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MITSURU MISAWA

As a publicly-held company, a bank is required to make timely and appropriate disclosures of corporate information to the public, including investors. In this article, the author studies what a Japanese bank is required to disclose in regard to its important management information including bad debts in terms of its timing and contents under the Japanese Commercial Law, Securities Exchange Law, Banking Law, and Financial Revitalization Law. After explaining comparable obligations under United States law, the author suggests changes to the Japanese policies.

It is important to better understand how Japanese banks operate and their required disclosure, if US banks are to compete with their Japanese counterparts, the second largest GDP country in the world. This advance knowledge is critical not only for US investors in Japanese banks but also for US institutional investors involved in transactions with Japanese banks.

The code of ethics of the Japanese Banking Association defines the importance of disclosure by its member banks as follows:

A bank, in consideration of its social responsibility and public mission, is required to obtain broad understanding and trust from the society, in particular, from its shareholders and investors.

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Fair disclosure of management information for being selected and judged by the market and users should contribute to not only the promotion of the society’s understanding of and trust on the bank but also to its own self-cleaning capability in order to achieve healthier management.

Such management information disclosures should be geared toward timely and appropriate provisions of various types of information required for rational judgments by shareholders, investor, and users.2

Generally speaking, it is not a desirable thing for a bank to disclose all corporate information. It is analogous to individuals disclosing their bookkeeping information, the amount of money they carry in their wallets or the amount of their pay check. However, if we consider that a bank is constantly involved in financial activities on a large scale, we can easily understand why those who are on the opposite side of those deals want such disclosures. It is also not difficult to understand that a bank wants to disclose positive information but negative information as well, because the latter will probably benefit the bank in the long run.

Persons on the other side of a bank transaction who want information about the bank include:

(1) the “government agency” who is to control the bank’s operation;
(2) the “auditor”3 of a company who is to monitor the bank’s operation;
(3) the shareholder4 (Incidentally, the shareholder wants such information not necessarily for its desire to participate in the management of the bank but rather for judging the optimum timing for trading the bank’s shares.); and
(4) the bank’s “transaction partner.”

The transaction partner wants information in order to decide whether to participate in a deal with the bank or what to do with a deal already in existence. Such information is important for the bank’s creditors and the bank’s customers (depositors).

However, it is not unusual for a bank to be unwilling to disclose information voluntarily or to want to disclose only beneficial information.
Various laws and regulations are set up to prevent banks from controlling information disclosure to their advantage, and those laws and regulations specify the types of information to be disclosed and who should receive them.

**STATUTORY REGULATION FOR DISCLOSURE IN JAPAN**

**Securities Exchange Law**

The Securities Exchange Law defines a disclosure system concerning securities exchange reports in order to provide investment judgment information to investors concerning the issuing market and the secondary market that constitute the securities market for the purpose of proper management of national economy and protection of investors.

Disclosure of corporate information that can result in insider trading is particularly important. Information disclosure becomes a critical issue particularly in a takeover bid ("TOB") and when a large amount of stocks is held by a shareholder. There are "TOBs by persons other than the issuer" and "TOBs for listed stocks by the issuing company." In the former instance, disclosed information becomes the basis of judgment for shareholders who are general investors if they deal in the particular stocks, i.e., whether they should sell the stocks in response to a TOB. Concerning TOBs, the Securities Exchange Law of Japan demands very strict accounting information disclosure for foreign companies as well, the same as in its source law, the US Securities Exchange Law.

**The Commercial Law**

The Commercial Law obligates corporations to submit various statements (operating statement, balance sheet, profit & loss statement, profit disposal plan, and schedules of financial statements) for reconciliation of interests among shareholders and creditors.

The Commercial Law, which governs all companies involved in commercial activities, also sets forth rules concerning information disclosure. It defines specifically the rules concerning: publication of items related to corporate registration, efficacies of registrations and publications, submission
of financial statements and schedules for financial statements to auditors, maintaining and publicly reporting financial statements, etc., and reporting, approving, and publicly reporting financial statements.

The corporate information disclosure system under the Commercial Law differs from the disclosure system under the Securities Exchange Law in the following ways:

1. A disclosure under the Commercial Law is aimed primarily at shareholders and creditors, but a disclosure under the Securities Exchange Law is aimed at the general public including those who are not the shareholders of the particular company.

2. A disclosure under the Commercial Law is aimed at primarily reporting dividend generating profits and the collateral capability of a corporation, while a disclosure under the Securities Exchange Law is aimed at providing information for making investment judgments, thus the disclosures are more detailed and cover a wider scope.

3. The protection of shareholders and creditors under the Commercial Law falls in the category of protection of private interests so that it is relying on an autonomous control under the private law, while the protection of investors under the Securities Law is based on a national objective aimed at proper management of the national economy through fair issuing and trading of securities.

Banking Law

Far more important to a bank, than the general regulations of the Commercial Law and the Securities Exchange Law, is the disclosure duty defined in the Banking Law. For a bank, which is engaged in a special business of handling another person’s asset, the contents of information to be disclosed and the method of disclosure are more specifically defined in this special law.

According to the Banking Law, a bank is obligated to generate an interim business report and a business report for each fiscal year and to submit them to the Financial Revitalization Committee. It mandates that balance
sheets and profit & loss statements must be publicly disclosed.\textsuperscript{20} It also obligates a bank to prepare explanatory documents concerning business and asset status for each fiscal year and display them in each branch office for inspection by the public.\textsuperscript{21} In addition, there is a rule that obligates a bank to submit reports and reference data to the Financial Revitalization Committee as required.

**Financial Revitalization Law**

According to the Financial Revitalization Law, a bank is obligated to strive to prevent occurrences of bad debts as well as to eliminate them actively through providing a sufficient amount of bad debt reserve, liquidating bad debts, and actively disclosing bad debts once they are generated.\textsuperscript{22}

As to the disclosure of bad debts, a bank must disclose risk-management loans, i.e., loans to bankrupt debtors, loans in default for three months or more, and loans with relaxed loan conditions. These loans are to be delineated by failure to make interest payments or a relaxing of loan conditions; this disclosure is required under the Banking Law.\textsuperscript{23}

The Financial Revitalization Law also requires a financial institution to disclose loans it owns classifying them according to the financial status and business record of each debtor, i.e., bankruptcy/rehabilitation loans and equivalent loans, dangerous loans, management-requiring loans, and normal loans.\textsuperscript{24} The definition of loan in this situation covers the entire scope of credits including not just loaned money but also debt guaranty.\textsuperscript{25}

**DUTY OF DISCLOSURE IN THE UNITED STATES**

**Statutory Laws**

Federal and state laws impose a duty on the officers and directors of corporations to disclose to current and potential investor all facts that are “material” to the corporation’s present and future financial health. The scope of “material” information is broad, and is generally regarded to be any information that a reasonable investor would consider important. Disclosure failures can lead to corporate liability, as well as the personal liability of officers
and directors. Regarding public companies, the primary laws are the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws require the disclosure of material information in connection with the registration, offering, and sale of securities, and the solicitation of proxies. They also require the reporting of financial conditions in annual 10-K, quarterly 10-Q, and other reports. This can include the reporting of not only past and current financial conditions, but also information that could have an effect on future financial conditions.

Unfortunately, the Securities Exchange Commission (“SEC”) has not yet offered specific advice regarding the scope of necessary disclosures for business entities such as banks whose activities are highly regulated by particular government agencies. These agencies have promulgated rules or guidelines. As an example, pursuant to notices issued by the Federal Financial Institutions Examination Council (“FFIEC”), banks may be subject to closer scrutiny if disclosure sufficiency questions arise. Other disclosure obligations to investors may arise owing to reporting duties imposed on accountants, auditors, and other professionals, or from contractual obligations to creditors or other parties.

The Sarbanes-Oxley Act was passed in 2002 after the run of corporate scandals. The intent was to bolster the governance of boards of directors at public companies and regulate the activities of the accounting profession. The act tightens auditing and accounting rules, primarily by requiring CEO and CFO certification of financial statements and the setup of independent audit committees. Although banks met many of Sarbanes-Oxley’s requirements through the Federal Deposit Insurance Improvement Act, the scrutiny is now greater. A ramping up of the disclosure effort is now required in order for banks to comply with the new rules that have come into play.

**Delaware’s Duty of Disclosure (Common Law)**

In general, Delaware recognizes that directors owe fiduciary duties to the corporation and its shareholders consisting of the duties of care, loyalty, and good faith. The duty of care requires directors to act on an informed basis and the duty of loyalty requires directors to serve the corporation and its shareholders to the exclusion of all other interests. The duty of good faith is
an overarching duty incorporating principles underlying the duties of care and loyalty.

Delaware law also recognizes that directors are subject to a fiduciary duty to disclose fully and fairly all material information within the directors’ control when it seeks shareholder action, such as in proxy solicitations or self-tender offers. In such cases, litigants need not establish reliance, causation, or actual monetary damages. Thus, in a traditional duty of disclosure case, Delaware courts focus on whether the allegedly misrepresented or omitted information is material to the shareholder action requested and whether it was communicated in a balanced and truthful manner. In this regard, Delaware courts have adopted the materiality standard articulated by the US Supreme Court with respect to the federal securities laws.

