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**Self-regulation in Private Law
in Japan and Germany**

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Legitimacy and Limits of Self-regulation in Japan

Takahito Kato*

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I. INTRODUCTION

In Japan, the legitimacy and limits of self-regulation are not necessarily themes that have been heavily studied, at least not among private law scholars.¹ Of course, the legitimacy and limits of self-regulation are connected with other problems relating to self-regulation. What I mean to say is that it is rare in Japan to research the legitimacy and limits of self-regulation as one issue. The reason for this is not clear, but self-regulation as a regulatory measure of course exists in Japan, and when the government studies the necessity of a new regulatory scheme, it often considers whether the regulatory purpose could be achieved through self-regulation.

The legitimacy and limits of self-regulation are relevant to the way in which the government approaches self-regulation. For example, I assume that the government has a problem to resolve and has to decide how to resolve it. In that case, self-regulation is one of the alternatives. It is also possible that some self-regulation already exists. In this case, the government has to decide whether to keep the self-regulation; to take steps to

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1 In the area of public law, self-regulation is regarded as a topic of study, unlike the case in private law. H. HARADA, *Jishu kisei no kōhō-gakuteki kenkyū* [Self-regulation from the perspective of public law] (Tōkyō 2007).

make the self-regulation more effective; or to substitute a public regulation, in the form of new legislation or administrative orders, for the self-regulation. To make this decision, it might be useful for the government to recognize the legitimacy and limits of self-regulation.

Therefore, I think we should look into the legitimacy and limits of self-regulation more proactively in Japan. In this article, I would like to introduce three individual matters that I see as relating to the legitimacy and limits of self-regulation in Japan. I will use these to analyze why self-regulation is selected to deal with a problem and under which conditions self-regulation functions well. I attempt to tackle the legitimacy and limits of self-regulation using a functional approach. I will now briefly explain these three matters.

The first matter is the role of the Japanese stock exchange in the introduction of outside and independent directors by Japanese listed companies.² In Japan it seems that the stock exchange regulation was selected to increase the number of outside and independent directors in listed companies. Analyzing why the stock exchange regulation, and not legislative actions, was selected is meaningful in considering the legitimacy and limits of self-regulation.³

The second matter relates to the process of how a self-regulation is created. One of the benefits of self-regulation compared with other regulatory measures is that we can expect the regulated parties to voluntarily follow such self-regulation because such parties are involved in the necessary consensus-building process preceding such self-regulation. By involving the regulated parties in the creation of self-regulation, we can avoid such self-regulation becoming unreasonable and unrealistic.⁴ Also, from an emotional standpoint, we can expect people to be more likely to follow a rule that they have created themselves rather than a rule that is forced upon them by law or government. These logics may apply when the regulated parties, which are also the parties involved in the creation of the self-regulation, have characteristics in common. On the other hand, when the characteristics of the regulated parties are diverse, the said benefit of self-

2 It is not clear whether the stock exchange's implementation of a corporate-governance-related regulation covering listed companies can be straightforwardly classified as self-regulation. In Japan, it seems that the corporate governance rules for listed companies set forth by the stock exchange are regarded as one type of self-regulation. T. KATO, *Shōken torihiki-jo to jōjō kigyō no kanri* [Management of Listed Companies by Securities Exchange], in: Kuronuma/Fujita (eds.), *Kigyō-hō no riron, Gekan* [Theory of Enterprise Law, last volume] (Tōkyō 2011) 685–686.

3 I analyzed the same matter from a different perspective. T. KATO, *Kōporēto gabanansu o meguru rīru no konvājensu* [The Convergence in Corporate Governance Rules], in: *Soft Law Journal* 18 (2011) 66–72.

