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FROM TATEMAE TO HONNE: A HISTORICAL PERSPECTIVE ON THE PROHIBITION OF INSIDER TRADING IN JAPAN

RICHARD SMALL

Insider trading is as illegal in Tokyo as breaking the speed limit—and about as widespread.1

I. INTRODUCTION

A quiet revolution has been taking place in Japan. The regulation of insider trading is being taken more seriously than ever. If the present enforcement and regulation trends continue, Japan’s prohibition of insider trading, oft considered a vital thread in the complex tapestry of regulation necessary for the creation of a successful financial market, will become truly world class. This is all the more remarkable in light of the criticism heaped on Japan a little over a decade ago for its lack of enforcement.

This Article analyzes the development of Japan’s regulation of insider trading from 1948 to the present. It argues that the prohibition can be divided into two distinct phases of development. The underlying rationale for the regulation and its enforcement, or lack thereof, in each of the phases is traced through an examination of the history of the prohibition. This Article demonstrates that the raison d'être of the prohibition has shifted from being

one of *tatemae* (first as an unsuccessful transplant of law from one country to another, and second as a response to international criticism, domestic scandal, and regulatory competition) to one of *honne* (which reflects the fundamentally changing structure of the Japanese economy, resulting in a real desire to enforce the prohibition). Part II investigates the background to the Securities and Exchange Law of 1948 (SEL 1948) and identifies the provisions that were applicable to insider trading. It then discusses the reason for the prohibition’s failure. Part III considers the amendments made to the SEL 1948 in 1988 (1988 Amendments). It contends that those amendments were once again the product of *tatemae*. The post-1988 revisions to the law, the case law, and the development of an independent watchdog are discussed in Part IV. It argues that these developments, driven by a pressing need to reform Japan’s economy in the aftermath of the bubble, marked the major turning point in the enforcement of the insider trading prohibition in Japan. This Article concludes, in Part V, that while Japan has adopted a new rationale for regulation, it still lacks the depth of commitment of the United States. Nonetheless, it welcomes Japan’s recent crackdown on insider trading.

II. THE ANATOMY OF *TATEMAE*

A. Securities and Exchange Act 1948

The genesis of Japan’s insider trading prohibition can be found in the Allied Occupation of Japan, which lasted from 1945 to 1952. During this period the Allies effectively imposed many changes on the Japanese legal system.

According to Kawamoto, the shareholder democracy movement in Japan was born out of the dismantling of the *zaibatsu* after the end of the Second World War. He tells of stock traders gathering in buildings and public parks,
necessitating fixed rules for dealing, and the reopening of the stock exchange. Kawamoto further recounts that those associated with the securities business who hoped for an early reopening of the stock exchange often implored the General Headquarters (GHQ) for permission to reopen the exchanges, but the GHQ refused on each occasion. The GHQ did not accept the proposed laws which the Japanese modeled after their old laws. However, when the Japanese subsequently redrafted their proposed law after the Securities Act of 1933 (SA 1933) and the Securities Exchange Act of 1934 (SEA 1934), the GHQ accepted the new law and allowed the reestablishment of the securities industry to go forward. Thus, Japan promulgated the Securities and Exchange Law of 1947. Soon, however, the SEL of 1948 replaced the 1947 version.

Four main articles of the SEL 1948, each of which was based on an American counterpart, could be interpreted as being applicable to insider trading. The first Article 58, was a generally worded anti-fraud provision which was clearly based on Section 10(b) of the SEA 1934. However, Article 58 did not develop in the same manner that Section 10(b) did in the United States. To date, only one case has been brought to trial under Article 58. There are both cultural and economic reasons for the lax enforcement of Article 58, which will be investigated at greater length below. Second, Article 50(3) granted the Ministry of Finance authority to promulgate Ministerial Orders to combat acts relating to securities transactions that may be “prejudicial to the protection of investors, detrimental to the fairness of transactions or undermining the credibility of the securities industry.”

6. See id. at 7-8. The General Headquarters of the Supreme Commander of the Allied Powers, under whose control Japan was placed following the end of the Second World War, was responsible for the rehabilitation of the Japanese economy.
9. See KAWAMOTO & ÔTAKE, supra note 5, at 7-8.
11. Article 58 provided that:
No person shall commit an act described in the following items: (1) To employ any fraudulent device, scheme or artifice with respect to buying, selling or other transactions of securities. (2) To obtain money or other property by using documents or by any representation which contain an untrue statement of a material fact or any omission to state a material fact necessary to make the statements therein not misleading.

SEL 1948, art. 58.
12. The SEC used its authority under Section 10(b) to fashion Rule 10b-5, itself patterned after Section 17(a) of the SA 1933, which became its favored and highly successful weapon for tackling insider trading. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 445-57 (1985).
14. SEL 1948, art. 50(3).
Finally were Articles 188 and 189, which had their roots in Sections 16(a) and 16(b) of the SEA 1934 respectively. Article 188 required those defined as insiders to report their stockholdings, and any changes thereto, to the government. Article 189 essentially provided that a company would have a right to disgorge the profit that an officer of the company made from a purchase and sale, or vice versa, of his company’s stock within a six month period using confidential information obtained through his position. It further provided that, if the company failed to pursue said officer within sixty days after a stockholder’s request to do so, the stockholder could bring an action on behalf of the company.

In 1953, shortly after the American occupation ended Article 188 was repealed, a move that effectively rendered Article 189 moot. This created something of a lacuna. How could an action be brought under Article 189 if the primary tool for monitoring insiders had been repealed? The official reason for Article 188’s repeal was that it was “inefficient.”

However, a number of alternative reasons have been advanced. First, Japanese commentators have noted that Article 188’s inefficiency was due to the fact that Japanese law does not require a beneficial owner of stock to register the stock in his own name. Thus, corporations could easily circumvent the reporting requirements. Second, because Article 188 did not provide for public disclosure—only reporting to the government—other shareholders would be unable to access the information necessary to launch an action. A third explanation provided by a Ministry of Finance official related to the fact that, before the advent of the computer, it was not practical for Ministry of Finance officials to deal with the vast volume of paperwork generated by Article 188’s compliance requirements. Likewise, Article 188 imposed too much of a burden on insiders to prepare such reports. Fourth, it has been suggested that it was not that the law was seen as inefficient, but...
rather that it was “excessive.” The business community was reportedly opposed to Article 188, and that opposition led to the revision of the law. That opposition could be read as implying that Article 188 had some sort of deterrent effect. According to Ishizumi “the reporting requirement, backed by criminal sanction, functioned as psychological pressure upon insiders to refrain from advantageously exploiting inside information on the markets.”

Finally, Article 190 prohibited insiders from making short sales of their corporation’s listed stock, punishable by a maximum fine of 300,000 yen. However, according to a report in the Nihon Keizai Shimbun, as of June 10, 1988 no case was ever initiated under this article.

Contemporaneous with the adoption of the SEL in 1948, the Japanese government established a Securities and Exchange Commission with duties similar in nature to its American namesake. However, shortly after the end of the Occupation, the Securities and Exchange Commission, along with Article 188, was abolished, and a new Securities and Exchange Council was established instead. Unlike its predecessor, which served as an independent body charged with supervision of the markets, the new Securities and Exchange Council was an advisory body, and eventually became a section of the Securities Bureau of the Ministry of Finance. As a result, Japan lost its independent watchdog for the securities markets.

B. Informal Controls on Insider Trading

In addition to the provisions of the SEL 1948, there were a number of attempts to combat insider trading via informal methods. For example, in 1965, the Ministry of Finance issued an ordinance under the authority of Article 50, restricting directors, officers, and other securities company employees from buying or selling securities on the basis of confidential information obtained in the course of their business.