In one decision, the Delaware Supreme Court appeared to expand claims based on disclosure allegations beyond those permitted under the traditional duty of disclosure, although under very narrow circumstances. In the leading case, Malone v. Brincat, shareholders of Mercury Finance Company brought a class action alleging that Mercury’s directors made false and misleading public disclosures and filed reports with the SEC over a four-year period that grossly overstated the company’s earnings, financial performance, and shareholders’ equity. The complaint further alleged that Mercury’s announcement in late 1996 that the company would have to restate its earnings for the prior three years caused an almost total depreciation of the company’s $2 billion market value.

On appeal, the Delaware Supreme Court sitting en banc held that the complaint should have been dismissed without prejudice because the plaintiffs alleged that defendants damaged the corporation but failed to assert a proper derivative claim. The Court recognized that the traditional duty to disclose was not implicated because the directors were not seeking shareholder action. The Court explained that the disclosure duty is a “specific application” of the more general fiduciary duties of care, loyalty, and good faith that is implicated only when directors seek such action. In such cases, the Court noted directors are required to disclose all material information
within the directors’ control regarding the requested action. Therefore, liti-
gants need not establish reliance, causation, or actual monetary damage to
recover under the duty of disclosure. Rather, the central issue is whether the
disputed information is material to the shareholder action requested and
whether it is communicated in a balanced and truthful manner. In that
regard, the Court, quoting Zirn,39 confirmed that “a good faith erroneous
judgment as to the proper scope or context of required disclosure implicates
the duty of care rather than duty of loyalty.40

INTERNATIONAL STANDARD APPLICABLE TO THE
UNITED STATES AND JAPAN

Non-Financial Disclosure

In 1998, The International Organization of Securities Commissions
(“IOSCO”)41 endorsed the International Disclosure Standards for Cross-
Border Offerings and Initial Listings by Foreign Issuers for equity securities
(“IDS98”),42 which set forth non-financial statement disclosure standards for
offerings and listings of equity securities. These standards are very significant
for Japanese banks in regard to what disclosures are needed.

IOSCO recognizes that:

Reliable, timely and readily accessible information is fundamental for
investors. Information should be disclosed on a timely basis, whether in
connection with an initial public offering or listing, continuously, cur-
rently or periodically, and in a form or manner either prescribed by
accounting standards, regulations, listing rules or law, together with the
information that is provided by the management under the principles of
fair presentation.43

IOSCO supports international accounting standards44 and does not have
an accounting standard of its own. As an agency responsible for controlling
the securities business and markets, the SEC in the United States has never
had its own accounting standard either.45 The SEC explicitly states that it
relies on the Financial Accounting Standard Board (“FASB”) as to the
accounting standard. On the contrary, the Finance Ministry of Japan\(^6\) has jurisdictions over both the “establishment of the accounting standard” and the “control of the securities business and market.” It is a common practice in developed countries to have an independent institution for setting the “accounting standard” so that the standard is free from any political interventions. Japan is the only developed country in which the office responsible for controlling the securities business and markets is also responsible for establishing the accounting standard.

On May 17, 2000, IOSCO approved 40 items of core standards that the International Accounting Standards Committee (“IASC”) had requested IOSCO to approve concerning cross boarder financial reporting. IOSCO made clear that it would approve the International Accounting Standard as the accounting standard when a company acquires funds overseas. Once this is approved in each country, every company of every country will be able to acquire funds in all other countries using financial statements based on the International Accounting Standard.

IOSCO is developing a comparable set of international disclosure standards for cross-border offerings and initial listings of debt securities by foreign issuers that would be based on IDS98. The adoption of both sets of non-financial statement disclosure standards by jurisdictions would facilitate cross-border offerings because a foreign issuer could use one disclosure document that would be accepted in multiple jurisdictions. At the same time, adequate investor protection would be assured through the use of the high quality disclosure standards of the IDS98.\(^7\)

Because most investors participate in the market through secondary trading rather than initial public offerings, providing high quality information to the markets on a periodic basis is crucial, even if a company only infrequently makes public offerings.\(^8\) Most retail investors also participate in the securities markets through secondary trading rather than through initial offerings of securities. Material information should be updated and provided on an ongoing basis to the public, so those who participate through secondary trading, and who are most in need of regulatory protection, can benefit from this same type of disclosure on an ongoing basis.\(^9\)

IOSCO claims that:
The fundamental principle of full and fair disclosure is that the listed entity should provide all information that would be material to an investor’s investment decision. Such information also includes management’s discussion and analysis (“MD &A”), where required, which could be disclosed in a separate report or included as part of a periodic report.50

IOSCO also recognizes that competent authorities in different jurisdictions have used two basic approaches, as well as a combination of the two, in order to ensure appropriate disclosure of information by listed entities in view of the interest of investors: (1) a “general obligation” approach and (2) a “prescription approach.”51 IOSCO further states that in spite of the different approaches used, most jurisdictions agree that listed entities should have an ongoing obligation to disclose information that would be material to an investor’s investment decision and that is necessary for full and fair disclosure.52

According to IOSCO, regulators in the European Union employ the general obligation approach and require listed entities to disclose information under a general obligation of materiality comprising price sensitive information, without specifically describing the types of events that would be deemed material. Such information, if determined price sensitive or material, would have to be disclosed immediately by issuers without any further qualification.53 This approach includes information that is typically assessed against (1) the likely effect of the information on the price or value of the relevant equities, (2) the information expectations of a reasonable investor in the market, and (3) the information to be disclosed has not been made available to the public. Some jurisdictions have indicated events that typically can be considered material.54

The United States and Japan, according to IOSCO, employ the prescription approach. In this approach a set of rules specify the disclosures that issuers must provide to investors and the public, and that are presumptively material. The US SEC requires all public domestic companies to file annual and quarterly periodic reports that address certain specified disclosure items. In addition, all public domestic companies must file current reports on Form 8-K in the intervening period between periodic reports to disclose a specific, comprehensive list of events that are presumptively material. Such
disclosure must be made within a few business days after occurrence of the corporate event that must be disclosed. It has been proposed to substantially increase the list of events that are presumptively material.55

The US exchanges require disclosure of price sensitive information. The definition of materiality that is used by the SEC has been developed by the courts and is not delimited by the notion of the effect on the price of an issuer’s securities. Thus, while the listed entity is required by the United States, the SEC’s rules require the disclosure of specific information or events in a prescribed manner. If investors feel that the disclosure is inadequate or misleading they can take legal action against the issuer and the courts will determine the materiality of the disclosure or non-disclosure.56

Also Japan provides a list of corporate events that are presumed to be material and require compulsory disclosure.57 It is noteworthy that consolidated financial statements were not required in the past in Japan but are now required in addition to individual financial statements for corporations who own subsidiaries.58 In the Ministry of Justice Ordinance, a “subsidiary company” is defined as one in which 50 per cent or more if its stock is held by the parent company.59 The Securities Exchange Law of Japan requires that the financial statements of an “important subsidiary company” be included in the securities report of the parent company.60 The Ministry of Finance Ordinance definition of a “subsidiary company” is the same as that in the Ministry of Justice Ordinance, but an “important subsidiary” is defined as one whose assets or sales are large enough to have a great effect on the financial situation of the parent company.61 Because different information concerning a subsidiary is required by the two ministries, what information is to be disclosed will depend on which ordinance is followed.

Financial Disclosure

Although the business activities of corporations are becoming more international every year, the accounting systems of individual countries seem to remain very local, differing from country to country. Recently, a cry was heard for the need for an international standardization of the accounting system so that investors can understand and properly compare the performance of corporations of other countries when they seek financing overseas. As a
result of these concerns, international accounting standards are gradually taking shape.

The Norwalk Agreement was the result of a joint meeting between the US Financial Accounting Standards Boards ("FASB") and the International Accounting Standards Board ("IASB") in September 2002. The agreement sought convergence between the International Financial Reporting Standards ("IFRS") and US standards, and laid the foundation for further convergence of various international accounting standards. It was decided that the IFRS is to be adopted officially in 2005 as the financial reporting standard for corporations in the European Union whose stocks are traded in markets.

The European Union has asked non-EU entities operating in the European Union to disclose information based on the "IFRS or an equivalent standard" starting in 2005. As of now, more than 250 Japanese corporations and Japanese local governments have issued stocks and bonds in the European Union. Most of these Japanese corporations disclosed financial information using Japanese accounting standards.