4 KATO, *supra* note 2, 689–690.

regulation vis-à-vis other regulatory measures will be lost. The reason is simple: more compromises will be made among the parties to reach a consensus on such self-regulation. In such a situation, creating self-regulation will entail significant costs, and the contents of such self-regulation are likely to become ineffective. In the past, I attended the Tōkyō Stock Exchange's (TSE) review process for its corporate-disclosure-related self-regulation. Such corporate disclosure regulation might have a stronger characteristic of self-regulation than the regulation regarding outside and independent directors mentioned above, because the stock exchange has more discretion in such a matter than in the corporate-governance-related one. But when there are over 3,500 listed companies to regulate, it is doubtful that common characteristics exist among all such companies, something which is necessary for the self-regulation to be effective. I would therefore like to analyse this matter based on my experience of being involved in the TSE's self-regulation review process.⁵

The third issue relates to the limits of self-regulatory organizations. Various self-regulatory organizations exist in Japan. For example, there is the Japan Securities Dealers Association (JSDA), a self-regulatory organization consisting of securities companies, which in many cases appear to have common interests in matters which may require self-regulation. As I noted in the discussion of the second issue, I view the nature of the regulated parties as relevant to the limits of self-regulation. In self-regulatory organizations, the members are subject to self-regulation, and they generally have interests in common. Also, there is a merit to self-regulation via self-regulatory organizations, which is that enforcement in response to violations is carried out at the level of the self-regulatory organization. Without strong self-regulatory organizations, self-regulation will be enforced only by reputation. On the other hand, there is a possibility that self-regulation will not be effective even in situations where the members have common characteristics. Such ineffectiveness is due to the limited scope of persons subject to such self-regulation, depending on the kind of self-regulatory organization. This is because a self-regulatory organization can directly regulate only its members.

For example, in Japan, discussion is ongoing about whether to regulate selective disclosure. Certain scandals have led the government to begin an amendment process regarding securities regulation.⁶ For example, an ana-

5 In October 2009, the TSE established a working group for disclosure under the Advisory Group on Improvements to TSE Listing System to study the disclosure system. I participated in the activities of this working group from 2009 through 2010.

6 The Financial System Council within the Japan Financial Services Agency proposed the introduction of a new rule banning selective disclosure after studying the

lyst in a securities company used non-public information received from an issuing company to solicit securities transactions. The JSDA introduced a self-regulation prohibiting analysts from approaching issuing companies for the purpose of receiving non-public information.⁷ This regulation might not be enough to resolve the problems, however, since it does not cover issuing companies engaging in selective disclosure. The selective disclosure issue arises between listed companies that disclose company information and securities companies that request the disclosure of such information, and therefore the issue will not be solved simply by regulating only listed companies or only security brokerage firms. I would therefore like to discuss the most recent events in Japan regarding this issue.

II. THE JAPANESE STOCK EXCHANGE'S CONTRIBUTION TO INCREASING THE NUMBER OF OUTSIDE AND INDEPENDENT DIRECTORS IN JAPANESE LISTED COMPANIES

1. *Did the Japanese Government Influence TSE Regulation, and How?*

From a global perspective, Japan was for years well-known for the fact that its listed companies did not elect outside and independent directors.⁸ Listed companies in Japan are not mandated to elect outside directors as long as they adopt a form of governance system called “Corporation with an Audit & Supervisory Board”.⁹

same in two subcommittees. See THE “WORKING GROUP ON CORPORATE DISCLOSURE” OF THE FINANCIAL SYSTEM COUNCIL, Report – Ensuring fair and timely disclosure of information to investors (18 April 2016), available at http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20160719-1/01.pdf; THE “TASK FORCE ON FAIR DISCLOSURE RULE” OF THE “WORKING GROUP ON FINANCIAL MARKETS” OF THE FINANCIAL SYSTEM COUNCIL, Report – Ensuring fair and timely disclosure of information to investors (7 December 2016), available at http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20170303-1/01.pdf. The Japan Financial Services Agency submitted the amendment proposal to the Diet on 3 March 2017 which was adopted on 5 May 2017.

7 JSDA, Guidelines concerning Association Member Analysts' Interviews, etc. with Issuers and Communication of Information (20 September 2016), available at http://www.jsda.or.jp/en_old/rules/E29-1.pdf.

8 G. GOTO, The Outline for the Companies Act Reform in Japan and Its Implications, *ZJapanR / J.Japan.L.* 35 (2013) 18–19.