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24. Id. at 489.
25. SEL 1948, art. 190.
27. See SEL 1948, arts. 171-81.
30. Shôken gaisha no kenzensei no jun sokutô ni kansuru shôrei [Ministerial Ordinance Concerning Rules on Sound Management of Securities Companies], Ministry of
In 1987, the Stock Exchange issued a notice listing factors that needed to be considered in preventing insider trading. Furthermore, since 1973, securities companies have implemented a policy of Chinese walls intended to prevent the flow of information between various departments that could facilitate insider trading. However, many have criticized this policy as being ineffective.

The United States and Japan signed a Memorandum of Understanding in 1986 aimed at sharing information in suspected cases of securities law violations. However, unlike the Memoranda of Understanding that the United States signed with the United Kingdom and Germany, critics have pointed out one rather obvious flaw with the memorandum signed with Japan: the Japan Memorandum does not provide any procedural mechanisms for dealing with requests for information. These various informal actions taken against insider trading seem to have made little overall difference to the enforcement of Articles 58 and 189, as evidenced by the dearth of cases.

C. Case Law

Since the promulgation of the SEL in 1948 until the law’s amendment in 1988, the Shokusan Jûtaku Sôgo case and the Fujiya case were the only two cases relating to insider trading. In the Shokusan Jûtaku Sôgo case, Shokusan Jûtaku Sôgo Co. filed suit under Article 189 of the SEL 1948 in the Tokyo District Court in 1973 seeking to recover profits made by one of its directors. The parties settled the case out of court in 1987. In the Fujiya Co.

Finance Ordinance No. 60 of 1965, art. 1(5).
33. See Lu, supra note 29, at 232-33.
38. Shôji hômu topikkusu: shokusan jûtaku jiken saikôsai kettei to rikurûto jiken [The Recruit
case the company brought an action against its parent, Tokiwa, under Article 189 of SEL 1948 to recover profits made in a short swing transaction. However, the Fujiya Co. case was not really an insider trading case because the parent company was forced to sell its holdings in Fujiya to comply with the Tokyo Stock Exchange rules for credit transactions. The parties settled in 1984. 39

D. Of Acorns and Oak Trees

Despite initial similarities between the Japanese and American legal regimes, the prohibition of insider trading in Japan failed to develop into the “judicial oak” that it did in the United States. 40 Indeed it has been observed that where commercial law reforms transplanting Western legal notions have been introduced in Asia as a result of economic duress, those reforms have often failed. 41

Lord Denning in Nyali Ld. v. Attorney General, also employing the metaphor of oak trees, stated that: “Just as with the English oak, so with the English common law. You cannot transplant it to the African continent and expect it to retain the tough character which it has in England. It will flourish indeed, but it needs careful tending.” 42 F.S.C. Northrop subsequently observed that: “In introducing foreign legal and political norms into any society, those norms will become effective and take root only if they incorporate also a part at least of the norms and philosophy of the native land.” 43

There is an active debate on the transplantability of law. Nicholas Foster broadly groups the two sides of the debate into culturalists on the one hand and transferists on the other, although he points out that scholars have recently begun to try and move past this. 44 The position of the transferists is

39. Naibusha torihiki no kisei wa wâku shiteiruka [Are the insider trading regulations working?], 1013 SHÔJI HÔMU 50 (1984) [author’s translation].
40. In 1975 Chief Justice Rehnquist spoke of the “judicial oak which has grown from little more than a legislative acorn” with reference to Section 10(b) of the SEA 1934 and the prohibition of insider trading. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).
42. Nyali Ld. v. Attorney General, 1 Q.B. 1, 16 (C.A. 1956).
44. Nicholas Foster, Transmigration and Transferability of Commercial Law in a Globalized World, in COMPARATIVE LAW IN THE 21ST CENTURY 55, 58-59 (Andrew Harding & Esin Örüç eds., 2002). See also COMPARING LEGAL CULTURES (David Nelken ed., 1997). For a general discussion on
put forward by Alan Watson among others, and holds that law and society are two separate notions, and that as a result law is autonomous from the society in which it operates. He argues that good laws are observed by those with lawmaking ability and they decide to import or transplant them into their own society because the law is good.\footnote{See Alan Watson, Legal Transplants: An Approach to Comparative Law (2d ed. 1993), Alan Watson, Comparative Law and Legal Change, 37 Cambridge L.J. 313 (1978).} The culturalists on the other hand, disagree with Watson’s notions and argue that law, in Foster’s words, is “a culturally determined artefact” and thus cannot be separated from its original purpose or the initial circumstances under which it was promulgated.\footnote{See Foster, supra note 44, at 59. The culturalist position is taken up by Legrand and the Seidmans. Pierre Legrand, The Impossibility of ‘Legal Transplants’, 4 Maasricht J. of Eur. & Comp. L. 111 (1997); Pierre Legrand, Against a European Civil Code, 60 Mod. L. Rev. 44 (1997); Pierre Legrand, European Legal Systems are Not Converging, 45 Int’l & Comp. L.Q. 52 (1996); Ann Willcox Seidman & Robert B. Seidman, State and Law in the Development Process: Problem Solving and Institutional Change in the Third World (1994).} Otto Kahn-Freund’s scholarship falls more on the culturalist side of the debate arguing that there are degrees of transplantability depending upon how closely a particular law is related to society and that therefore it should not be taken for granted that a law can be transplanted.\footnote{Otto Kahn-Freund, On Use and Misuse of Comparative Law, 37 Mod. L. Rev. 1 (1974).}

As discussed above, Japan was obliged to pass the SEL 1948 under duress, with little or no concern for the norms or culture that was to receive the law. Indeed, the wording of Article 58 of the SEL 1948 and Section 10(b) of the SEA 1934 was almost identical. There can be little argument, especially in the light of the lack of cases, that the law as regards insider trading in Japan was a failure, at least until the mid-1990s.

The question then, is why the law failed to take root. There are a number of explanations. First, the original law in the United States was promulgated under very special circumstances that were peculiar to the United States and did not exist in Japan. Second, the structure of Japan’s economy and society was somewhat different to that of the United States at the time. And third, Japan’s differing concept of law was not taken into consideration.

1. The Great Crash of 1929

One of the defining features of the SA 1933 and the SEA 1934, is that they were promulgated, in great part, as a reaction to the Great Crash of
One could argue that the prohibition of insider trading in the United States was driven by a reaction to a deeply traumatic event, an event which did not occur in Japan. The laws were then uprooted and grafted onto a country that did not seek to heal such a wound. Rather, the driving force in Japan, as noted above, was the desire to reopen their markets. And to do so required the satisfaction of a ruler who had until recently still been traumatized by the Great Crash. The result was the transplant of a legal regime that not only failed to take into account the context against which it was created, but also failed to consider the cultural background of the receiving country.

Therefore, to this day, while insider trading is effectively viewed as *malum in se* in the United States as a result of the psychological scaring of the Great Crash, in Japan it is simply *malum prohibitum*, and as such is less strictly enforced. Indeed, Whitner comments that:

This lack of enforcement reflects a general marketplace perception that there is nothing wrong with insider trading. Trading on insider

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48. On Thursday October 24, 1929 the U.S. stock market crashed, abruptly bringing to a halt a decade of prosperity, which many commentators and economists thought could and would last indefinitely. In the aftermath of the Great Crash of 1929 there was considered to be an urgent need to legislate to answer calls to curb the worst excesses of the stock market.

In the Securities Act of 1933, and more comprehensively in the Securities Exchange Act of 1934, the government had sought to prohibit some of the more spectacular extravagances of 1928 and 1929. Full disclosure was required on new security issues, although no way was found of making would-be investors read what was disclosed. Inside operations and short selling after the manner of Mr. Wiggin were outlawed. Authority was given to the Federal Reserve Board to fix margin requirements and these could, if necessary, be made a hundred per cent and thus eliminate margin trading entirely. Pool operations, wash sales, the dissemination of tips or patently false information and other devices for rigging or manipulating the market were prohibited. Commercial banks were divorced from their securities affiliates. Most important, the principle was enunciated that the New York Stock Exchange and the other exchanges were subject to public regulation and the Securities and Exchange Commission was established to apply and enforce such regulation.