During the years that followed the mid 1990s, many Japanese companies whose operations appeared healthy on financial statements started to fail one after the other, causing a general distrust in the Japanese accounting system. Facing such a situation, the Japanese corporate accounting system made an about-face starting to rehabilitate its standard, and is currently on its way to matching the International Accounting Standard. The recent revamping of the accounting rules in Japan is trying to eliminate the gap with the US accounting standard and the International Accounting Standard from the standpoint of providing an accounting standard that provides information useful for investors and creditors in decisionmaking, which is the basic principle of the global standard. The US accounting standard and the International Accounting Standard are considered the embodiments of the global standard in Japan and it is now regarded as an urgent and extremely important issue to make the corporate accounting system match the global standard.

Japan is now negotiating diligently with the European Union and is asking for its approval of the Japanese accounting standard as an equivalent to the IFRS. If the Japanese accounting standard fails to be recognized as an equivalent of the IFRS, disclosure by Japanese companies based on the
Japanese accounting standard currently in the European Union would not be allowed, severely affecting the financing activities of Japanese companies seeking to raise funds in the European Union. Japanese corporations also are concerned about the possibility that Japanese accounting standards could be branded as inferior to the European or US Accounting Standards, thus causing a general mistrust among investors in Japanese capital markets.67

There have been divergent opinions from the government and private sectors about the adoption of the IFRS in Japan and no consensus has yet been reached.

Opinions of the Government

Japanese corporations typically generate two sets of financial statements in accordance with the Commercial Law and the Securities Exchange Law. Corporations would be freed once and for all from the burden of preparing two financial statements if the International Accounting Standards (“IAS”) were adopted. However, both the Ministry of Justice, which has jurisdiction over the Commercial Law, and the Financial Services Agency (“FSA”),68 which has jurisdiction over the Securities Exchange Law, are objecting to the adoption of the IAS.

One of the reasons the FSA opposes the imposition of the IAS is that “it is not accepted as a practice even in the United States to apply the International Accounting Standards to both domestic and foreign corporations as fair and appropriate accounting standards.”69 However, the position of the FSA is inaccurate, because the SEC allows the use of foreign accounting standards including the IAS on the condition of reconciling these figures with US Generally Accepted Accounting Practices (“GAAP”).70 For example, Bayer AG,71 a German pharmaceutical company, filed its financial statements prepared in accordance with the IAS (Form 20-F) with the SEC in order to be listed on the New York Stock Exchange in January 2002.72 The same rule also has been applied to Russian and Chinese corporations. Rostelecom73 (a Russian company) was listed on the New York Stock Exchange on February 17, 1998. The American Depositary Shares of PetroChina74 (a Chinese company) was listed on the New York Stock Exchange on April 6, 2000. Both filed their financial statements in accordance with Form 20-F. The New York
Stock Exchange welcomes foreign corporations to be traded there and approves the use of the IAS. The flexible position of the New York Stock Exchange corresponds to the change of the SEC’s position on September 29, 1999, for new disclosure requirements for foreign companies that were allowed to use IAS.75

Opinions of Private Sectors

The Japanese Federation of Economic Organizations (also known as Keidanren in Japanese)76 is taking a negative position with regard to standardization at this point in time.77 On July 24, 2003, the IASB Chairman Sir David Tweedie visited the Keidanren and stated that:

The purpose of IASB is to establish a uniform high quality accounting standard that can be used in all markets of the world. Because people lost trust in accounting practices in various countries of the world through the experiences of unfortunate incidents exemplified by the Enron incident in the United States and the financial crises of Asian countries, there is a strong desire to establish an international uniform accounting standard. We dearly wish Japan's cooperation in this regard.78

The Keidanren responded to this plea by saying:

We have yet to see evidence that any evaluation has been made of the opinion we submitted to the IASB concerning the draft of the accounting standards and any reasons why our opinion was not adopted. Thus, we would like to see an improvement on the evaluation procedure. We believe that the IASB is too biased and we wish the IASB would conduct more discussions with more consideration of the realities of practical business matters.79

The Keidanren's comments are purposefully vague and unclear. This is a typical way that Japanese show hesitation in accepting another's position. The Keidanren's position is a “wait and see” position, and because the Keidanren's opinion is a collection of all companies who are members (1623
companies), this “wait and see” position is the current consensus of most Japanese companies.

**SELECTIVE DISCLOSURE OF CORPORATE INFORMATION IN THE UNITED STATES**

**Background**

In October 2001, the SEC implemented Regulation FD concerning selective disclosure.80 The rule was intended to prohibit US companies’ directors from selectively disclosing unpublished important information to analysts and institutional investors. In other words, if a company wishes to disclose unpublished information, the company cannot disclose it to selected people, but rather must disclose it broadly to the general public. If it has selectively disclosed unpublished important information by mistake, it must disclose the same information immediately to the general public. If a company fails to follow Regulation FD, the SEC is entitled to issue an elimination order or to file a civil suit seeking an injunction and payment of a fine.81

The SEC feels that corporate information is the lifeline of the market and fairness and equity must be maintained in providing information. Selective disclosure of information that can affect share prices results in profit gaining opportunities for certain people only. Such disclosure can damage investors’ trust in the market, and thus must be prohibited. On the other hand, there are concerns that restriction of information disclosure by legal punishment may force corporations to be too cautious about information disclosure and may result in a reduction of information available to the public,82 thus increasing volatility of stock prices.83

Regulation FD has not been introduced in Japan. However, Regulation FD does seem to be the right direction for further development of the market and it is hoped that there will be serious discussions among those involved and that improvements will be made in advancing fair and just information disclosures. Regulation FD in the United States is not applicable to offshore companies, but some of the Japanese companies, especially those that are listed on the US markets, are already reviewing their information disclosure practices as a result of the implementation of Regulation FD.
Although Regulation FD gives some examples as to what is “important information,” there is no exact definition of important information. Its scope may cover a much wider range than the important information defined in the Japanese Securities Exchange Law. Consequently, those Japanese companies are reviewing their disclosure practices on the assumption that information that falls into a gray zone between the assumed scope of Regulation FD and the important information defined in the Japanese Securities Exchange Law may be treated on the same basis.

**DIFFERENCE BETWEEN US AND JAPANESE INSIDER TRADING REGULATIONS**

In adopting a regulation in Japan similar to Regulation FD in the United States, the differences between the US and Japanese regulations concerning insider trading must be kept in mind. Even though it is punishable under the Japanese regulation if some people gain profits as a result of selective disclosure of information, it may be difficult to do so under US law.

In contrast to Japan, there is no statutory law that supports the insider trading regulation in the United States. Regulations and remedial actions have been accomplished under the common law developed under Section 10 of the Securities Exchange Law of 1934, which was originally intended to control market manipulations; this is on what SEC Rule 10b-5 is based. This US common law followed the concept that insiders of a company who trade securities using internal information are punishable under the Securities Exchange Law, if their acts constitute breach of their duties to the shareholders of the company that issued the securities. Although the scope of cases to which the violation of the Securities Exchange Law is applicable was expanded later to include cases in which the violators breached their fiduciary duties to those who are outside the company that issued the securities, violations that are punishable as insider trading are nonetheless still limited to cases in which the use of undisclosed information constitutes a breach of duty to certain people.

It has been considered that a person who trades securities based on information received from an insider can be accused of insider trading only when the insider's information constitutes a breach of the insider's fiduciary duty.
and the person receiving the information knew or was in a position to know about it. In such a situation, it was also considered that the judgment as to whether the insider was breaching the fiduciary duty should be based on an implied datum whether the insider gained any personal profits directly or indirectly.

Under such a common law, it was difficult to prove wrongdoing of a company in a situation when the company selectively discloses its performance information to analysts and the like in order to avoid erratic fluctuations of its stock price, resultantly allowing some people to obtain personal gains using such information. Thus it was difficult to regulate such a situation within the framework of the insider trading rule.

In Japan, however, detailed regulations exist concerning insider trading. The Securities Exchange Law, as well as related ordinances, formally define insider trading. Breach of fiduciary duty is not listed as a requirement for insider trading in Japan. Therefore, the insider trading regulation is applicable in Japan if a company provides guidance to certain analysts, as in the United States, this guidance corresponds to unpublished important information defined in Section 166-1 of the Securities Exchange Law, and the analyst or the corporation the analyst belongs to tried to trade the particular company’s stocks.

Moreover, unlike the US common law, the Japanese Securities Exchange Law and related ordinances (some have umbrella clauses) provide detailed definitions, including numerical standards as to what constitutes important information in each category of determined facts, occurred facts, and closing or estimated value concerning profits. This helps companies decide whether a piece of information is an important fact or not, and whether or not to disclose the information to certain people only, or to disclose it to the public.

Consequently, the problems associated with selective disclosures that have been noted in the United States can be avoided in Japan simply by following the disclosure laws and the insider trading regulations already in existence. This has delayed the introduction of Regulation FD in Japan, because it has not been seen as necessary.
The United States has requested that the financial statements of Japanese corporations written in English include a notation (legend), such as: This is prepared in accordance with the Japanese Securities Exchange Law and accounting standard, and not under the accounting standards of any other country. This request, of course, means that the Japanese accounting process is not completely trusted internationally. The problem does not lie with the corporations that are forced to write such statements but rather the problem is derivative of the antiquated accounting system of Japan. The parties who are negatively affected as a result of these unique accounting standards are the corporations who are not trusted and the investors (users of the financial statements) who are unable to obtain accurate financial information.