9 In a “Corporation with an Audit & Supervisory Board”, a member of such a board supervises management together with the board of directors. But there are limits to the supervisory role vis-à-vis management by such a member of the “Audit & Supervisory Board”, because the latter does not possess the right to vote on the management's election, even though they have a right to attend the board of directors' meetings. “Audit & Supervisory Board” is “*kansa-yaku-kai*” in Japanese, and is

Today, most listed companies in Japan have one or more outside and independent directors on their board of directors.¹⁰ I may be jumping to conclusions, but it seems that the number of outside and independent directors being elected by listed companies has increased in tandem with the repeated self-regulatory changes made by the TSE to encourage these companies to elect such directors. However, such self-regulation by the TSE was not its own initiative, but rather a measure to achieve harmonization of interests through law or governmental measures. In other words, the government used the TSE to achieve the regulatory purpose based on the public consensus-building process. Externally, however, the TSE appears to have played a large role in having Japanese listed companies elect outside and independent directors.

2. *The Recent Transformation of the TSE Regulation Relating to Outside and Independent Directors*

The TSE first amended its regulation to require listed companies to have one or more independent executive members – meaning outside directors or auditors who do not have a conflict of interest with general shareholders – and to disclose this in their corporate governance report in December 2009.¹¹ Since this requirement was stated as part of “Matters to be Observed”, listed companies violating this requirement were subject to enforcement.¹² Listed companies were, however, allowed to report their outside auditor as the required independent executive. In the TSE regulations,

composed of “*kansa-yaku*”. While “*kansa-yaku*” is often translated as “statutory auditor”, recently the association of *kansa-yaku*, which might be viewed as a self-regulatory organization, has strongly recommended that “*kansa-yaku-kai*” be translated as “Audit & Supervisory Board”. THE JAPAN CORPORATE AUDITORS ASSOCIATION, New Recommended English Translation for “*Kansayaku*” and “*Kansayaku-kai*” (4 September 2012), available at <http://www.kansa.or.jp/news/ns121023-1.pdf>.

10 TSE, Appointment of Independent Directors by TSE-Listed Companies [Final Figures] (27 July 2016), available at <http://www.jpx.co.jp/english/listing/others/ind-executive/tvdivq0000001j9j-att/b5b4pj000000171dc.pdf>. The ratio of such outside and independent directors on the board of directors is not large from a global perspective, so the role of such directors in the supervision of management may be still limited. However, in this article, I would like to focus on the role of the Japanese stock exchange in increasing the number of outside and independent directors in Japanese listed companies, and not the role of such directors themselves.

11 TSE, Listing System Improvements based on the Listing System Improvement Action Plan 2009 (Matters for prompt implementation) (29 October 2009), available at <http://www.jpx.co.jp/english/equities/improvements/general/tvdivq0000004ib-att/summary.pdf>.

12 TSE, Securities Listing Regulations, Rule 436-2 (as of 30 December 2016).

“auditor” means a member of the “Audit & Supervisory Board”. Therefore, this amendment was limited as a measure to have listed companies elect outside and independent directors. Notwithstanding these limitations, the number of listed companies electing outside and independent directors has increased since this amendment.¹³

Later, in May 2012, the TSE introduced a new rule under “Matters Desired to be Observed” regarding independent executives, which stated, “Listed companies shall make efforts to designate independent executives, in consideration of the meaning of such independent executives having right to vote in the Board of Directors.”¹⁴ The TSE later amended this rule in 5 February 2014 to say “An issuer of listed domestic stocks must make efforts to secure at least one independent director/auditor as a member of its board of directors.”¹⁵ Because these rules are part of “Matters Desired to be Observed”, no enforcement will take place when listed companies violate such rules.¹⁶ However, it is my view that here the TSE has made one step further to encourage listed companies to elect outside and independent directors.

From 1 June 2015, companies listed on the TSE were obliged to comply with “Japan’s Corporate Governance Code” or explain why they did not comply.¹⁷ Many rules regarding outside and independent directors exist in the Corporate Governance Code, which means the listed companies are required to “comply or explain” in this regard.¹⁸

13 TSE, TSE-Listed Companies White Paper on Corporate Governance 2013 (February 2013) 23–24, available at <http://www.jpx.co.jp/equities/listing/cg/tvdivq0000008jb0-att/b7gje6000003ukm8.pdf>.