It should be noted however, that prior to the Great Crash of 1929 there had been a movement internationally towards corporate law reform. Many European countries enacted new company laws in the late 1920s. As Loss and Seligman well document, the Great Crash of 1929 proved to be ammunition for one camp in a much longer running battle between two different philosophies regarding the regulation of the markets. **LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 24-25 (3d ed. 1995).** On the one hand it was argued that tough punitive laws, such as New York’s anti-fraud statute, were the solution, on the grounds that preventative laws would be detrimental to honest business. On the other hand it was argued that preventative measures were best. Louis D. Brandeis’s *Other People’s Money and How the Bankers Use It*, first published in *Harper’s Weekly* in 1913-14, was the leading proponent of the disclosure philosophy. **LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT (1967).** Brandeis’s approach held that it was not up to the law to stop people from making bad decisions or investments, but that if disclosure were required then people could judge for themselves. Thus when the SA 1933 and the SEA 1934 were promulgated it was against this background. The debate did not end there. Since the 1960s, economists have questioned the disclosure philosophy. **See LOSS & SELIGMAN, supra, at 26-33.**
information is viewed by many Japanese investors as a legitimate, even necessary, basis for stock market investments. In the light of the fact that Japan’s securities laws were imposed upon the country by U.S. Occupation forces following World War II rather than adopted in response to domestic pressure, it is not surprising that insider trading is taken less seriously than in the United States, whose securities laws have their roots in the 1929 stock market crash and the subsequent Depression.49

2. Indirect Financing

In the post-war period, Japanese companies relied mainly on indirect financing (borrowing from banks) rather than direct financing (equity or debenture) to obtain capital.50 This is attributed to a number of factors, including the Japanese government’s low interest rate policy and the preference of Japanese individual investors to leave their assets in financial institutions for liquidity and safety.51 The latter provided financial institutions with a large pool of funds to loan out. The keiretsu corporate structure further contributed to the reliance on indirect financing. A keiretsu is best described as a network of affiliated corporations, usually organized around a main bank, to which fellow keiretsu firms tended to look to for financing.52

As in Germany during the post-cold-war period,53 the markets were not the primary source of capital in Japan. As a consequence of the majority of financing being indirect, the importance of the stock market was reduced. Therefore, the rationale underlying the prohibition of insider trading in the United States was rendered less persuasive in Japan.54 The Nihon Keizai Shim bun pointed out that the United States and Europe viewed the prohibition of insider trading as a vital part of the capital formation process.

50. See Diagram 1, infra, at 324.
51. JAPAN SECURITIES RESEARCH INSTITUTE, SECURITIES MARKET IN JAPAN 2002 1-5 (2002).
52. While Miwa and Ramseyer have recently questioned the very existence of the keiretsu, Milhaupt in his rebuttal not only confirms the existence of the keiretsu, but also finds that, in their role as main bank, they played some role in limiting bankruptcy in Japan. See Curtis J. Milhaupt, On the (Fleeting) Existence of the Main Bank System and Other Japanese Economic Institutions, 27 LAW & SOC. INQUIRY 425 (2002); Yoshiro Miwa & Mark Ramseyer, The Fable of the Keiretsu, Mar. 2001, available at http://www.law.harvard.edu/programs/olin_center/.
54. For an overview of the rationale underlying the prohibition of insider trading in the United States, see Richard Small, Confidence, Fairness and the Law & Economics Debate of the Prohibition of Insider Trading, 3 ICCLP REV. 26 (2000).
whereas Japan considered insider trading merely as a case of cheating. As a result of this differing view of insider trading it was argued, efficient regulations have not advanced as quickly in Japan as in other countries. This could be explained by a Japanese economic mindset that still emphasizes indirect rather than direct financing.

As a result of relying more heavily on indirect finance, the Japanese were less concerned with investor confidence since the markets did not play such a vital role in the distribution of funds to pertinent sectors of the economy. Under Japan’s capitalist development model, as defined by Chalmers Johnson, the post-war, high-speed growth period was in large part attributable to the Ministry of International Trade and Industry’s (MITI) (now known as the Ministry of Economy, Trade and Industry or METI) direction of funds to those companies and industries that needed capital. In effect, MITI performed the function of distributing funds via the banks rather than the stock market. As a result, arguments over the harm caused by insider trading to issuers and investors, which were tenuous at best anyway, were far less relevant in the Japanese context.

55. Bassoku kyôka no shushi wo hanei [Reflections on the aim of strengthening the penal regulations], NIHON KEIZAI SHIMBUN, Apr. 16, 1999.
3. The Keiretsu System

The keiretsu are defined by their cross-share holding structure, in which member companies hold each other’s shares. This has the obvious effect of removing a large number of shares from circulation thus reducing the liquidity of the stock market. Imhof noted that one result of this arrangement was that since there was such a thin float on Japan’s stock exchanges it was relatively easy to manipulate the market.58 Karel van Wolferen contended that the securities houses and the keiretsu themselves stood to lose if the insider trading regulations were enforced.59 Furthermore, insider trading as a result of information sharing between firms was an accepted part of business practice in Japan. Indeed one journalist commented in the late 1980s that: “The privileged distribution of inside information has traditionally been respectable in Japan because it is seen as a way of lubricating corporate relationships.”60

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57. See JAPANESE SECURITIES RESEARCH INSTITUTE, supra note 51, at 4.
58. See Imhof, supra note 37, at 251.
60. Nigel Holloway, Squeezing the manipulators: Japan Prepares to Tackle Insider Trading in 

https://openscholarship.wustl.edu/law_globalstudies/vol2/iss2/2
Moreover, since the financial institutions at the core of these large keiretsu groups were part of the so-called convoy system it has been suggested that they had a “strong influence over the new legislation and regulation.”\textsuperscript{61} One could argue that the keiretsu groups even had the power to block laws that were not in their best interests, including those designed to combat insider trading.

Finally, Japanese tolerance for insider trading helped protect domestic corporations from foreign takeovers. For example, the United States would have benefited from the prohibition of insider trading in Japan being enforced because it would have helped to break down the keiretsu structure, making it easier for American companies to mount successful takeover bids for Japanese companies. It was noted in the late 1980s that as Japanese investment grew in the United States, “Congress is going to wonder why it is so difficult for U.S. companies to acquire Japanese firms.”\textsuperscript{62}

4. Japanese Legal Consciousness

Arguably, the United States and Japan have different legal consciousnesses. According to Upham, the laws of the West reflect notions of individuality and laissez faire competition that are completely different from social norms in Japan, which are built on social relativism and cooperation.\textsuperscript{63} A number of Japanese scholars argue that Japanese behavior is conflict adverse.\textsuperscript{64} Kawashima states:

Traditionally, the Japanese people prefer extrajudicial, informal means of settling a controversy. Litigation presupposes and admits the existence of a dispute and leads to a decision which makes clear who is right or wrong in accordance with standards that are independent of the wills of the disputants . . . [to] resort to litigation has been condemned as morally wrong, subversive, and rebellious.\textsuperscript{65}

\textsuperscript{61} See Karaki, supra note 56, at 339.
\textsuperscript{62} Nigel Holloway, Tougher Enforcement Planned, FAR E. ECON. REV., Sept. 15, 1988, at 94, 95.
\textsuperscript{63} See FRANK K. UPHAM, LAW AND SOCIAL CHANGE IN POSTWAR JAPAN (1987); TAKIE SUGIYAMA LEBRA, JAPANESE PATTERNS OF BEHAVIOR (1976).
\textsuperscript{64} Yosiyuki Noda, Nihon-jin no seikaku to sono hô-kannen [The Character of the Japanese People and their Conception of Law], 140 MISUZU 2, 14-26 (1971), reprinted in HIDEO TANAKA, THE JAPANESE LEGAL SYSTEM (1976).
\textsuperscript{65} Takeyoshi Kawashima, Dispute Resolution in Contemporary Japan, in LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY 41, 43-45 (Arthur T. von Mehren ed. 1963). Noda goes even further and states, “To never use the law, or be involved with the law, is the normal hope of honourable people.” Y. NODA, INTRODUCTION TO JAPANESE LAW 159-60 (1976).
As a result of this legal consciousness, people in Japan bring far fewer cases than in the United States. Other scholars, however, have submitted alternative suggestions for the comparative lack of litigation in Japan. John O. Haley, for example, argues that although both Christian and Confucian based societies promote a non-litigious solution to disputes, Japan has succeeded in the “implementation of this interdiction through institutional arrangement.” He further posits that the myth of non-litigiousness in Japanese society reinforces institutional impediments by providing a justification for them. Regardless of the reason, the evidence clearly suggests that individuals in Japan, when compared to their American counterparts, are far less likely to resort to the court system to resolve conflicts. This differing legal consciousness has clearly had a negative impact on the enforcement of the insider trading regulations. Finally, Imhof suggests that the senpai-kôhai relationship, the seniority based advancement in Japanese companies and the government, and the lack of legal absolutism in Japanese society have all contributed to make the enforcement of the insider trading regulations a failure.