In the August 1995 annual report of the International Monetary Fund ("IMF"), Japan’s banking policy administration was accused of failing to take effective measures to revive the deteriorating banking system. It was further pointed out that “waiting would not recover the loss, but rather increase it,” and the report (the IMF) asked Japan to take speedy action to correct these problem banks. The report also stated that (1) market mechanisms that were supposed to help depositors and investors in selecting banks were not working because of insufficient disclosures of the operating information of the banks; and (2) it was necessary for stakeholders to demand establishment of a more clear-cut rule specifying how the necessary funds were to be secured for clearing the bad debts of the problematic banks, including public funds.

Another problem in this area concerns Japanese GAAP. The Commercial Code and the Securities Exchange Law are reliant on a comprehensive GAAP for proper implementation. The Japanese GAAP was incorporated in the “Corporate Accounting Principles” established in 1949 based on the Commercial Law of Japan. More specifically the “Corporate Accounting Principles” were generated as an interim report by the Corporate Accounting Rule Investigative Committee of the Economic Stabilization Agency in 1949 and the “Annotations to Corporate Accounting Principles” as an interim report by the Corporate Accounting Rule Council of the Ministry of Finance in 1950. A concept of the accounting philosophy as
shown in the Corporate Accounting Principles placed importance on the profit and loss calculation for a particular period, assuming that the particular period and the particular corporation was of on-going concern. According to its preamble, it states that

The Corporate Accounting Principles consist of the summary of practices recognized as generally fair and reasonable among those practices evolved within actual corporate accounting works and they represent the rules to be abided by corporations in processing their accountings without really having those practices evolved within actual corporate accounting works and they represent the rules to be abided by corporations in processing their accountings without really having to be regulated by the laws and regulations.

Consequently, in Japanese accounting, it is customary to honor traditional accounting practices. Therefore companies tend to mimic and follow whatever others are doing. This did not present any shortcomings when the economy was all but rosy in the years after World War II, but the same practice is causing problems in more recent years.100

The GAAP has a strong enforcement power in Japan. For example, an auditor has to issue a favorable opinion as long as the accounting is done in accordance to the GAAP. Therefore, it can be safely assumed, for the issue pointed out by IMF, that the root cause of the delay in determining the amounts of bad loans was due to the overly generalized philosophy contained within the “Corporate Accounting Principles.” If the US accounting standard was applied, a loan balance, after deducting reserves, would be specified in a “net realizable value.”101

The problem was that even the Finance Services Agency (“FSA”) of Japan was still honoring the existing GAAP. The FSA also provided administrative services for the Corporate Accounting Rule Council,102 which had prepared the accounting principles. It was in a position to improve the accounting principles once problems with the principles were identified. The biggest problem resulted from the fact that the administrative offices of the Japanese government did not necessarily realize the importance of a revised accounting standard.103
DIFFERENCES IN BANK DISCLOSURE PRACTICES BETWEEN THE UNITED STATES AND JAPAN — DAIWA BANK CASE

Officers and directors of Japanese companies are not fully realizing the importance of the disclosure requirements. The Daiwa Bank case is a good example of this. In 1995 it was discovered at Daiwa Bank’s New York Branch that one of its employees had been illegally trading US Treasury bonds for over 11 years without detection, resulting in an accumulated loss of $1.1 billion to the bank. This incident has since mushroomed into an international scandal, resulting in civil, criminal, and administrative liabilities in both the United States and Japan. There has never been an economic incident with such a tremendous international impact between Japan and the United States.

In 1995, certain stockholders brought suit in the District Court of Osaka claiming $1.1 billion (¥110 billion) in damages, caused by the loss at the New York Branch of Daiwa Bank, against 49 defendants, including the former chairman of the board, former officers, and the current president and officers of the bank. The Bank’s stockholders originally requested Daiwa Bank’s auditor to initiate an action against the management of the Bank within 30 days, but the auditor refused to do so. As a result, those stockholders decided to sue the Bank’s directors in accordance with the Commercial Code.

Despite the fact that Daiwa Bank learned of a huge loss due to unauthorized dealings, it issued 50 million shares of preferred stock on July 27, 1995. This act deceived shareholders, thus the directors could be indicted criminally and civilly under the Japanese Securities Exchange Law. There were no claims by the shareholders’ derivative action as to this point in Japan. Although they knew about the huge loss mentioned previously, the management of Daiwa Bank delayed disclosure of that information to the Federal Reserve Board (“FRB”) for a substantial period. The FRB thought that this delay was a serious violation of the reporting rule under the International Banking Act. In addition, Daiwa Bank may have been required to disclose this important information (which logically would influence the securities market) to stockholders as well as to the general public. Although this is not
US AND JAPANESE BANK DIRECTORS’ DUTY OF DISCLOSURE

the direct concern of the FRB, if the management of Daiwa Bank felt it had a responsibility to its stockholders to disclose, it should have reported such information to the United States and Japanese authorities at the appropriate time. From this standpoint, whether the bank and its directors were obligated to disclose such information to the stockholders is strongly related to the reporting duty to the FRB. The Bank and its directors may have been responsible for the disclosure of important information under the Securities and Exchange Law of Japan as Daiwa Bank’s stock was traded on Japan’s stock market.114

What is notable here is that Daiwa Bank asked a third party to purchase its stock without disclosing the concealed losses, thus damaging this third party. Daiwa Bank issued 50 million shares of preferred stock on July 27, 1995. Asahi Mutual Life Insurance Co. (“Asahi Seimei”), a major life insurance company in Japan,115 bought a large sum of Daiwa Banks common stocks shortly before the incident was disclosed.116 Asahi Seimei commented later that “the stock purchase was made on the request of Daiwa and it was regretful that the loss disclosure was not made.”117

The facts of this case reveal that a “director of Daiwa Bank urged Asahi Seimei to buy Daiwa Bank’s stock from the open market without disclosing an important piece of information regarding Daiwa Bank that might affect the market negatively.”118 Asahi Seimei already owned 2.7 million shares of Daiwa Bank stock at that point.119 Asahi Seimei decided, however, that additional shares would be helpful to enhance its business in the Kansai District, where Daiwa Bank had its head office, and thus, bought a total of 5 million shares in six installments between late August and late September 1995, immediately before the disclosure of this incident.120 During this period, Daiwa Bank shares traded at slightly over 800 yen per share; the price subsequently dropped to about 600 yen per share, causing the insurance company to incur an unrealized loss of ¥650 million (about $6.5 million).121

The question to be examined is whether Daiwa Bank had a duty to disclose this important information to stockholders, including Asahi Seimei, according to the Securities and Exchange Law of Japan. When a director discloses an important piece of information about a company, he or she may either disclose it or make the company disclose it. In either case, the director must always choose between the following duties: (1) the duty owed to...
stockholders to disclose the information as soon as possible; and (2) the duty owed to the company not to disclose any information without first investigating thoroughly the accuracy of the information. In some cases, this choice can be an extremely difficult one. Even though the director did not sell the stock he himself owned to Asahi Seimei, Asahi Seimei would not have purchased Daiwa Bank stock if it had known of the negative information. Therefore, as far as the director’s duty of disclosure is concerned, it is reasonable to assume that the case is similar to the director’s selling of his own stock to another stockholder without disclosing the negative information. Daiwa Bank’s transaction with Asahi Seimei illustrates the difference in director’s duties under United States and Japanese laws.

**DAIWA BANK — US DISCLOSURE**

For liability to occur under the common law disclosure duty in the United States: (1) a party involved in a business transaction must intentionally prevent another party from obtaining an important piece of information by concealment or otherwise; or (2) a party must owe to another party a duty “to exercise reasonable care to disclose matters known to him that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.” Otherwise, it cannot be sued for fraud based on its failure to disclose information. As to the fiduciary, however, the party has not only an “affirmative duty of utmost good faith, and full and fair disclosure of all material facts,” but also an affirmative duty to “employ reasonable care to avoid misleading his clients.”

Under US case law, it has been discussed extensively whether a fiduciary relationship exists between a director and a stockholder. It is clear that such a fiduciary relationship does exist between a director and a company if a director buys the company’s stock from a stockholder and takes advantage of knowledge of internal information of the company. Similarly, there exists the question of whether or not Daiwa Bank had a disclosure duty with regard to Asahi Seimei, a stockholder, in urging Asahi Seimei to buy shares from the market.

The “majority” rule is that, “officers and directors do not have active liabilities for disclosure responsibilities unless misstatement, unclear representa-
tion, or intentional concealment was made either verbally or by actions. However, because they have fiduciary obligations to the company and the stockholders with regard to trading with the company and for the company, they have the disclosure duties.\textsuperscript{125} According to this rule, it is fair to conclude that the directors of Daiwa Bank had a disclosure duty in the Asahi Seimei case.

