6. Commercial Law

Financial Products Exchange Law
Law No. 102, June 27, 2007 (Effective on September 30, 2007)

Background:

On June 7, 2008, "the law to amend parts of the Security Exchange Law (Shoken-torihiki-hou) etc" and "the law for the preparation for the related laws involved with its implementation" were passed by the 164th Diet. They were also promulgated on June 7, 2008. These laws aim to respond to the changes in the environment surrounding the financial and capital markets and to establish a "Financial Products Exchange Law (Kinyushohin-torihiki-hou)", which is a cross-sectional legal system to protect investors. The Financial Products Exchange Law has the purpose thoroughly to protect the users of markets, enhance their convenience, ensure the function of markets to promote investment rather than saving and to respond to the internationalization of financial and capital markets.

The Financial Products Exchange Law mainly has four contents.

First, the law regulates the investment services, including the increased regulated-commodities and services by comprehensive definitions of the collective investment scheme and the extended derivative trading.

Second, the law strengthens the disclosure systems, such as quarterly disclosure, the internal control of financial statements, TOB and large block-holdings.

Third, the law aims to ensure the adequate operation of self-regulated businesses.

Fourth, the law makes stricter the civil penalties and sanctions of manipulation.

In this article, we will chiefly focus on "the internal control" through the comparison of the internal control systems in the Financial Products Exchange Law with those in the Corporation Law. Interest in internal control systems has been growing, because of increased corporate crime in

Japan, for example *in re Daiwa Bank*, which is the case where the words "internal control" ware used first in Japan. The need to establish internal control systems is recognized in Japan and thereby the Financial Products Exchange Law as well as Corporation Law requires certain corporations to establish internal control systems.

At first we will look at how the provisions concerning internal control systems are respectively stipulated in the Corporation Law and the Financial Products Exchange Law. Then, we will especially consider whether they are different from each other and, if so, how they are different.

Main Provisions:

(1) The Internal Control Systems in Corporation Law

In Japan, the structure of corporate organs is very complicated by the enactment of new Corporation Law in 2005. In this article, we shall consider four types of corporations in Corporation Law; (a) the corporation which has a board of directors but does not have committees (Torishimariyakukai-setti-kaisya, we will call this (A) corporation for convinience), (b) the corporation which has three committees (a nominating committee, an audit committee and a compensation committee) (Iinkai-setti-kaisya, (B) corporation), (c) the corporation whose capital reckoned up in the balance sheet in the latest business year is more than 500 million yen or debt is more than 20 billion yen (dai-gaisya, (C) corporation), and (d) the corporation which does not have either a board of directors or committees ((D) corporation).

The Corporation Law stipulates that the board of directors in (A) corporation can not entrust directors with the preparation for the regimes to ensure that the performance of duties as a director satisfies the laws and article of association, and those prescribed by the Ordinance for Enforcement of the Corporation Law (Kaisya-hou-sekou-kisoku) to ensure other fair business of corporations (Art. 362. para. 4 no. 6 of the Corporation Law) (the material matters). The board of directors in (C) corporation has to decide these material matters (Art. 362. para. 5 of the Corporation Law). The Corporation Law specifies that the board of directors in (B) corporation has to decide the matters stipulated by the Ordinance for Enforcement of the Corporation Law which are necessary

for performing the duties of the audit committee (Art. 416. para. 1 no. 1 ro of the Corporation Law) and prepare for the regimes to ensure that the performance of duties as executives satisfies the laws and article of association, and those prescribed by the Ordinance to ensure other fair business of corporations (Art. 416. para. 1 no. 6 ho of the Corporation Law). The Corporation Law also stipulates that the directors in (D) corporations which have more than one director can not entrust each director with the preparation for the regimes to ensure that the performance of duties as a director satisfies the laws and article of association, and those prescribed by the Ordinance to ensure other fair business of corporations (Art. 348. para. 3 of the Corporation Law) (the material matters) and if a (D) corporation is also a (C) corporation, it has to decide the material matters (Art. 348. para. 4 of the Corporation Law). In short, all corporations other than the corporation which has only one director are regulated by the provisions concerning the above-mentioned preparation for "regimes".