5. Public Prosecutors

Public prosecutors have not pushed for prosecutions under Article 58. Overall, the criminal conviction rate in Japan is nearly one hundred percent. Although public prosecutors have the discretionary power to prosecute, once a prosecutor decides to indict, a conviction is expected. In a large number of cases, prosecutors drop cases despite indictments. However, if a public prosecutor acquires too many not-guilty verdicts it will harm his or her career. As a result, public prosecutors are unwilling to prosecute until they are certain that they can gain a conviction. It has been reported that Article 58 was unpopular with prosecutors because they found it difficult to define the

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67. See Haley, supra note 66, at 390.
68. Senpai is defined in Kenkyusha’s as “a senior; a superior; an elder” whereas kôhai is a “younger man; the younger generation.” See Kenkyusha’s, supra note 2, at 1491, 880 respectively. The senpai-kôhai relationship in Japanese society is a rigid one that dictates that the kôhai must show reverence to the senpai in all matters, even though the kôhai may personally disagree with the senpai.
69. See Imhof, supra note 37, at 255-57.
70. In 2000 a mere forty-six people were acquitted out of the 986,914 who were prosecuted. This works out at approximately only 0.005% of cases resulting in an acquittal. See II-3 Hôzenji-ken saiban kakutei jin-in [Table II-3 Total number of defendant’s final judgments] HANZAI HAKUSHO HEISEI 14 NENKAN [CRIMINAL WHITE PAPER 2001], at http://hakusyl.moj.go.jp/image/hoo2003h.jpg. See also JOHN O. HALEY, AUTHORITY WITHOUT POWER 121-38 (1991).
scope of insider trading. Finally, as noted by Haley, the relative lack of public prosecutors in Japan forms an institutional impediment to the effective enforcement of law. In the light of the reluctance of authorities to prosecute in general, it is understandable why there have been relatively few prosecutions for insider trading.

6. Bureaucratic Informalism

“Bureaucratic informalism,” a term coined by Frank Upham, is another reason often given for the failure of insider trading regulations in Japan. The bureaucracy drafts almost all laws presented to the Diet. According to Upham, bureaucrats prefer vague legislation that needs supplementary administrative guidance later on. Under this system, bureaucrats retain social control through a system of administrative guidance and ministerial ordinances. Thus it was not in the bureaucracy’s interest to allow for easy enforcement of the law. Instead, it has been argued that bureaucrats would rather erect barriers to shareholder litigation, such as the high cost of litigation (due in part to the relative dearth of lawyers in Japan compared to the United States) and the lack of class action suits. Since public prosecutors are unlikely to use vague laws to secure a conviction, bureaucratic informalism of the kind described by Upham has certainly encouraged non-enforcement of the insider trading laws in Japan.

7. “Professional” Work

Tatsuta noted that because few Japanese participated in securities markets until the 1980s, the public was indifferent to insider trading regulation. He stated that the view at the time was that securities dealing was “professional” work; associating “professional” with organized crime. Hard-working non-professionals believed they had no way of profiting from markets because professionals controlled securities deals. Although a non sequitur, Tatsuta claims that as a result, most Japanese people did not feel that insider trading was immoral.

73. See Upham, supra note 63, at 16-27.
8. Party Coffers

Politicians themselves are alleged to have benefited from dubious share transactions in order to fund campaigns for public office. Indeed there have been a number of stock market scandals over the years in which politicians have been implicated. The most famous case to date, the Recruit-Cosmos scandal, led to the resignation of the then Prime Minister Noboru Takeshita. As alleged beneficiaries of such dubious share transactions, it is hardly surprising that politicians did not endorse more rigorous enforcement of insider trading prohibitions.

E. Unique Lacunae

The underlying rationale for the promulgation of the insider trading prohibition was one of tatemae. Japan enacted the SEL 1948, including its insider trading provisions, out of duress, not choice. As a precondition to re-opening the securities markets, the Allies forced the Japanese to adopt a legal regime that was not compatible with the socio-economic structure of Japan. Ostensibly, the Japanese accepted an alien regulatory system to placate the Allies.

With hindsight however, the Japanese government’s actions make it clear that it had little or no intention of enforcing the law. They effectively made it extremely difficult to enforce Articles 58 and 189 by de-toothing the law, abolishing the independent watchdog, and then removing the provision for monitoring the markets. As a result of these lacunae, the insider trading laws went unenforced.

In the ensuing years, rather than amend the law to make enforcement more effective, the Japanese government remained passive. This subsequent failure can be explained, in part at least, by the culturalist theory of legal transplants—the law was an unsuccessful legal transplant because the original law itself was a product of a unique set of circumstances that bore little relevance to the Japanese context. Furthermore, it was roughly grafted onto the Japanese legal system with scant regard for Japan’s differing

76. Numerous politicians and senior corporate leaders, including the then NTT Chairman Shindo Hisashi, were sold shares in the Recruit-Cosmos company at a deep discount prior to its initial public offering, as a form of bribery. It has been estimated that total bribes were about ¥1.33 billion ($1.2 million) to forty-four politicians. While no charges for insider trading were brought, such cases demonstrate why politicians may lack the willpower to create a more transparent financial market. See Lu, supra note 29; Holloway, supra note 60, at 93.

77. See Zoglin, supra note 74; Lu, supra note 29.
historical circumstances and cultural norms. This transplant failure is evidenced by the lack of cases.

III. TOWARDS A MODERN PROHIBITION OF INSIDER TRADING

A. Radices of Reform

The events leading up to the promulgation of the 1988 Amendments provide vital insight into the reasoning behind their enactment. In 1987, the Tateho Affair, a major insider trading scandal brought the matter not only to the general public’s attention in Japan, but also to the attention of the foreign media. Criticism from domestic and overseas commentators over the handling of the case exposed the weaknesses inherent in Japan’s insider trading laws.78 The following year, a government report recommended strengthening the law. Finally, as the markets began to globalize, external factors pressured Japan to conform to the norm against insider trading.79

1. The Tateho Affair

Tateho kagaku kōgyō kabushiki kaisha [Tateho Chemical Industries] (Tateho), a company listed on the Osaka Stock Exchange, had a market capitalization of approximately two and a half billion yen in 1987. That year, the company suffered a loss of approximately twenty-four billion yen as a result of futures market transactions for Japanese Government Bonds. In response to the crises, company management and Tateho’s eight banks arranged a conference on August 31, 1987 for the next day. On September 2, 1987, Tateho publicly announced its losses, which resulted in a considerable decline in its stock price.80

One day before management announced the losses to the public (September 1, 1987, during the conference in which Tateho informed the banks of the losses), one of Tateho’s banks, Hanshin sōgo ginkō (Hanshin), sold 337,000 shares in the company. On September 1st, Tateho shares closed at a price of ¥1,820. After the announcement of the losses, Tateho shares closed at ¥1,520 (trading limits prevented the stock from closing lower). A week later, on September 8th the price stood at ¥720. One month later, on