The “minority” rule states that “the insider (officers, directors, and majority shareholders owning more than 10 percent of the stocks) of a company is construed to have a fiduciary relation with a stockholder in a stock trading so that the former has to make a complete disclosure on all important matters.”\textsuperscript{126} Based on this, there is no question that a disclosure duty existed for those Daiwa Bank directors in the Asahi Seimei case.\textsuperscript{127}

Against this backdrop of US common law, the securities laws\textsuperscript{128} contain several prohibitive rules against fraudulent activities;\textsuperscript{129} in particular, they deem “insider’s” use of insider information in trading securities as illegal. Specifically, Section 10(b) of the Securities Exchange Act of 1934 obligates certain insiders, namely officers, directors, and major stockholders, to pay the company any profit they earn because of insider information within the past six months. Whether such an action is to be construed as “insider trading” is judged according to Rule 10b-5, a derivative rule of Section 10(b).

It is difficult to believe that the insiders of Daiwa Bank did not trade Daiwa stock at all while important information was being withheld. If there were any such trading, Rule 10b-5 should be applied. The directors of Daiwa Bank had the choice “either to disclose the important information or to abstain from trading.” It would have been the same choice when asking Asahi Seimei to buy Daiwa Bank’s stock from the market. The Daiwa Bank director had the choice “either to disclose or not to ask for such a trade.”

In the United States, the disclosure duty under Rule 10b-5 is not limited to deals between an insider and a stockholder; it also imposes a duty on insiders to urge the company to disclose fully any important information that might influence the evaluation of the stock on the market. Although the responsibility of disclosure falls to the company, the company’s response is generally slow and hindered by its own self interest. Thus, the responsibility of disclosing to the general public seems to fall on the insiders themselves. There is no question that insiders will be charged with violations of 10b-5 for distributing false information through reports, newspaper releases, com-
ments by directors, or any other methods, even if they were not involved in any trading. The question, however, is whether or not they will be convicted of violating Rule 10b-5 when they fail to announce an important piece of information that most likely will affect the market price. There is no Supreme Court case that deals with this particular issue. Both the SEC and the US courts consider it appropriate to temporarily withhold an important piece of information from the market if there is a sufficient business reason to do so. During the period the information is withheld, neither the issuer nor the insiders may conduct trading. If this concept is applied to the Asahi Seimei situation, Daiwa Bank’s (or its directors’) request that the third party purchase the Bank’s stock is equivalent to doing the trading itself, and thus, a court is likely to find that it was not possible to conduct such trading legally while withholding such information.

Accordingly, leading stock exchanges in the United States request listed companies to “quickly disclose any news or information that is reasonably expected to provide a serious effect on the securities market,” and to “take actions to deny quickly any groundless rumors that otherwise might cause abnormal market reactions or price fluctuations.”

Taking these rules and regulations in the United States as the premise, the Asahi Seimei case, in which a director of Daiwa Bank asked and actually made the third party buy the Bank’s shares, though acquired in the stock market, can be considered a violation of the law in the United States because of its similarity to the situation in which an insider would be involved in the transaction. In this case, the insider was obligated to disclose the important information known to him because of his position, but unknown to the other party, which would have affected the other party’s investment judgment. In such a case, a clash is inevitable between the Rule 10b-5 duty of a director to disclose important information as soon as possible and the duty of a director under the common law not to disclose information prematurely. If disclosure prior to the buying or selling is inappropriate or unrealistic, then the only choice left is to give up trading. Moreover, if it is proved that the director not only failed to disclose such important information, but also intentionally concealed it, there is a possibility that he would be accused of violating both the general fraud prohibition provision, Section 9(a)(4), which prohibits market manipulation, and Rule 10b-5.
The Daiwa Bank case, however, is entirely different under Japanese law. Under Japanese law it is difficult to establish a complaint against Daiwa Bank and its directors as to the non-disclosure of the important information. Although disclosing fraudulent information is an offense under Japanese law, failure to disclose information that would affect the stock price is not.

Japanese law prohibits insider trading, as does Rule 10b-5 of the US Securities Exchange Act of 1934. However, if an insider owns the stock of his own company under a third party name or a fictitious person, voluntary reporting will probably be meaningless. In addition to the fact that it is practically impossible to detect the violation, the stipulation that the director who benefited from the insider trading must return the resulting profit to the company makes it difficult to expect any significant effects, given the social custom of Japan, unless there is an internal power struggle within management. Consequently, this Japanese insider-trading rule is seldom activated.

As a result, the question of whether a director of a company has a duty to inform the other party about inside information when trading his or her own company stocks generally has been met with a negative answer. In fact, except in a clear case of fraud, the contract will not be negated. A director will not be obligated to indemnify the other party just because the director failed to disclose a piece of inside information about the company that the director came to know in the course of his or her work, unless the other party asked the director to disclose such information. Moreover, a director will not be held legally accountable for his or her company’s nonfeasance in failing to disclose important information, even if it was information that could be reasonably expected to have a substantial influence on the securities market according to this rule. Therefore it is impossible to label the responsibility of any particular director for non-disclosure of the information in the Asahi Seimei case as a violation of Section 189 of the Securities and Exchange Law of Japan, which corresponds to Rule 10b-5 of the US Securities Exchange Act of 1934.

Even in Japan, however, the situation would be different if a person is actively involved in concealing information, in addition to delaying its disclosure. Although it is difficult to seek punishment based on violation of the
Insider Trading Prohibition (Article 189 of the Securities and Exchange Law of Japan), as those cases in the United States are not established in Japan, such action can probably be prosecuted as an illegal transaction that violates the general fraud rule.\(^\text{136}\)

One must conclude that it is difficult to hold a director in Japan legally accountable in these cases, unless the failure to disclose important information is accompanied with some fraudulent action such as concealment. While numerous investors, in addition to Asahi Seimei, must have bought Daiwa Bank’s stock prior to the disclosure of the incident and incurred damage due to the price drop of the stocks,\(^\text{137}\) there is no legal remedy based on the Securities and Exchange Law of Japan.\(^\text{138}\) The only way to obtain a remedy is to bring a derivative suit under the Commercial Code, charging a violation of the directors’ duty of loyalty to the company. In regard to Asahi Seimei’s purchase of the stocks, the Ministry of Finance commented on the issuing of preferred stocks in Japan by Daiwa Bank immediately before the incident was disclosed, saying, “There is no specific procedural problem in regard to the Securities and Exchange Law.”\(^\text{139}\)

**CONCLUSION**

After World War II, Japan enacted the Securities Exchange Law (based on two American statutes: (1) the Securities Act of 1933 and (2) the Securities Exchange Act of 1934), which called for detailed disclosure to insure the protection of investors. However, the disclosure requirements in Japan have a few material defects when compared to its American counterparts. For instance, the Japanese law does not require the preparation of quarterly consolidated financial statements; something very customary in the United States. This difference is vital because a consistent internationally-oriented government policy toward investment and securities regulation is an indispensable prerequisite to the internationalization of the Tokyo market.

Every corporation, including banks, listed on the securities exchange must disclose its business contents accurately. It is a basic requirement if corporations and stock markets are to be trusted. Generally Japanese companies and banks have not felt a need to immediately disclose important information, until now. It is important for Japanese companies and banks to observe
the disclosure principle more stringently and to disclose pertinent operating information to stakeholders, such as stockholders and corporate customers, earlier, more quickly, more frequently, and more thoroughly, rather than reporting it privately to authorities such as the Ministry of Finance. The more thoroughly Japanese companies and banks conduct disclosure, the higher their market evaluations will be. By assuming full and strict responsibility of management and supervision, they will be able to regain the trust of the international securities market.

To maintain a trustworthy Japanese disclosure system, and to build a financial market that can be respected by the rest of the world, it is first mandatory to solve the basic problems underlying the system, such as the accounting standards. The economic recovery of Japan will foster the economic recovery of the world. For Tokyo to be a real world market, it is necessary to build a more efficient disclosure system and support the overall restructuring of socio-economic systems in Japan.

While a reformation of the financial system is currently under way in Japan, it is essential to promote a “new financial flow” and to normalize the risk of distribution as well as to improve efficiency in the economic society as a whole in order to seek further development. As a premise to this, a renewal of financial services to support such a reform is indispensable. The strengthening of the disclosure system, especially the accounting standards, is most essential. Such a refurbishment of the system will enable users of Japanese financial services around the world to select combinations of risks and returns with more peace of mind.

A series of actions taken in the United States, triggered by the Enron incident, starting with the “Sarbanes-Oxley Act” of July 2002, strongly suggested to the world that enhancement of accounting, disclosure, and auditing as well as corporate governance are keys to the vitalization of the economic society. Efforts by governments of various countries, the IOSCO, and others toward “standardization” are accelerating. With Japan’s economic activities becoming more international and versatile, its standard environment cannot be isolated from the “international trend.” The government must get more involved in reshaping and improving the system from the standpoint of “international harmonization.”