14 TSE, Securities Listing Regulation, Rule 445-4 (as of 10 May 2012).

15 TSE, Securities Listing Regulation, Rule 445-4 (as of 10 February 2014).

16 Those TSE regulations are components of the “Code of Corporate Conduct” in the Securities Listing Regulation of the TSE. “If the TSE deems that a listed company violates a provision regarding the matters to be observed, the TSE may recommend said listed company to take appropriate measures or make a public announcement, etc. to that effect”, see <http://www.jpx.co.jp/english/equities/listing/code-of-conduct/index.html>.

17 TSE, Securities Listing Regulation, Rule 436-3 (as of 1 June 2015); TSE, Japan’s Corporate Governance Code – Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term (1 June 2015), available at <http://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/20150513.pdf>.

18 For example, “Principle 4.8: Effective Use of Independent Directors” reads as follows: “Independent directors should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid- to long-term. Companies should therefore appoint at least two independent directors that sufficiently have such qualities. Irrespective of the above, if a company in its own judgement believes it needs to appoint at least one-third of directors as independent directors based on a broad consideration of factors such as the in-

3. *The TSE's Independence from Legislative and Administrative Bodies*

As mentioned above, it is clear that the TSE repeatedly introduced changes to its rules to encourage listed companies to elect outside and independent directors. But these changes may be viewed as the TSE merely responding to requests from legislative or administrative bodies, and not acting on its own initiative.

For example, the changes the TSE introduced in December 2009 seem to be based on the following proposal from the Financial System Council's Study Group within the Japan Financial Services Agency:

“Naturally, the best form of corporate governance will differ depending on the organization, size, line of business and other aspects of each individual company; but in spite of the difficulties in applying the same rule to all companies, if the above line of thinking is adopted one can say that there is room for improvement, since there is a considerable gap between this and the reality that 55% of companies listed on the TSE have not appointed any outside director.

The stock exchanges should present a model of corporate governance in line with the above thinking, which is regarded as suitable for the majority of listed companies for securing the confidence of shareholders, investors and others. Based on this, stock exchanges should adopt measures that would require companies to sufficiently disclose the details of their respective governance systems and the reasons for selecting a particular system. Furthermore, with respect to the details of statutory disclosure relating to the status of corporate governance, revisions should also be made if necessary, in conjunction with the matters described in the rest of this chapter.”¹⁹

The changes made on 5 February 2014 were also closely linked to law-making activities related to Japanese company law, which began in 2010. As part of these law-making activities, the question of whether to mandate Japanese listed companies to elect outside and independent directors was discussed. The law-making activities related to Japanese company law often start with the minister of justice referring the matter to the Legislative Council of the Ministry of Justice. In this case, the Company Law Subcommittee was in charge of the actual review. Its role was to create a draft outline of the Company Law amendment. Within the subcommittee, wheth-

dustry, company size, business characteristics, organizational structure and circumstances surrounding the company, it should disclose a roadmap for doing so.”

19 THE FINANCIAL SYSTEM COUNCIL'S STUDY GROUP ON THE INTERNATIONALIZATION OF JAPANESE FINANCIAL AND CAPITAL MARKETS, Report by the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets: Toward Stronger Corporate Governance of Publicly Listed Companies (17 June 2009), available at <http://www.fsa.go.jp/en/news/2009/20090618-1/01.pdf>. One scholar attending the study group and discussing the changes made by the TSE has noted that such changes were merely a realization of the consensus reached in the study group's discussion. KATO, *supra* note 3, 79 note 52.

er to mandate the election of outside and independent directors was discussed intensively, but the subcommittee could not propose such an obligation. Instead, they decided to impose a rule that listed companies that have not elected outside and independent directors must explain their reasons for not doing so. When the Legislative Council of the Ministry of Justice approved the subcommittee's proposal, the council requested that the securities exchange alter its regulations to impose the obligation on the listed companies to elect at least one outside director.²⁰

Regarding the amendments relating to Japan's Corporate Governance Code, the formulation of the same was the Japanese Government's policy, while the content of the code was determined by the Council of Experts Concerning the Corporate Governance Code. The TSE assumed the role of secretary of the council together with the Japan Financial Services Agency.²¹

4. *Why the TSE Needed Public Assistance to Change its Regulation Regarding Outside and Independent Directors in Listed Companies*

As demonstrated above, the transformation of the TSE regulations regarding outside and independent directors in listed companies resulted from public consensus-building procedures undertaken by legislative or administrative bodies. Based on this fact, I would like to comment on the following two points regarding the legitimacy and limits of self-regulation.