79. See Akio Takeuchi, Insaidâ torihiki kisei no kyôka (jô) [Strengthening the insider trading regulations (I)], 1142 SHÔJI HÔMU 2, 3-4 (1988) [author’s translation] [hereinafter Takeuchi (I)].
80. Ichiro Kawamoto, Hô kaisei ni itaru keii [How and why the law was changed], 806 KINYÛ SHÔJI HANKEI 98 (1988) [author’s translation].
October 2nd, the share price fell to ¥520. As a result of acting on the inside information, Hanshin managed to avoid suffering a considerable loss. The exact amount of loss avoided is uncalculatable, however, had the bank sold at the closing price on September 2nd it would have received only approximately ¥512,240,000 as opposed to roughly ¥613,340,000 it received for selling at the closing price on September 1st. The Osaka Stock Exchange investigated the allegations of insider trading. Incredibly, they issued a statement concluding that there had been no wrongdoing on Hanshin’s part.81

In addition, three management level officers of Tateho were alleged to have sold stock in the company between August 11 and August 21, 1987. Of the three, the Osaka Stock Exchange, in accordance with Section 189 of SEL 1948, advised one officer to disgorge his profits back to the company within six months.82 The Tateho Affair captured the media’s attention and attracted considerable public interest. As a result, numerous commentators have pinpointed this scandal as being one of the major factors that triggered the adoption of the 1988 Amendments.83

2. The 1988 Securities and Exchange Committee Report

In October 1987, the Ministry of Finance set up a special study group called the Securities Exchange Committee to investigate the regulation of insider trading.84 The report, submitted on February 24, 1988, explained the importance of fairness and confidence to the successful operation of the

81. Osaka shôken torihikiyo no hoppô bun [Announcement of the Osaka Stock Exchange], reprinted in Kawamoto, supra note 80, at 99-100 [author’s translation].

82. Chôsa kea (gaiyô) [An Outline of the Investigation Results], reprinted in Kawamoto, supra note 80, at 99-100 [author’s translation].

83. See Kawamoto, supra note 80. See also Harald Baum, Japanese Capital Markets: New Legislation, 22 LAW IN JAPAN 1 (1989); Lu, supra note 29; Kawamoto & Otake, supra note 5, at 19; TOKYO BENGOSHIKAI KAISHAHOBU [COMPANY LAW SECTION OF THE TOKYO LAWYERS ASSOCIATION], INSайдА TORIHIKI KISEI GAIDORAIN [INSIDER TRADING REGULATION GUIDELINES] 2 (1989) [author’s translation]; OSAMU SEKINE, INSайдА TORIHIKI KISEI NO SÔGÔ KAISETSU [A GENERAL EXPLANATION OF THE INSIDER TRADING REGULATIONS] 1 (1989) [author’s translation].

84. Shôken torihiki shingikai [Securities exchange committee], Naitbusa torihiki no kisei no arikata ni tsuite [Ways to regulate insider trading], Feb. 24, 1988 [hereinafter Securities Exchange Committee Report], reprinted in Zôkangô [Special Issue], Kaisei shôtorihô to kinyû sakimono torihiki hô no kaisetsu to kenkyû–insайдА torihiki kisei wo chishin ni [Explanation and study of the change in the securities and exchange law and the financial futures trading law: The regulation of insider trading], 806 KINYÛ SHÔJI HANREI 179 (1988) [author’s translation]. The report made four recommendations. Id. First, preventative measures should be improved amongst issuers, on stock exchanges, and among broketed/dealers. Id. Second, administrative authorities should take appropriate measures to enforce the changes. Id. Third, provisions similar to the scrapped Article 188 of the SEL 1948 should be reintroduced, i.e., that insiders should report to the government any changes in their stock holdings. Id. Finally, the penalties for a breach of the insider trading provisions should be increased. Id.
securities markets, and that in order to ensure such fairness and confidence insider trading had to be regulated. The report then examined the treatment of insider trading by other major financial markets including the United States, the United Kingdom, France, and Switzerland.

A number of proposals for the revision of the insider trading regulations in Japan then followed. In light of the committee’s findings, the report recommended immediate re-regulation of insider trading. The final paragraph of the report declared, “we should improve [the regulation of insider trading] whenever it is necessary and when we do so we need to take into consideration international trends of regulation.”

3. Japanese Commentary

External pressure, closely linked to the Tateho Affair, provided the second key factor in Japan’s decision to strengthen its prohibition on insider trading. In Japan, pressure for change originating from outside Japan is known as gaiatsu, which translated literally means “foreign pressure.”

Takeuchi, discussing the then forthcoming amendments to the SEL 1948, referred to gaiatsu and the Tateho Affair as being the two main reasons for the 1988 Amendments.

Takeuchi further acknowledged that because investors compete for information within the stock market, possession of inside information clearly creates an anti-competitive effect. He noted that while there had been no insider trading cases in Japan, there were thirty to forty a year in the United States. Despite isolated reports of insider trading in the last forty years, Takeuchi did not suggest that insider trading never occurs on the Japanese markets. On the contrary, he even joked that it was unbelievable that all investors on the Tokyo Stock Exchange were angels, and commented that there was pressure to amend the law from foreign critics who complained that as “the Japanese markets don’t regulate insider trading, it [Japan] is an insider’s heaven.” Takeuchi concluded that Japan had to amend its securities laws to avoid conflict with foreigners.

85. See Securities Exchange Committee Report, supra note 84.
86. See Takeuchi (I), supra note 79, at 3.
87. Id.
88. Id. at 3.
89. Id. at 4.
90. Id. at 3-4. Japan is traditionally a country where people strive to avoid conflict. Therefore, in this case, Takeuchi perhaps suggests that, in order to avoid a direct confrontation with the United States over this issue, it was simply preferable to promulgate some legislation. See Noda, supra note 64.
Takeuchi was not the only commentator to mention international pressure. Although a number of commentators acknowledged the trend in global financial markets towards strengthening provisions against insider trading, they did not specifically credit international pressure for the passage of the 1988 Amendments. However, those commentators continued to state that Japan should still take note of such developments when considering its own legislation.\footnote{91}{Kazuo Nikawa, *Insaidâ (naibusha) torihiki kisei no seibi* [The maintenance of insider trading regulations], 1191 KINYÛ HÔMU JIJYÔ 34, 34 (1988) [author’s translation]. Several other articles published at the time noted that there was a growing trend in the international markets towards increasing or strengthening the regulation of insider trading. For instance:

The number of countries that have passed insider trading regulations has increased, additionally international securities trading has also increased, as a result of this international environment the passing of insider trading laws has become an important issue.

Setsu Tatsuta, *Insaïdâ torihiki kisei no shinrippô ni tsuite* [Concerning the new insider trading regulations legislation], 1191 KINYÛ HÔMU JIJYO 39, 39 (1988) [author’s translation].}

Indeed, it was noted that it was becoming more important to keep pace with international trends in regulation since Tokyo was now considered one of the three major stock markets in the world along with New York and London.\footnote{92}{See Nikawa, supra note 91, at 34. In March 1988, *Ekonomisuto* published three articles discussing the regulation of insider trading in the United States, the United Kingdom, and Japan in a special section entitled “Insaïdâ tengoka” ni mesu wa hairu ka [Insider’s heaven: The scalpel is plunged in], 66 EKONOMISUTO 44 (1988) [author’s translation].}

An April 1988 *Shôji hômu* [Commercial and Judicial Affairs] article discussing the February 1988 report submitted by the Securities Exchange Committee on ways to regulate insider trading, mentioned the Ivan Boesky scandal in the United States, and observed that the United Kingdom had recently strengthened its laws prohibiting insider trading.\footnote{93}{Shigeru Kobayashi, *Naibusha torihiki no kisei no arikata ni tsuite* [Ways to regulate insider trading], 1141 SHÔJI HÔMU 13 (1988) [author’s translation].}

In particular, the author focused on the United Kingdom’s Company Securities (Insider Dealing) Act of 1985 and the Financial Services Act of 1986. The article noted that “various foreign countries are in the process of strengthening and improving the regulation of insider trading, and that this strengthening of the prohibition of insider trading has become an international trend.”\footnote{94}{Id.}

Thus, in the minds of Japanese academics, the international trend toward prohibiting insider trading, *gaiatsu* and the Tateho Affair, provided the main *raison d’être* for strengthening the law.