As each country has its own history, value system, and political system,
so each country’s corporate accounting is uniquely its own. However, due to economic globalization, business environments are starting to homogenize across borders. Therefore, it is important to adapt the corporate accounting system in Japan to the global economy, not only for financial and capital market reform, but also for supporting international activities of Japanese companies and banks. The more global the company’s activities are, the more important it will be for the company to compete under the same international rules. If Japan as a nation fails to follow the global standard, it will be more difficult for Japanese companies and banks to finance overseas and the Japanese economy will eventually lose its vitality.

NOTES

3 Refer to Commercial Law, Article 273 ff.
4 Id., Article 230-10 ff.
7 Id., Article 27-2 ff.
8 Id., Article 27-23.
9 Id., Article 27-2 to 27-22.
12 Commercial Law, Articles 11 and 188.
13 Commercial Law, Article 12.
14 Commercial Law, Article 12.
15 Commercial Law Article 281-2.
16 Commercial Law, Article 282.
17 Commercial Law, Article 283.
19 Banking Law, Article 19. For the homepage of FRC, see http://www.fsa.go.jp/frc/ (last visited July 8, 2005).
20 Id., Article 20.
21 Id., Article 21.
23 Enforcement Regulation of Banking Law, Article 19-2, For the Banking Law Ordinance (March 31,1982, MOF No.10), see http://law.e-gov.go.jp/cgi-bin/idxsearch.cgi (last visited July 8, 2005).
25 Id., Article 4.
26 15 U.S.C. §§ 77a–77mm (1934), as amended, 15 U.S.C. §§ 77a–77mm (1970), and 15 U.S.C. §§ 78a–78jj (1934), as amended, 15 U.S.C. §§ 78a–78hh (1). The Act of 1933 was intended to achieve “truth in securities” related to the public offerings in the issuing market, while the Act of 1934 intends mainly to control activities of brokers and dealers as well as the securities market where they operate; at the same time, it established a disclosure system (Securities Report System) that obligates them to disclose pertinent information continuously.
27 F must be filed within 90 days after the close of the registrant’s fiscal year by registrants who do not meet the definition of an accelerated filer. For the details, see SEC home page, http://www.sec.gov/ (last visited July 8, 2005).
28 Form 10-Q shall be used for quarterly reports under Section 13 or 15(d) of the Securities Exchange Act of 1934. For the details, see SEC home page, http://www.sec.gov/ (last visited July 8, 2005).
29 The Council is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System and to make recommendations to promote uniformity in the supervision of financial institutions. For the details of the Council, see http://www.ffiec.gov/ (last visited July 8, 2005).
30 It is said that the Sarbanes-Oxley Act, passed in response to major corporate accounting scandals such as Enron and Tyco, is the most sweeping regulatory reform of publicly traded markets since the 1930s. For details, see The Sarbanes-Oxley Act Community Forum, http://www.sarbanes-oxley-forum.com/.
41 The International Organization of Securities Commissions (IOSCO) was born in 1983 from the transformation of its ancestor inter-American regional association (created in 1974) into a truly international cooperative body. Now IOSCO’s membership stands at 181 members and it is still growing rapidly. The SEC of the United States and the MOF of Japan are also the active members. The Organization’s members regulate more than 90 percent of the world’s securities markets and IOSCO is today the world’s most important international cooperative forum for securities regulatory agencies. Among the recent key achievements of IOSCO is the adoption in 1998 of a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles) recognized today by the world financial community as international benchmarks for all markets. For the details of IOSCO, http://www.iosco.org/about/see.
42 For the details of IDS98, see http://www.iosco.org/pubdocs/pdf/IOSCOPD132.pdf.
43 Id., p.2.
44 This is a collective name for accounting standards established by the International Accounting Standards Board (IASB) with the purpose of being approved and observed internationally. International Accounting Standards (IAS) were issued by the International Accounting Standards Committee (IASC) from 1973 to 2000. The IASB replaced the IASC in 2001. Since then, the IASB has amended some IAS, has proposed to amend other IAS, has proposed to replace some IAS with new International Financial Reporting Standards (IFRS), and has adopted or proposed certain new IFRS on topics for which there were no previous IAS. See generally the Web site of the IASB at http://www.iasb.org (last visited July 8, 2005).
46 The Ministry of Finance was reorganized on January 6, 2001. The name was changed from “Okurasho” to “Zaimucho” in Japanese, but the English name still remains the same. For more information about the reorganization, see the Ministry’s Web site at http://www.mof.go.jp (last visited July 8, 2005).

47 Id.

48 Id.

49 Id.

50 Id.

51 Id. at p.3.

52 Id.

53 Id.

54 Id.

55 Id. at p.7.

56 Id.

57 Id. at p.10.

58 Ministry of Justice Ordinance, no.22, (May 29, 2002). For the details, see http://www.moj.go.jp/PUBLIC/MINJI29/refer01.html.

59 Ministry of Justice Ordinance of note 55, Art. 9.

60 Securities Exchange Law, Arts. 23, 24. See Ministry of Finance Regulation of June 1, 1972, Concerning Registration of Offers and Sales of Securities No. 32, Art. 15.

61 Ministry of Finance Ordinance, No. 32, (June 1, 1971), Art 15.


63 In June 1973, the International Accounting Standards Committee was established through the joint efforts of 10 countries, including the United States, Japan, England, France, and Germany. This committee was reorganized as the IASB in April 2001.

64 This is a collective name for accounting standards established by the International Accounting Standards Board (“IASB”) with the purpose of being approved and observed internationally. International Accounting Standards (“IAS”) were issued by the International Accounting Standards Committee (“IASC”) from 1973 to 2000. The IASB replaced the IASC in 2001. Since then, the IASB has amended some IAS, has proposed to amend other IAS, has proposed to replace some IAS with new International Financial Reporting Standards (IFRS), and has adopted or proposed certain new IFRS on topics for which there was no previous IAS. See generally the

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65 In October 2002, SEC Chairman Harvey C. Pitt applauded the decisions by the FASB and the IASB to work together toward greater convergence between US Generally Accepted Accounting Principles and international accounting standards. He said, “This is a positive step for investors in the United States and around the world. It means that reducing the differences in two widely used sets of accounting standards will receive consideration by both boards, as they work to improve accounting principles and address issues in financial reporting.” See U.S. Securities and Exchange Commission, Press Release, Actions by FASB, IASB Praised (Oct. 29 2002) at http://www.sec.gov/news/press/2002-154.htm (last visited July 8, 2005).


68 See FSA Web site, infra.


72 See U.S. Securities and Exchange Commission, Press Release, SEC Adopts New Disclosure Requirements for Foreign Companies, available at http://www.sec.gov/ news/press/pressarchive/ 1999/99-125.txt (Sep. 29, 1999) [hereinafter SEC Press Release]. The SEC adopted new disclosure requirements for foreign companies in 1999. The rule changes brought SEC disclosure requirements for foreign companies closer to the international standards endorsed in 1998 by the International Organization of Securities Commissions, the global association of securities regulators. This reduced the barriers foreign companies face when raising capital or listing their securities in more than one country. The rule changes incorporated these standards into Form 20-F, the basic disclosure form for foreign private issuers. The new
requirements became effective, September 30, 2000.


75 See SEC Press Release, supra.

76 The Japanese Federation of Economic Organizations is a general economic organization consisting of 1,623 companies and other organizations, which include 91 companies with foreign capital affiliations and 1,306 major representative Japanese companies. It is the strongest interest group in Japan that applies pressure on the government as well as overseas organizations by collecting opinions from all corners of business communities on any important issues of business communities ranging from economic and industrial issues to labor issues urging speedy solutions. See the Federation’s Web site at http://www.keidanren.or.jp/Japanese/profile/pro001.htm (last visited July 8, 2005).


79 Id.

80 The US SEC made the following statement as a reason for establishing Regulation FD: “SEC had had a concern over the rising number of cases where important corporate information is disclosed only selectively. In various cases reported, companies chose to provide important information such as future profit estimates to be disclosed the to selected securities analyst and/or institutional investors in private meetings and conference calls shutting out the general public and mass media people. Those who received the selectively disclosed information will be in unfairly advantageous positions compared to those who will receive the information when the securities issuers make official announcements….Selective disclosure damages the investors' trusts on our market and can cause serious conflict of interest among securities analysts.” SEC Proposed Rule: Selective Disclosure and Insider Trading (57-31-99) dated December 15, 1999. See http://www.sec.gov/rules/proposed/34-42259.htm (last visited July 8, 2005).

81 Id.

82 The Securities Industry Association (SIA) stated in its letter to the SEC dated June 13, 2000 that, while it agrees that company officers’ ill-intended selective disclosure of information to specific analysts and investors must be avoided by all
means, the proposed rule will not be proper for achieving its goal but rather may prevent the flow of information to the market on the contrary. Although it admits that there is a need for some rule concerning selective disclosure, the letter suggests that there could have been a better approach if a review for further refining the means of preventing fraudulent acts had been made based on the past court cases of fraudulent acts. See the letter of Stuart J. Kaswell, SVP, SIA to Arthur Levitt, Chairman, SEC, on June 13, 2000, http://www.sia.com/2000_comment_letters/.