First, if these public consensus-building procedures did not exist, the TSE might not have been able to change the situation regarding outside and independent directors. Since the regulations regarding outside and independent directors relate to the core composition of the board of directors, the stock exchange must have had a strong interest in designing such a system. The TSE appears to have wanted listed companies to have one or more outside and independent directors for a long time. In Japan, there is the TSE and other stock exchanges, but the TSE surpasses the other stock exchanges in terms of the number of listed companies and transaction volume. For companies that plan to list their shares for the first time, the TSE is the only feasible option unless there are special reasons to choose otherwise. Therefore, the TSE is in the position to act to increase the numbers of outside and independent directors in TSE-listed companies in accordance with the interests of investors rather than those of listed companies. How-

20 GOTO, *supra* note 8, 21–22.

21 THE COUNCIL OF EXPERTS CONCERNING THE CORPORATE GOVERNANCE CODE, Japan's Corporate Governance Code [Final Proposal] – Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term (5 March 2015), available at <http://www.fsa.go.jp/en/refer/councils/corporategovernance/20150306-1/01.pdf>.

ever, regarding the composition of the board of directors, even a strong stock exchange such as the TSE could not initiate a big change without the help of public consensus-building procedures.²²

Similar issues may arise regarding other self-regulations – namely, there may be situations where self-regulations cannot be introduced without public consensus-building procedures. The combination of public consensus-building procedures and self-regulation, however, may lessen the benefits of self-regulation. One of the benefits of self-regulation is that by having the regulated parties participate in the private consensus-building process, the content of the regulation may become more flexible and the regulated parties will have an incentive to comply with the regulation because they have been given the right to participate in the creation process.²³ The regulated parties may also be invited to participate in a public consensus-building process, but it seems that the differences between such public and private processes are extensive.

Second, it seems questionable whether the Japanese government may legitimately choose to utilize the regulations of the stock exchange to encourage listed companies to elect independent and outside directors. As noted above, public consensus-building procedures have been held mainly by councils governed by the Japan Financial Services Agency. These consen-

22 In other articles, I have analyzed why the TSE needed assistance from public organizations such as the Japan Financial Services Agency to increase the number of outside and independent directors. KATO, *supra* note 2, 697–711; KATO, *supra* note 3, 66–72.

First, let us consider the interests of stock exchanges in listed companies' election of outside and independent directors. There may be differences between countries regarding what roles are expected of outside and independent directors, but many countries seem to expect that outside and independent directors will supervise company management in the place of shareholders, who cannot supervise management due to collective action problems. In other words, outside and independent directors are expected to confront company management as representatives of investors. Investors can then comfortably purchase shares in listed companies since such representation exists within the company's governance structure. Japanese listed companies have recognized that electing outside and independent directors requires material changes to their company governance structures, which have mainly consisted of insiders. Therefore, the interests of listed companies, especially management, and investors may have conflicted with regard to the election of outside and independent directors.

In a situation where such interests collide, it is difficult for stock exchanges to support either the company management or the investors, because the income structure of the stock exchange is dependent on the number and transaction volume of listed companies. It is therefore necessary for stock exchanges to obtain support from both listed companies' management and investors to receive steady income.

23 KATO, *supra* note 3, 66–67.

sus-building procedures are, however, not the same as those required in legislative processes.²⁴ There are at least two ways to introduce regulations regarding the composition of listed companies' boards of directors. One is to amend the Japanese Company Act,²⁵ and the other is to amend the regulations of the stock exchange. The former requires a legislative process, but the latter does not. In the latter case, the amendment process is much more modest than in the former case: The stock exchange simply requests the Japan Financial Services Agency's approval of an amendment, and the Financial Services Agency approves the amendment.