\footnote{91}{Kazuo Nikawa, *Insaidâ (naibusha) torihiki kisei no seibi* [The maintenance of insider trading regulations], 1191 KINYÛ HÔMU JIJYÔ 34, 34 (1988) [author’s translation]. Several other articles published at the time noted that there was a growing trend in the international markets towards increasing or strengthening the regulation of insider trading. For instance:

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93. Shigeru Kobayashi, *Naibusha torihiki no kisei no arikata ni tsuite* [Ways to regulate insider trading], 1141 SHÔJI HÔMU 13 (1988) [author’s translation].

94. Id.
4. Non-Japanese Commentary

Japanese commentators referred to the Western media as the source of much of the gaiatsu. Numerous examples of such negative press about insider trading in Japan appeared. For instance, some months before the Tateho Affair, Forbes published an article highly critical of the Japanese stock market, declaring that: “The Tokyo market is more like the U.S. market of sixty years ago, when what we call today stock rigging, insider dealing, painting the tape, buying pools, market manipulation still called the tune. Only in Japan, part of the rigging is done as government policy.”

Furthermore, commentators noted how ironic it was that the United States was not more vocal in critiquing the lack of regulation in Japan because as an occupying force after World War II, it had approved the enactment of Japan’s first insider trading laws. An article in the Journal of Financial Crime summed up the view that the Tateho Affair and pressure from the United States were responsible for the enactment of the 1988 Amendments: “Insider trading has historically been tolerated in Japan. Prominent securities market scandals, such as the Tateho Chemical case in 1987, and increasing U.S. criticism of Japanese market practices, led to the Japanese Government’s amendments of the Securities and Exchange Law in 1988.”

Even after the Japanese government had announced its intention to strengthen the prohibition of insider trading, the foreign media remained critical of the then proposed amendments to the SEL 1948. One source commented that the new proposed amendments were in effect pointless if “the authorities are not up to the task of surveillance.” The same commentator carried on to point out that even though the Tokyo Stock Exchange’s capitalization was a third larger than that of New York, it had only thirty-one monitoring staff while the securities bureau of the Ministry of Finance had fewer than 150, a stark contrast to the SEC in New York which at the time had a staff of 2,000.

As Japanese financial markets began to internationalize increased

96. See Whitmer, supra note 49, at 15.
98. See Holloway, supra note 62, at 95.
99. Id. at 95.
100. The first steps in the internationalization of the Japanese financial markets occurred in 1971, with the liberalization of yen-denominated bond issues abroad. However, the pace did not really pick up until the mid-1980s. In 1980, the Foreign Exchange and Foreign Trade Control Law was substantially revised, thus liberalizing international transactions. The U.S.-Japan Yen-Dollar Committee Report 1984 stressed the importance of the free movement of capital as well as open and
scrutiny from the Western media followed. The world perceived that the Japanese financial markets were a closed, unfair, and illiquid system that operated for the sole benefit of insiders. Numerous media reports covered this topic and the Tateho Affair cemented those opinions. The Japanese government was left with no alternative but to respond to the growing criticism.

B. The 1988 Amendments

On May 25, 1988 the Diet passed legislation amending the SEL 1948.101 The 1988 Amendments updated reporting requirements as well as the core prohibition and penalty provisions. First, the reporting requirements for issuers were expanded under Article 154.102 In addition, Article 188 provided that a securities company whose client is a corporate insider must submit a report to the Ministry of Finance on behalf of that client.103 Article 189 was amended to require the Ministry of Finance to provide information obtained under Article 188 if they determined that short-swing trading had occurred in breach of Article 189.104 Article 189 granted the alleged insider time to respond to the allegations first.105 Article 190, which previously only prohibited short swing sales of stock, was expanded to prohibit short swing sales of convertible bonds, bonds with warrants, warrants, and options.106 Articles 190-2 and 190-3 updated the provisions

liberal capital markets. In 1985, bond futures trading commenced, and in 1987 securities options trading commenced and the commercial paper market was introduced. See Oda, supra note 4, at 268-70.


102. SEL 1948, art. 154 (amended in 1988). Under the original Article 154, the Ministry of Finance could request the stock exchange to submit a report on a listed company. Under the 1988 Amendments, the Ministry of Finance can make a direct request of any company listed on the stock exchange, as well as to the Stock Exchange itself, to submit a report or data. Furthermore, it empowers competent officials in the Ministry of Finance to conduct an inspection of the accounting books, documents, or other articles.

103. Failure to file such a report or providing false information in the report, is punishable by a maximum fine of three hundred thousand yen. However, this information is provided only to the Ministry of Finance, and therefore cannot serve as the basis for an action against an alleged insider by a corporation or one of its shareholders. Id. art. 188.

104. Id. art. 189, ¶ 4-9.

105. An alleged insider has, under Article 189(5), twenty days within which to file an objection with the Ministry of Finance. If such an objection is filed the Ministry of Finance will act as if no report had been filed in the first place under Article 188. However, there is a three hundred thousand yen maximum fine for filing a false objection. Furthermore, if the corporation fails to attempt to recover the short-swing profits within a certain period of time, the Ministry of Finance is then obliged to disclose the information to the public, allowing shareholders of the corporation in question to attempt to recover the short-swing profits.

prohibiting insider trading and trading by tender offer insiders respectively.107 Article 190-2 provides for the most fundamental prohibition—prohibiting a corporate insider from dealing in her company’s stocks (or bonds, warrants, or options) which are listed on a stock exchange when in possession of material non-public information.108 Material information was defined as being that information deemed material enough to affect the investment decisions of investors.109 Article 190-2 also restricted the sale of stock by tippees, who were defined as people who have received material facts from either a corporate-related party or a former corporate related party. Tippees were subject to the same restrictions as insiders.110 Former corporate related parties are defined as any person who falls into one of the definitions provided by the law.111 These parties are constructively a part of the organization within one year of ending their relationship with the organization.112

Article 190-3 was similar in nature to Rule 14e-3 in the United States, prohibiting corporate related parties defined in Article 190-2 of an acquiring corporation from dealing in securities of a takeover target based on knowledge of a tender offer obtained through their relationship with the acquiring corporation. No deals can be made until such information has been disclosed to the public, as provided under Article 190-2.113 Finally, Article 200, the penalty provision, was updated to include a maximum six month prison sentence and/or a maximum fine of half a million yen for a breach of either Article 190-2 or 190-3. Disclosure to the public was defined as

107. The provisions are now in Article 166 of the SEL (amended 2001).
108. SEL 1948, art. 190-2 ¶ 1. Paragraph 1 of Article 190-2 then defines corporate related parties of which there are five major types: (i) those directors, agents, or other employees of the corporation who have obtained material facts during the course of their duties; (ii) principal shareholders where they have obtained material facts due to their right to inspect the corporation’s accounts; (iii) those who due to their supervisory authority over the corporation have obtained material facts during the course of their duties; (iv) those who have contracts with the corporation and have obtained material facts as a result of entering into such contracts or in the course of performing such contracts (e.g., lawyers, printers, accountants); and (v) others from a legal entity falling into categories (ii) to (iv) if they have obtained the material facts during the course of their duties. Id. Items 1-5.
109. Id. ¶ 3.
110. Id. ¶ 1.
111. Id.
112. Id.
113. Paragraph 2 of Article 190-3 defines information concerning a tender offer as information that a corporation intends to make or withdraw a tender offer for another corporation. However, some information may be exempt where it is deemed not to be material enough to affect an investor’s investment decisions. Ministry of Finance Ordinance No. 10 of 1989, art. 7.
information made public by the corporation as defined by the Cabinet Ordinance of 1965.114

C. The Anatomy of Tatema Revisited

This new regulatory regime for insider trading marked a significant departure from the previous stance held by the Japanese authorities. The regulations reflect Japan’s desire to have its financial markets viewed as being on a par with those of London and New York. Along with Tokyo’s rapid internationalization the reality was that the Japanese government, in the light of the Tateho Affair and overseas criticism, could no longer turn a blind eye to the issue of insider trading.