83 Henry M. Paulson, the chairman of board of Goldman Sachs, made a negative evaluation of the rule that “FD’s motive was good but, but it ended up increasing the market’s volatility in the actuality.” See Alan McNee, ERisk, “End of the Line for Fair Disclosure?,” on Tuesday, April 17, 2001, http://www.erisk.com/ResourceCenter/Regulation/EndoftheLineforFairDiscl.asp.

85 Security Exchange Law, Arts 166-1, 166-2, 166-3.
92 The following is an example of a legend:

Summary of Significant Accounting Policies. Basis of presentation, Nissan Motor Co., Ltd. (the Company) and its domestic subsidiaries maintain their books of account in conformity with the financial accounting standards of Japan, and its foreign subsidiaries maintain their books of account in conformity with those of the countries of their domicile. The accompanying consolidated financial statements have been prepared in accordance with accounting principles and practices generally accepted in Japan and are compiled from the consolidated financial statements filed with the Minister of Finance as required by the Securities Exchange Law of Japan. Accordingly, the accompanying consolidated financial statements are not intended to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

For details, see Nissan, Annual Report, at http://www.nissan.com (last visited July 8, 2005). The legends of cautionary statements can only be found in the English version of financial statements based on the Japanese Securities Exchange Law, not in any financial statements of SEC registered companies prepared based on the US


95 See Nihon Keizai Shinbun [Japanese Disclosures not Showing Real Pictures], Nikkei, Jan. 25. 1995 (discussing a way to solve the bad debts, referring also to the IMF’s report.)


97 It was established in the government as a control organ to restore the Japanese economy after World War II in 1946 and was abolished in 1952 because it had accomplished its goals. See http://www.nira.go.jp/pubj/seiken/v08n07.html (last visited July 8, 2005).

98 The principle role was to refurbish the financial accounting standards of Japan. This function has been switched to the Accounting Standards Board of Japan (ASBJ). The ASBJ was established in April 2004 as a subordinate organization of the Financial Accounting Standards Committee of Japan (FASCJ). The FASCJ was established on July 26, 2001 as a private sector organization that plays a principal role in refurbishing the financial accounting standards. For background information, see http://www.asb.or.jp/j_fasf/message.html (last visited July 8, 2005).

99 The Ministry of Finance was reorganized on January 6, 2001. The name was changed from Okurasho to Zaimucho in Japanese, but the English name still remains the same. See the Ministry of Finance Internet site for more information at http://www.mof.go.jp (last visited July 8, 2005).

100 For example, Keidanren admitted that the Japanese accounting system needs to be changed. See the discussion memo of their general meeting held on May 25, 2000, available at http://www.keidanren.or.jp/japanese/profile/soukai/063/01-houkoku/kaigo.html (last visited July 8, 2005).

101 “Net Realizable Value” is a method of determining the present value of a troubled asset to its present owner based on the assumption that the asset will be held for a
period of time and sold at some future date. The present value includes future earnings that the asset is expected to generate, less the cost of owning, holding, developing, and operating the asset. To compensate for these costs, the asset's projected future net cash flows are discounted using a formula that incorporates the cost of capital (the cost of paying dividends and interest). Net realizable value, therefore, is based on a formula incorporating what the asset must earn in order to pay for its share of the costs of running the business. Net realizable value is one accounting method used to calculate the present value of an asset (a loan) at some point after the loan has become past due and a book value is no longer valid. The synonym is "fair value." For the discussion of "fair value" measurements by FASB, see [URL: http://www.fasb.org/project/fv_measurement.shtml].

102 The Financial Services Agency ("FSA") was created as of July 1, 1997, with the integration of the Banking Supervisory Agency and the Financial System Planning Bureau of the Ministry of Finance. The new FSA has integral responsibility over the planning of the financial system and the supervision and inspection of financial institutions. In view of the rapid changes in the environment surrounding the economy and financial markets, the planning focused on building a stable and vigorous financial system, and securing efficiency and fairness in the financial markets. In the supervision and inspection of financial institutions, further efforts to maintain and improve the soundness of financial institutions were made. Coordination with foreign financial authorities was strengthened in order to cope adequately with the globalization of finance. For details on the FSA, see its Web site at http://www.fsa.go.jp (last visited July 8, 2005).

103 See Nikkei, September 21, 2002, at 3 (Prime Minister Koizumi frequently conferred with the Minister of the FSA, Yanagisawa, in order to push his pet reform project forward—the clean up of the "bad loan problem." The FSA resisted the change claiming that they "cannot issue policies that contradict with the traditional financial administration policies and accounting principles," which clearly shows FSA's poor understanding of the bad loan problem.).

104 In 1995 Daiwa Bank was the 17th largest bank in the world with about $318 billion in assets and more than 9,000 employees. The corporation stock was listed on the Tokyo Stock Exchange. Established in 1918 its main office was located at 2-1 Bingo-Machi, 2-Chome, Chuo-ku, Osaka-shi, Osaka, Japan. Tokyo Keizai Japan Company Handbook 1100 (1996).


106 For details of the concealment by Daiwa Bank, see Yoshiyuki Watanabe, "Daiwa
108 The case was brought by two individual stockholders and one corporation stockholder.
109 “Stockholders Representative Action to be Filed Tomorrow Asking 1.1 Billion Dollars in Damages,” Nihon Keizai Shinbun, art. 30 (November 26, 1995).
110 Commercial Law, Arts. 267, 275–274.
111 In September 2000, a decision was handed down by a Japanese court in this shareholder’s representative action that ordered the defendants, 12 directors of Daiwa Bank, to pay bank damages totaling $775 million (approximately 82.9 billion yen). These damages ranged from $530 million (approximately 56.7 billion yen) to $70 million (approximately 7.5 billion yen) per person. The international society was greatly shocked by the size of such penalties. However the disclosure issue was not a count of this suit. See Osaka District Court, September 20, 2000. Civil Sec. No. 10, Shojihomu, Oct. 5, 2000, pp. 4–51.
112 A wide range of international observers desire a more stringent disclosure requirement for Japanese banks. For example, Kevin Mellyrin, a consultant, and Arthur M. Mitchell, a lawyer, claimed that “[I]f Japan wants to develop world-class financial institutions that are necessary to secure its position in the world economy, it is necessary for Japan to ask for a more thorough and consistent disclosure practice from its bank.” “Self-Renovation of Japanese Banks Desired Urgently,” Nihon Keizai Shinbun, December 4, 1995 at 23.
113 See Sections 7(3) and 10(b) of the International Banking Act, added in 1991 as amended.
The Board may order a foreign bank to terminate the activities of such branch, agency, or subsidiary, if the Board finds that —
A the foreign bank is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country; or
B (1) there is reasonable cause to believe that such a foreign bank or any affiliate of such foreign bank, has committed a violation of law or engaged in an unsafe or unsound banking practice in the United States; and as a result of such violation or practice, the continued operation of the foreign bank’s branch, agency, or commercial lending company subsidiary in the United States would not be
consistent with the public interest or with the purpose of this Act, the Bank Holding Company Act of 1956 or the Federal Deposit Insurance Act.


And in case of termination of a Federal branch of agency:

The Board may transmit to the Comptroller of the Currency a recommendation that the license of any Federal branch or Federal agency of a foreign bank be terminated in accordance with section 4(1)[12 U.S.C. § 3102(2)] if the Board has reasonable cause to believe that such foreign bank or any affiliate of such foreign bank has engaged in conduct for which the activities of any State branch or agency may be terminated.

Also, see FRB Rule on Reports of Crimes and Suspected Crimes.

12 C.F.R. § 208.20 (1996) provides:

A state member bank shall file a criminal referral report…in every situation where the State member bank suspects one of its directors, officers, employees, agents, or other institution-affiliated parties of having committed or aided in the commission of a crime… A state member bank shall file the report…no later than 30 calendar days after the date of detection of the loss or the known or suspected criminal violation or activity. If no suspect has been identified within 30 calendar days after the date of detection of the loss, or the known, attempted, or suspected criminal violation or activity, reporting may be delayed an additional 30 calendar days or until a suspect has been identified; but in no case shall reporting of known or suspected crimes be delayed more than 60 calendar days after the date of detection of the loss or known, attempted, or suspected criminal violation or activity. When a report requirement is triggered by the identification of a suspect or group of suspects, the reporting period commences with the identification of each suspect or group of suspects.

Any foreign bank or any office or subsidiary of a foreign bank, that —

A fails to make, submit, or publish such reports or information as may be required under this Act or under regulations prescribed by the Board or the Comptroller of the Currency pursuant to this Act, within the time period specified by such agency; or

B submits or publishes any false or misleading report or information… shall be subject to a penalty of not more than $20,000 for each day during which such failure continues or such false or misleading information is not corrected.