However, it must be noted that the words "internal control" are not used either in the Corporation Law or in the Ordinance for Enforcement of the Corporation Law. Rather, the Corporation Law requires managers to prepare the regime for adequately performing the duties as those who are responsible for the corporate business. Therefore, the Corporation Law seems to aim to ensure the sound performance of the business.

Furthermore, the Corporation Law apparently requires only (C) corporation to simply decide whether it will establish the "regime" or not. Is it possible to decide that the corporation will not establish the regime? In fact, if a (C) corporation is a large listed corporation, it seems to be difficult or eventually impossible for such a corporation to engage in business without establishing the regime. If the board of directors decides not to have the regime, they will be burdened with stricter accountability. If the damages are caused by the corporate crime under the condition that the corporation does not establish the regime, the directors will be responsible for the duty of care.

(2) The Internal Control Systems in Financial Products Exchange Law

The systems of reports of internal control were created in the Financial Products Exchange Law, and the corporation which has to submit the reports of securities and issue the securities listed on the financial products exchange, in each business year, shall submit the documents

concerning financial accounting of the corporation and its corporate group, as well as the reports evaluated by the standards stipulated by the Cabinet Office Ordinance which are necessary for ensuring the accuracy of the other information (Art. 24. 4.4 para. 1 and 4 of the Financial Products Exchange Law). This provision aims to enhance the reliance on the disclosed financial information. The Financial Products Exchange Law refers to these reports as the reports of internal control. The corporations other than the above-mentioned corporations can submit the reports of internal control (Art. 24. 4.4 para. 2 of the Financial Products Exchange Law).

As a rule, these corporations shall be audited by certificated public accountants or an auditing corporation (Art. 193. 2 para. 2 of the Financial Products Exchange Law). This is becaue the Financial Products Exchange Law follows the Sarbanes-Oxley Act and is also called JSOX.

Editorial Note:

The internal control systems in the Corporation Law aim to establish a regime to ensure that directors accurately perform their duties, while the reports of internal control in the Financial Products Exchange Law have the purpose of ensuring the accuracy of documents and other information concerning financial accounting. Moreover, the corporations shall evaluate the internal control systems in the reports of internal control systems. However, the internal control systems can create the reliable financial information, only if they are established in the corporation as a whole and effectively operate. In this sense, the internal control systems in the Corporation Law are not fundamentally different from those in the Financial Products Exchange Law.

It is the internal audit that evaluates whether the internal control systems in the corporation as a whole are established and are operating effectively or not. According to "the standard of internal control" established by the Institute of Internal Audit—Japan, which is a de facto standard, the internal audit is a business to advise and recommend the managers by fairly and independently reviewing or evaluating how the management has been operated from the perspective of legitimacy and rationality in order to serve the effective achievement of the mission of the management, and to support certain managerial operations. The section of the internal audit

plays an important role in advising or supporting managers from the neutral standpoint in order to evaluate to what extent the mission of the management has been achieved. The section of internal control directly belongs to the chief executive officer, and therefore, it seems to become more important to what extent the section is independent of the officer.

Since the internal control is a system in the corporation as a whole, each section in the corporation recognizes, evaluates, analyses, responds to and controls the risk that is an important element of the internal control. At the same time, the corporation recognizes, evaluates, analyses, responds to and controls such risks as a whole. The section of internal audit evaluates whether the internal control systems have been established and how they are operated. In short, the section of internal audit "audits" the internal control systems. In the Financial Products Exchange Law, the managers shall evaluate and report the internal control systems. The internal audit will become an important vehicle for directors to perform their duty of compliance. Similarly, in the Corporation Law, auditors or audit committee will use the internal audit as a supplementary instrument to inspect whether the internal control systems have been established and are operating effectively.

From the perspective of the internal audit, the internal control systems in the Corporation Law are not entirely different from those in the Financial Products Exchange Law. Rather, both of them should effectively operate together, and thereby, the efficient and sound management should be achieved. Japanese corporation will have to take into consideration how the management should enhance the internal control systems, including what the internal audit should be.

7. Labor Law

Labor Contract Act
Act No. 128, December 5, 2007 (Effective on March, 2008)

Background:

From around 1990, types of employment in Japan have become diver-