There is little doubt from the analysis of events leading to the 1988 Amendments that they were once again motivated in great part by a need to placate critics. Japan’s failure to set up an independent watchdog to police the markets and enforce the new law further reinforces the notion that tatema, rather than honne, was the driving force behind the decision to re-regulate insider trading in 1988. However, the fact that a domestic scandal set the train of events in motion suggests that the Japanese government was beginning to internalize the notion that insider trading needed to be addressed more seriously.

Some Japanese academics referenced the oft-cited Western justifications for the prohibition such as fairness and confidence in the markets, to lend support for establishing more effective securities statutes. Notwithstanding that, Baum hit the nail on the head when he pinpointed reputation (read tatema) as a prime motivation for the regulation.115 Lu was more blunt when she argued that the 1988 Amendments “created very strict-looking rules in order to convince foreigners that the Japanese market is a fair one.”116

114. Cabinet Ordinance No. 321 of 1965, art. 30 (amended by Cabinet Ordinance No. 23 of 1989). The Ordinance states that a chief executive officer (CEO) satisfies the public disclosure requirement when the CEO or an agent of the corporation provides the information to at least two different news media sources, followed by a lapse of at least twelve hours. Whether or not the news media then choose to broadcast that news is irrelevant.
115. See Baum, supra note 83, at 20.
116. See Lu, supra note 29, at 237.
IV. FROM TATEMAE TO HONNE

A. Post-1988 Revisions

In 1992, the provisions concerning insider trading were moved from Articles 188-190 to Articles 163-167 of the SEL.\textsuperscript{117} Administration of the SEL, which has been moved several times, currently lies with the Prime Minister.\textsuperscript{118} The revisions made to the law since 1988 fall into three main categories. Firstly, the scope of the law has been gradually widened. The revisions not only expand the types of financial instruments covered,\textsuperscript{119} but the amendments also broaden the range of people to whom it is applicable\textsuperscript{120} and the markets which fall within it.\textsuperscript{121} Second, the definition of material information, now contained in Article 166(2), has been steadily widened and redefined, making it a more comprehensive, and consequently more complex, definition than at the time of the 1988 Amendments.\textsuperscript{122} Third, the revisions significantly enhanced penalties. “Natural” persons convicted of SEL violations are subject to up to three years imprisonment, and/or a fine of three million yen (previously six months and half a million yen respectively).\textsuperscript{123} For legal entities, the penalty was increased to a fine not exceeding three hundred million yen (previously half a million yen).\textsuperscript{124} In

\begin{itemize}
  \item \textsuperscript{117} Law No. 73 of 1992. Revisions to the law became effective from July 20, 1992.
  \item \textsuperscript{118} From July 1, 2000, the administration of the SEL was changed from the Minister of Finance (\textit{Ôkura daijin}) to the Financial Reconstruction Commission (\textit{Kinyû saisei iinkai}), then on January 6, 2001 administration of the SEL was again changed, this time to the Prime Minister (\textit{Naikaku sôri daijin}).
  \item \textsuperscript{119} On December 1, 1998, the definition of the instruments covered was expanded to include securities based on a futures index, options, foreign markets’ futures, and over-the-counter derivatives.
  \item \textsuperscript{120} The expanded definition also included the following people: executives at a parent company where that company holds ten percent or more of the subsidiary or contractors; a contractor in negotiations with either the parent or the child company; and any executive within the tippee’s company where the tippee received the information from the tipper about the tipper’s company through a business relationship. From July 1, 2000, anyone related to a subsidiary company fell within the scope of the prohibition.
  \item \textsuperscript{121} From July 20, 1992, provisions were expanded to cover the over-the-counter markets.
  \item \textsuperscript{122} Changes were also made to the definition of material information: from April 1, 1994, any knowledge pertaining to the acquisition of or divestiture of any part of the business; from October 10, 1994, information relating to a company’s buyback of its own stock; from June 1, 1997, information concerning the delisting of a stock from a stock exchange; from December 1, 1998, information relating to the reduction of capital through buyback, a foreign company repurchasing overseas, a business loss and a change in the prospective dividend; from October 1, 1999, information relating to an exchange or transfer of securities and from July 1, 2000, information to do with any company within a group to which the company belongs, where they know the actual results will be different from the estimate and for companies listed on the stock exchange any information concerning a subsidiary.
  \item \textsuperscript{123} SEL 1948, art. 198 (amended 2000).
  \item \textsuperscript{124} The penalties were increased on December 30, 1997.
\end{itemize}
1999, the penalties were changed yet again, this time providing for a forfeiture of the proceeds received by the insider via illegal insider trading.\textsuperscript{125}

Although no single revision is in itself particularly startling, when taken together as a whole they serve to create a relatively comprehensive regime. Certainly, if the rationale for the adoption of the original amendments in 1988 was to placate foreign and domestic critics, but with no real intention of enforcing them, the same cannot be said for the subsequent amendments. The later revisions clearly demonstrate that Japan is serious about enforcing the law. These post-1988 amendments can serve no other useful purpose than to more clearly define the scope of the prohibition and increase convictions. Empirical evidence from the case law bears this out. The fact that the law now falls under the direct auspices of the Prime Minister further reinforces the impression that enforcement of insider trading law has gained prominence in the political agenda.

B. Stock Market Surveillance Institutions—Towards a Japanese SEC

Despite the promulgation of the 1988 Amendments, Japan found itself once again with a lacuna because it lacked an effective watchdog along the lines of the SEC in the United States. As discussed above the Japanese version of the SEC was abolished soon after it was established, and replaced by a totally ineffective regime.\textsuperscript{126} As a result, there were no successful prosecutions for insider trading for over forty years. Even though the 1988 Amendments strengthened the law, absent an independent watchdog, there was no real means for enforcement.

This led the \textit{Economist}, in 1990, nearly two years after the 1988 Amendments came into force, to suggest that insider trading was not taken seriously as a crime and that it was just as common a practice as speeding.\textsuperscript{127} The article stated that the police decided to crack down on insider trading by enforcing the new amendments to the SEL because the prosecutor’s office seemed incapable of doing so.

However, in 1991, the situation began to change. First, the government created the Securities and Exchange Surveillance Commission (SESC) in 1992. The next step involved the establishment of the Financial Supervisory Agency in 1998. The commitment to enforcement finally came of age with the birth of the Financial Services Agency in 2000.

\textsuperscript{125} Forfeiture was provided for in the amendments taking effect from December 1, 1998.

\textsuperscript{126} See supra notes 27-29 and accompanying text.

\textsuperscript{127} See supra note 1 and accompanying text.
1. The Securities and Exchange Surveillance Commission

Following a series of loss compensation scandals in the late 1980s and early 1990s, the Advisory Committee to the Prime Minister recommended in the autumn of 1991 that a watchdog independent from the Ministry of Finance be set up to monitor the financial markets. According to Aoki, the Ministry of Finance’s unofficial administrative guidance was largely to blame for the scandals. On July 20, 1992 the Shōken torihiki tō kanshi iinkai [Securities and Exchange Surveillance Commission] was officially established under the auspices of the Ministry of Finance. While the SESC has always been located within either the Ministry of Finance (1992-98), the Financial Supervisory Agency (1998-2000), or the Financial Services Agency (2000-present), it works independently of them. The SESC’s Chairperson and Commissioners are appointed directly by the Prime Minister’s office. The Chairperson of the SESC described the SESC’s purpose as follows: “Our mission is to ensure fair transactions in the securities and financial futures markets, thereby maintaining the confidence of investors in these markets.”

