

Treatment of an electronic confirmation under the Financial Instruments and Exchange Act (FIEA) in Japan

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Under the FIEA, it is clearly permitted to deliver an electronic confirmation instead of physically delivering a confirmation in writing when certain conditions¹ are met. (Art.37-4 of the FIEA, Art.110, Para.1, Item 2, *Ho / Para.2 – 7 of the Cabinet Office Ordinance Concerning Financial Instruments Business (Kinyu Shouhin Torihiki Gyoutou ni Kansuru Naikaku Furei)* / FSA's response to the public comments No. 243 in page 376²)

On another front, there is a regulation to limit the use of electronic confirmation.

Article 166 of the FIEA (Prohibited Acts of Corporate Insiders) stipulates the insider trading regulations which applies to credit derivatives transactions: corporate insider who has come to know Material Fact Pertaining to Business or Other Matters (defined in the FIEA, hereinafter referred to as "insider information") shall not enter into the derivatives transactions relating to the specified securities (*Tokutei-Yūkashouken*)³ before such insider information becomes public. (Art.166, Para.1)

However, the insider trading regulations shall not apply where such derivatives transactions are concluded or decided to be concluded before obtaining any insider information on the specified securities referenced in the credit derivatives (limited to cases specified by a Cabinet Office Ordinance). (Art. 166 Para 8)

In the articles of the Cabinet Office Ordinance relating to Art.166 Para.8, it is stipulated that the application of the insider trading regulations is to be exempted, if (i) the insider information is obtained after the conclusion of contracts, (ii) it is a delivery of the securities or payment of cash as a result of the occurrence of credit events, and (iii) such credit derivatives transactions are concluded in written agreements on paper. This means the written form of confirmation is necessary to be applicable to the exemption of the insider trading regulations (Art.59, para.1, item 3 of the Cabinet Office Ordinance Concerning Securities Trading Regulations (*Yūkashouken no Torihikitouno kisei ni Kansuru Naikaku Furei*)). Therefore, under the current FIEA, CDS transaction confirmed by electric confirmation shall not apply to such exemption of the insider trading regulations.

ISDA's proposal

Given the current regulation mentioned above, ISDA is proposing to the Financial Services Agency (FSA) to amend the Art. 59, para.1, item 3 the Cabinet Office Ordinance Concerning Securities Trading Regulations to include the credit derivatives which are confirmed by electronic data processing system that satisfies the following conditions:

- 1) where electronic data processing system is operated by a third party;

¹ It is required to obtain consent of a counterparty relating to use an electronic confirmation instead of delivery of confirmation in writing.

² Published on 31 July 2007. <http://www.fsa.go.jp/news/19/syouken/20070731-7.html> (only in Japanese)

³ Under the FIEA, securities subject to the insider trading regulations are specified, e.g. stock, CB etc., and such securities are defined as "specified securities (*Tokutei-Yūkashouken*)".

- 2) where a party entering into a transaction confirms the contents of the transaction by such electronic data processing system, and the confirmed data of the transaction is to be stored as an electronic data; and
- 3) where it is recognized that the electronic data is legally effective at the same level as written data on paper under the laws applicable to such electronic data processing system. (in case it is operated in a foreign state, the laws of the said country).

ISDA continues the discussions with the FSA relating to such amendment of the regulations and understands that the FSA examines this issue. However, as of the date of this letter, no clear responses from the FSA are given to the ISDA whether the FSA will amend the regulation.