Let us assume that the Japanese government decided to resolve a certain issue via self-regulation. It could make this kind of decision without a legislative process by specifically giving the self-regulation authority for this purpose. If such a decision by government was made to circumvent the legislative process, it would appear that the resulting self-regulation has a serious legitimacy problem.

III. DIVERSITY IN THE CHARACTERISTICS OF LISTED COMPANIES

Since the composition of the board of directors is closely connected to the management structure of a listed company, the company management, investors, stock exchanges and other third parties have strong and diverse interests in it. Therefore, it may have been difficult for the stock exchange to create a regulation relating to the composition of the board of directors without public consensus-building procedures. On the other hand, since issues regarding the disclosure of listed companies relate to the listed companies and investors only, the stock exchange may be able to initiate self-regulation on these issues more easily than on those of board of directors.

As a matter of fact, the TSE has adopted the following self-regulations regarding the disclosure of listed companies. First of all, there is the timely disclosure rule (*tekiji kaiji seido*).²⁶ Under this rule, listed companies must immediately disclose material non-public information, as enumerated in the TSE regulation, if such a case arises.

24 In the legislative procedures, the consensus-building process seems mainly to involve interested groups. GOTO, *supra* note 8, 16. I believe that a similar process has been undertaken in the councils regarding outside and independent directors, but it might not be a key priority. What is more important for those councils might be consensus building among corporate governance professionals, similarly to the case within the High-Level Group of Company Law Experts in the EU.

25 *Kaisha-hō*, Law No. 86/2005.

26 TSE, Securities Listing Regulation, Rule 402 (as of 4 November 2016).

Second, there is the earnings reports rule (*kessan tanshin*).²⁷ Under this rule, listed companies must immediately disclose their quarterly account settlement once it is completed.

The Financial Instruments and Exchange Act,²⁸ which is an important component of the Japanese securities regulations, contains mandatory disclosure rules similar to the timely disclosure and earnings reports rules. Simply speaking, the stock exchange disclosure rules require listed companies to disclose more information sooner than the mandatory ones.

I was involved in the review of the earnings reports rule.²⁹ During the review process, I realized that the diversity of listed companies' understandings regarding the importance of disclosure may sometimes prevent the stock exchange from creating self-regulation concerning disclosure.

First, companies whose shares are widely owned by institutional investors, or companies that frequently utilize equity financing, are aware of the importance of corporate disclosure. It is clear that disclosure is the key to establishing a good relationship with institutional investors. If there is any issue with disclosure, the cost of equity financing will rise. Such listed companies have an incentive to disclose, without the regulations of the stock exchange, because of this awareness. Therefore, the stock exchange's regulations on disclosure are meaningful only in the sense that they would make those companies which don't recognize the importance of disclosure do so adequately.

When the stock exchange is developing a new regulation, it will usually create a working group that includes representatives from listed companies.³⁰ Some working group members are usually chosen from blue chip companies, which are aware of the importance of disclosure and are already adequately disclosing their information. It seems that blue chip companies would not object to the stock exchange changing the regulation and imposing more stringent disclosure obligations, since they are already engaging in adequate disclosure and such stringent obligations would not burden them. The purpose of the regulatory change is to have other companies adequately disclose their information. They, however, do sometimes object to such change, because it would prevent their voluntary and flexible disclosure practices. For them, increased disclosure obligations via stock exchange regulations would only mean more costs.

Therefore, for the stock exchange to create an effective disclosure regulation, it must be able to limit the scope of application; however, this is not

27 TSE, Securities Listing Regulation, Rule 404 (as of 4 November 2016).

28 *Kin'yū shohin torihiki-hō*, Law No. 25/1948.

29 See *supra* note 5 and accompanying texts.

30 *Id.*

easy. The TSE has three markets – Main Market, Mothers and JASDAQ – and the Main Market is divided into two departments.³¹ If the companies within each market have a common understanding of the importance of disclosure, it may be effective to have different regulations for each market. However, it is unclear whether such a common understanding exists.

IV. THE LIMITATIONS OF SELF-REGULATION VIA SELF-REGULATORY ORGANIZATIONS

There can be self-regulation without a self-regulatory organization, but the existence of a self-regulatory organization aids the effectiveness of self-regulation in various ways, including but not limited to its introduction, review and enforcement. However, the limitation of the members of a self-regulatory organization will limit the scope of the self-regulation.