12 U.S.C. § 3110(c) (1994) provides:

Whoever, with the intent to deceive, to gain financially, or to cause financial gain or loss to any person, knowingly violates any provision of this Act or any
regulation or order issued by the appropriate Federal banking agency under this Act shall be imprisoned not more than 5 years or fined not more than $1,000,000 for each day during which a violation continues, or both.

114 If Daiwa Banks stocks were traded on the US market or if Daiwa Bank had been issuing its securities in the United States, so that there were stockholders in the United States, then the US Securities Acts would have been applied. However, this was not the case.


117 Id. Although a company is now allowed to own its own stocks in the form of Treasury Stocks in Japan, as in the United States, it was forbidden to do so at the time in Japan. Commercial Law, Art. 210. Therefore, when a company wanted to ask the third party to obtain the company’s stock or increase the number of stocks the third party owns, it was a common practice in Japan to ask the third party to purchase the company’s stocks through the stock market.

118 Id.

119 Id.

120 Id.

121 Id.

122 Restatement (Second) of Torts, § 550 (1976).

123 Id. § 551 (2) (a).

124 SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963). In equity law, fraud includes all actions, omissions, and concealments that cause damage to other people, with violations of duties, trusts, or confidences duly placed under the common law or the equity law, or all actions, omissions or concealments to deprive other people inappropriately and unconscionably of opportunities to make profits.

125 The leading case for this view is Carpenter v. Danforth, 52 Barb. 581 (N.Y. Sup. Ct. 1868).


127 A third theory on this matter is an intermediate position in that it states that an insider owes a responsibility for nondisclosure in special circumstances. Even from
this standpoint, the disclosure duty of Daiwa Bank is undeniable. For the third theory, see *Strong v. Repide*, 213 U.S. 419, 431 (1909). The court held that the purchase of stocks from minor stockholders by a dominant stockholder and administrative general without disclosing the pending sale of a company asset, constituted an unlawful fraud. Its decision was based on its finding that it was the defendants’ duty to act honestly and disclose the facts prior to said purchase, *given the defendants’ positions as insiders and the special knowledge they had.* Id.


129 The most important ones are Section 17(a) of Securities Act of 1933 and Sections 9(a)(4) and 10(b) of Securities Exchange Act of 1934. These rules determine that “the use of market maneuvering or fraudulent device or contrivance related to the issuing, buying, or selling securities is illegal.”

130 In the Texas Gulf Sulpher case, in which the focus of the lawsuit was a misleading newspaper report describing a large mineral deposit found in Canada as un PROMISING, the Second Circuit Court stated in its final judgment that it seems that it is not unfair to hold the management of a company to be responsible to confirm the accuracy of any announcements the company makes to stockholders or the general public. *SEC v. Texas Gulf Sulpher Co*, 410 F.2d 833, 861–866 (2d Cir. 1868), cert. denied sub nom. *Coates v. SEC* and *Kline v. SEC*, 394 U.S. 976 (1969). In other words, the court delivered a judgment that rule 10b-5 is always considered to be violated in a case such as follows: when an announcement was made in a rationally calculated method in order to influence the investing public, *e.g.*, by media reporting financial status, and said announcement was fraudulent or likely to cause misunderstanding or, so imperfect as to cause misunderstanding irrespective of whether the announcement was motivated by secret purpose of the officers of the company or not.


134 Securities and Exchange Law, Art 189.

135 The disclosure of important information based on the request of the stock exchange also is not uncommon in Japan as a follow-up procedure to information already announced. After the incident was disclosed, the possibility of a merger between Daiwa Bank and Sumitomo Bank was rumored. In response to this, the Tokyo Stock Exchange requested both banks to disclose information in writing, but both banks responded by saying that “there is no specific merger plan.” “Chairman of Tokyo Stock Exchange Asks for Disclosure if Any Changes Exist in Sumitomo Bank and Daiwa Bank Merger,” *Nihon Keizai Shim bun*, November 22, 1995 at 4.
The Tokyo Stock Exchange further asked both banks to “disclose information as quickly as possible if any changes occur, since the merger was expected to affect the stock prices.”

The Securities and Exchange Law of Japan also prohibits fraudulent operations with Article 58 against illegal trading, which corresponds to Article 17(a) of the US Securities Act of 1933 and against manipulation of the stock market with Article 125, which corresponds to Article 9 of the US Securities Exchange Act of 1934. The difference between Article 58 and Article 125 is that Article 58 is a comprehensive prohibition rule to prohibit all fraudulent actions in general while Article 125 is intended to secure a free and open market. Due to the nature of these two rules, it often happens that a case violates Article 125 and Article 58 at the same time.

Daiwa Bank installed an internal proposal organization to promote the disclosure of management information by the end of 1995 as the result of the experience. This was received as a progressive effort. In order to prevent any recurrence of such an incident and to improve the transparency of management, an organization called “Action Direction Committee,” a permanent organization consisting of outsiders was started. The committee members included owner/operators of other companies, scholars, professionals, journalists, and general individual customers, totaling about 10 people. The committee discussed and proposed ways to save individual customers and corporate customers, and to be more informative to the stockholders.


*Id.*

Sovereign Bank held mortgages on three rental properties in Pennsylvania. The mortgages contained assignment of rights provisions, and gave the bank the right to collect rent upon default. When the owners of the properties defaulted, the bank filed a foreclosure action, and it obtained a default judgment in April 1999. In September 2000, the bank sent notice to the tenants, informing them that from now on it would collect their rent. Later that month, the bank was appointed receiver of the mortgaged properties. Four months later, in January 2001, the properties were sold to the bank “for cost” by the county sheriff (the court’s opinion does not explain what constitutes a “for cost” property sale).

In February 2001, the mortgagors filed a petition for bankrupt-
cy protection under Chapter 7 of the Bankruptcy Code. The bankruptcy trustee commenced an adversary proceeding seeking the turnover of the rental funds by the bank in its capacity as receiver. The bank moved for summary judgment. The bankruptcy court denied the bank’s motion for summary judgment and found in favor of the trustee, ordering the bank to turn over the rental funds to the bankruptcy estate. The court held that “because [the bank] took control of th[e] property as a custodian and not the owner…the legal interest did not transfer…” The district court affirmed the bankruptcy court, and the bank appealed.

On further appeal, the United States Court of Appeals for the Third Circuit reversed. The issue on appeal was whether rents collected by the bank were property of the bankruptcy estate. This issue turned on whether the debtor had any legal or equitable interest in the rents as of the date of the bankruptcy petition. The Third Circuit held that the bank had taken the appropriate steps to obtain legal title to the rents before the bankruptcy petition was filed, thereby extinguishing the debtor’s interest in the funds. It also found that the bank did not forfeit its right to the rents by seeking an appointment as receiver. The trustee argued, and the lower courts held, that upon becoming receiver, the bank acquired a fiduciary duty to turn over the funds to the bankruptcy trustee. The Third Circuit held that the bank’s appointment as receiver did not negate its right to the rent. The bank held title to the rent by legally enforcing its rights under the mortgage — an act distinct from its actions as receiver. Therefore, the bank was entitled to keep the rents rather than turn them over to the bankruptcy trustee.


In May 1993, Plaintiff Kenneth Fackrell and his father opened a savings account at American National Bank as joint tenants with rights of survivorship. According to Fackrell’s testimony, at the time he opened the account, Fackrell specified that he
intended the interest from the account to supplement his father's retirement income, and that his father was allowed to withdraw the interest on his own signature, but that a withdrawal of principal would require the signatures of both Fackrell and his father. Fackrell also testified that the Bank agreed to manage the account on this basis. After Fackrell's father died in July 2002, Fackrell decided to close the account. The bank informed Fackrell that the money had been withdrawn and the account closed in December 1993. Fackrell brought suit against the bank in October 2002 to recover his initial deposit with the bank, and the bank answered, denying liability and asserting defenses on the basis that the money was withdrawn by the co-owner of the account. The trial court determined that:

1. the father's signature alone was an unauthorized signature under Oklahoma UCC Section 3-403;
2. the evidence was not conclusive as to whether bank statements were made available under Oklahoma UCC Section 4-406;
3. both parties failed to use ordinary care; and
4. under Oklahoma UCC Section 3-406(b), the negligence of the bank was greater than Fackrell's negligence in not monitoring the account over the ten years since he opened it.

Accordingly, the court held that the bank was responsible for 70 percent of the loss. The trial court awarded Fackrell judgment in the amount of $7,000.

On appeal, the Court of Civil Appeals of Oklahoma affirmed. The court reasoned that "[w]here two signatures are required for payment of an item, the absence of one of the signatures constitutes an 'unauthorized signature' under [Oklahoma UCC] § 3-403(a), and unless excused, bank bears liability for payment of an instrument bearing such an 'unauthorized signature.'" The court therefore held that the trial court did not err in determining that Fackrell's father's signature alone — without Fackrell's counter signature — constituted an unauthorized signature under Oklahoma law. The court further held that, given Fackrell's negligence in failing to monitor the account, the trial court's allocation of the loss was supported by competent evidence.