of Japan enacted in 2009:

expanded the scope of regulated entities to include rating agencies;

set out a system of financial alternative dispute resolution; and

amended the disclosure rules for secondary offerings of securities.

Under the amended disclosure rules, exemptions are more readily available and certain types of secondary offerings for foreign securities may enjoy reduced disclosure requirements (for example, treasury bonds issued by certain foreign countries or securities listed on certain foreign exchanges.)

The amendments will take effect in a staggered way from April 2010.

Tokyo AIM commenced operations in June 2009. This is a new exchange, modelled on London's AIM, targeting Japanese professional investors and non-residents (whether professional or not) and employing a flexible regulatory approach to listing and disclosure (for example, assessment by J-Nomad (modelled on Nominated Advisor in London's AIM); English language disclosure availability).

The Settlement and Payment Systems Act was enacted. This Act (i) introduced regulations in respect of prepaid settlement methods (so-called "electronic money") the records in respect of which are maintained only on a server or on the internet, and (ii) was amended to permit non-banks to conduct and provide fund transfer services. This Act will come into force in 2010.

Japan Association of Turnaround Professionals started its service. In terms of debt restructurings, the Japan Association of Turnaround Professionals (JATP) started its mediation service at the end of 2008 and the workout process provided by JATP has been used more and more frequently throughout 2009. In addition, the Enterprise Turnaround Initiative Corporation of Japan (ETIC), a restructuring fund acting under special legal framework and financially supported by the government, commenced operations in October 2009, and is currently working intensively on the workout of Japan Airlines.

Commercial and Corporate sector. Under Japanese commercial and corporate laws, all paper share certificates issued by any listed company became invalid and had to be converted to electronic share certificates in January 2009. All transfers of listed shares are now effected through an electronic system. The conversion process took 5 years to prepare, so there was very little confusion in the market with regards to the implementation.

As a result of the change to the electronic share certificate system, the way to execute rights as a shareholder also changed. For example, a shareholder who wants to propose a shareholders' meeting agenda must request the depository trust company to send a notice to the company stating that the shareholder is qualified to propose an agenda (terms of holding shares, number of shares, and so on) instead of the company being required to confirm the shareholders entry in the registry.

In 2009, the courts made the following important rulings:

A "fair" share buy-out price should be determined when a company plans to "squeeze-out" minor shareholders considering the aggregate value of control and squeeze-out premiums.

If a company has established an internal control system to prevent reasonably expected inappropriate behaviour, it will not be liable for any tort committed by its employees where the commission of such tort is not reasonably anticipated.

Corporate governance has been the subject of much discussion in 2009. In particular the necessity of maintaining an independent director and the role of the statutory auditor (*Kansayaku*) have been

discussed. It is expected that such issues will form the basis of discussions to be held by the Democratic Party in relation to the drafting of a new Listed Company Act (*Kokai-Kaisha Ho*).

Expected major reforms in the financial and corporate sectors in 2010

Three months have passed since the Hatoyama administration came into office on 16 September 2009, and most commentators suggest that in 2010 the new administration will make genuine efforts to implement policies to which the Democratic Party of Japan (DPJ) is committed.

Financial measures which the Cabinet planned in "Emergency Economic Countermeasures for Future Growth and Security" on 8 December 2009. These are as follows:

Extending the term of the existing emergency credit guarantee scheme for small and medium-sized enterprises (SMEs) and easing the eligibility criteria for SMEs seeking to benefit from it.

Making of urgent loans to save SMEs through Japan Finance Corporation and Shoko Chukin Bank (two government-owned banks).

Imposition of an obligation on financial institutions to strive to revise loan terms when requested by an SME or a residential mortgage borrower to ease the debt burden through enforcement of the Act Concerning Temporary Measures to Facilitate Financing for SMEs, and implementing necessary financial inspections and supervision to enhance the effectiveness of the Act.

Increasing the volume of long-term loans to medium and large-sized enterprises in financial crisis through the Development Bank of Japan.

Introduction of a system that eases the effects of the relatively high interest rates resulting from deflation, which reduces the yields on loans made by private financial institutions and the Japan Finance Corporation.

Making of urgent loans by the Japan Bank for International Co-operation and providing guarantees to support overseas business operations of Japanese companies.

Main Points of the Draft Blueprint for the Development of Institutional Frameworks Pertaining to Financial and Capital Markets. According to these, which were published by the Financial Services Agency of Japan (FSA) on 17 December 2009, the government is reviewing the following policies in view of the recent global financial crisis and the actual condition of Japanese markets (no policy determinations have been made to date):

The prevention of contagion and reducing settlement risk in Japanese markets by introducing regulations to require financial instruments business operators with large-scale over-the-counter (OTC) derivative transactions businesses to use the central counterparty clearing system (CCP) established in Japan and by requiring trade repositories and the CCP to submit information on OTC derivative transactions to the FSA.

Strengthening the systems of the Japan Government Bond Clearing Corporation (JGBCC) to increase the use of its clearing services and reduce the settlement risk.

Formalising regulations and supervision on a consolidated basis for securities companies whose overall risks are difficult to assess under current non-consolidated based regulation and supervision.

Strengthening regulations applicable to major shareholders of financial instruments business operators and requiring such shareholders to ensure that the business operations of the financial instruments business operator are conducted in an appropriate manner.

Introducing prudency standards on a consolidated basis which cover the entire group of companies led by an insurance company or an insurance holding company in order for the FSA to have a better understanding of the financial soundness of the group as a whole.

Expanding the items to be reported by hedge fund managers to the FSA.

Introducing more comprehensive regulations on unsolicited offers for derivative transactions.

Developing a reporting system for the short selling of securities.

Public Company Act. According to the 'DPJ Policies INDEX 2009', the DPJ has taken the view that the Public Company Act should be enacted and that:

It should be obligatory for listed companies to introduce outside directors.

It should be obligatory for listed companies to involve employee representatives in a board of auditors.

A double derivative action system similar to the one in the US should be introduced in Japan.

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