Let us look at an example regarding the disclosure of material non-public information. Japanese securities regulation includes the timely disclosure rules in the TSE's regulation but did not have a rule banning selective disclosure and promoting fair disclosure in the Financial Instruments and Exchange Act until 2017. From 2015 to 2016, some selective disclosure scandals took place.³² In those cases, the sell-side analysts in the securities companies received material non-public information from the listing companies, and the securities companies offered securities transactions to their customers using that information.

Those offers were illegal.³³ The JSDA therefore took steps to deal with the scandals and amended its analyst rule.³⁴ Briefly speaking, the new rule forbids analysts from asking listed companies for material non-public information. The JSDA's action might be a rational way of dealing with the scandals, but its self-regulation is not enough to achieve fair disclosure. Selective disclosure happens not only because analysts ask listed companies for material non-public information, but also because the listed companies use that information to maintain good relationships with the analysts. A regulation to

31 TSE, Securities Listing Regulation, Rule 101-103 (as of 4 November 2016).

32 SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION, Recommendation for Administrative Action based on Findings of the Inspection of Deutsche Securities Inc. (8 December 2015), available at <http://www.fsa.go.jp/sesc/english/news/reco/20151208-1.htm>; SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION, Recommendation for Administrative Action based on Findings of the Inspection of Credit Suisse Securities (Japan) Limited (15 April 2016), available at <http://www.fsa.go.jp/sesc/english/news/reco/20160415-1.htm>.

33 Art. 117 para. 1 no. 14, Cabinet Office Ordinance on Financial Instruments Business, based on Art. 38, no. 8, Financial Instruments and Exchange Act.

34 See *supra* note 7 and accompanying texts.

achieve fair disclosure has to be broad enough to regulate not only the analysts but also the listed companies. The JSDA's self-regulation is too narrow in terms of the targets for achieving fair disclosure.

A good way to resolve this narrowness of its targets might be for the JSDA to cooperate with the TSE, which could regulate the listed companies. Generally speaking, such cooperation might be more difficult than one might expect. The cooperation of two or more self-regulatory organizations might make the consensus-building procedures required to decide on the content of the self-regulation more challenging. Without some official process, an effective self-regulation likely cannot be established. On the other hand, and as mentioned above, the necessity of public consensus-building procedures may lessen the benefits of self-regulation.³⁵

In terms of responsibility for enforcement, some agreement might be necessary. If multiple self-regulatory organizations are in charge of a certain self-regulation, the enforcement level may be excessive or too limited. Since violations of the self-regulation by members of one self-regulatory organization would impair the reputation of this organization relative to the others, the organization may engage in excessive enforcement. On the other hand, if multiple self-regulatory organizations are in charge of enforcement, certain organizations may free-ride on the enforcement of others because enforcement would entail costs. Self-regulation by multiple organizations may seem attractive, but it requires particular considerations to design a system that would work effectively.

V. CONCLUDING REMARKS

Legitimacy and limits of self-regulation represents a very important research topic. Self-regulation is deeply rooted in the Japanese regulatory structure. When the government tries to introduce a new regulation, the legitimacy and limits of self-regulation should be considered more seriously. In some cases, public regulation might prevent a new self-regulation from being established. In other cases, an effective self-regulation cannot be established without public assistance. Such public assistance is not necessarily an evil. However, we should be slightly more concerned about the reasons why the government facilitates self-regulation. It is my guess that there might be some cases where the government uses self-regulation to bypass legislative action, without any legitimate reason.

Tackling the legitimacy and limits of self-regulation means seeking the conditions under which an effective self-regulation can be established and well managed. Generally speaking, if the number of regulated parties is

35 See *supra* note 23 and accompanying texts.

small and they have common interests, self-regulation will work well. On the other hand, if the number of regulated parties is large and they do not have interests in common, it is difficult for self-regulation to be effective. In the latter case, a self-regulatory organization has to play an important role in the creation, review and enforcement of the self-regulation. On that topic, I think a historical and comparative analysis could be fruitful. Self-regulation has a long history, and each country has its own, distinctive self-regulation tradition.