The SESC serves three functions: compliance inspections, market surveillance, and enforcement. The SESC has three options open to it to deal with any misconduct or fraud. First, it can make a recommendation for an administrative disciplinary action to the Financial Services Agency. Second, it can file an accusation with the public prosecutor, who may then take up the matter. And third, it can make a policy proposal to the Financial Services Agency.

Since its establishment, despite being short staffed when compared to the SEC, the SESC has been relatively active. According to its 2001 Annual Report, the SESC had a total staff of 255, which is equivalent to a mere 8 percent of the 3,285 people employed by the U.S. Securities and Exchange Commission.
Report (covering the period from July 1, 2001 to June 30, 2002), the SESC has brought a total of sixteen cases of insider trading since its inception in 1992.\footnote{SESC 2000 Report Data Appendix, supra note 136, at 69.}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{diagram2.png}
\caption{Number of investigations of insider trading carried out by the SESC 1995–2001\footnote{See SESC 2001 Report Data Appendix, supra note 136, at 69.}}
\end{figure}

The number of investigations carried out by the SESC relating to insider trading has increased dramatically over the past five years. The SESC investigated 236, 190, and 249 suspected cases of insider trading in its 1999, 2000, and 2001 reporting periods respectively.\footnote{Id.} In addition, during the 2001 reporting period it investigated 112 cases of suspected price manipulation and thirty-one cases of suspected rumor spreading.\footnote{Id.} Over the past two years, the SESC has also participated in so called “Internet Surf Days”


\footnotetext[137]{Id.}

Commission. In fiscal 2002, the SESC had an annual budget of only $23.33 million, or 5.3 percent of the SEC’s $437.9 million budget.

organized by the International Organization of Securities Regulators, aimed at uncovering fraudulent schemes involving the Internet. Furthermore, the SESC cooperates with various Japanese Self-Regulatory Organizations that also monitor the markets for violations of self-imposed rules.

The establishment of the SESC alone is remarkable because it demonstrates that Japan is taking the concept of independent inspection of its financial markets seriously. An effective regime against insider trading cannot exist without a means of monitoring the market to ensure that all participants follow the rules. Thus, the SESC is a crucial element in the creation of an effective regime against insider trading.

A genuine regulatory enforcement mechanism represents a fundamental change of policy over the previous four decades. Previously, despite statutory prohibitions there were no successful prosecutions involving insider trading. And, largely thanks to the lack of an independent watchdog, only two cases were brought in the four decades from 1948 to 1988.

2. The Financial Supervisory Agency

As part of a program of reform set in motion by then Prime Minister Ryutaro Hashimoto to revitalize Japan, and following the publication of the Keizai hakusho [Economic White Paper] in July 1996 (1996 Economic White Paper), the government announced Japan’s equivalent to the United Kingdom’s Big-Bang. \(^\text{140}\)

The 1996 Economic White Paper warned that Japan’s economic system needed reformation if it was to move from a “catch-up” based economy to a “post catch-up” based economy. \(^\text{141}\) In response to the 1996 Economic White Paper’s comments, the Ministry of Finance issued a document entitled Financial System Reform: Toward the Early Achievement of Reform on June 13, 1997. The paper suggested that the foundation for the Japanese Big-Bang should be based upon the creation of a “free, fair, and global” market. \(^\text{142}\) The

\(^{139}\) Id. at 82-83.


\(^{141}\) Id.

paper noted the increased number of new financial products in U.S. and European markets, and stressed similar enhancements of Japanese financial markets to "prevent its possible hollowing out."143

Following a number of scandals involving the Ministry of Finance in the early 1990s, the Jûsen Scandal of 1995 in particular, critics attacked the Ministry of Finance.144 Partly in response to these criticisms, the government decided to divest the Ministry of Finance of some of its powers. As a result, in June 1998, the Diet established the new independent Financial Supervisory Agency as an external bureau of the Cabinet Office.145 The government effectively transferred the Ministry of Finance’s supervisory and inspection authority, and the SESC, to the newly created Financial Supervisory Agency.

3. The Financial Services Agency

On July 1, 2000, the Financial Supervisory Agency and the Ministry of Finance’s Financial Planning Department merged to form the Financial Services Agency.146 The SESC moved to the new Financial Services Agency as well. Although physically located on the Financial Services Agency’s premises, the SESC remains independent. The commissioner of the Financial Services Agency listed six basic policy principles of the new agency: establishment of a reliable and vigorous financial system, development of a state of the art financial infrastructure, development and proper implementation of regulations to protect users, ensuring transparency and fairness in financial administration based on clear rules, enhancement of expertise and foresight of the staff and improving the administrative structure, and the reinforcement of cooperation with foreign regulators and contribution to international rule-making.147

Despite a rather complicated birth, Japan now has an independent watchdog for the financial services industry with responsibilities that include market surveillance and, through the SESC, control of insider trading. As a result, Japan is now back in the situation that GHQ had originally intended

143. See Financial System Reform—Toward the Early Achievement of Reform, supra note 142.
144. The Jûsen Scandal is cited by Aoki as a primary reason for the collapse of the Ministry of Finance. See Aoki, supra note 128, at 101-03. Oda names of the loss-compensation scandal of 1991 as a motive for the reformation of the Ministry of Finance. See Oda, supra note 4, at 287.
146. Kinyûchô setchi hô [Law establishing the financial services agency], Law No. 130 of 1998 (amended 2000).
some half a century earlier. This time, the pressure for reform originated more from within the Japanese system rather than from foreign duress.

The catalyst for the reform of Japan’s financial system and, in turn, the Ministry of Finance was triggered by the realization that Japan needed to reorganize its economic model. Although many critics made reference to “hollowing out” and the need to compete, rather than to silence foreign critics, the changes were the product of the recognition that in order for the Japanese economy to recover it needed to undergo fundamental structural change. This realization marks the beginning of the second phase in the development of Japanese insider trading law.

4. Self-regulatory Organizations

In addition to the SESC, a number of self-regulatory organizations exist to police securities markets and the ethical conduct of members. Such organizations include the Japan Securities Dealers Association, the Financial Futures Association, the Tokyo International Financial Futures Exchange, and the Tokyo Stock Exchange.

The Tokyo Stock Exchange’s surveillance department, known as the Department of Market Surveillance and Compliance has the power to investigate suspicious trades and then impose penalties on the company in question or refer the case to the SESC. The data released by the Tokyo Stock Exchange indicates a similar trend in the growth of insider trading investigations when compared to SESC figures.

From 1995 to 2000, the number of suspicious trades doubled and the number that resulted in investigations increased by approximately three hundred and fifty percent. The Tokyo Stock Exchange also publishes guidelines and circulations that member companies are obliged to comply with. A number of the guidelines are related to the prohibition on insider trading.

149. See Diagram 3, infra.
Diagram 3: Number of Cases Where Insider Trading was Suspected and Investigated by the Tokyo Stock Exchange, 1995 – 2000

C. Case Law

Since the promulgation of the 1988 Amendments, there have been relatively few prosecutions for insider trading compared to the United States. However, when compared the period from 1948 to 1988, there has been a marked difference in prosecution rates. There have been sixteen reported cases since the new amendments came into effect, including two opinions from the Supreme Court.

For enforcement to succeed, the frequency of prosecution and the imposition of penalties are of greater interest, and arguably more importance than the raw number of cases. Despite the small data sample, there is a clear trend towards increasing the penalties imposed for violations of the law. As

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24, 1995).

151. See TOKYO STOCK EXCHANGE, COMPLIANCE REPORT, supra note 150, at 28.

152. See SHIN INSAIDÂ TORIHIKI KISEI GAIDOBUKU [NEW INSIDER TRADING REGULATIONS GUIDEBOOK] 149-63 (2001) and SESC 2001 Report Data Appendix, supra note 136, at 26-34, for details of the sixteen cases. Shortly after the enactment of the 1988 Amendments, a large-scale case of insider trading occurred on the Tokyo Stock Exchange. In the so-called Shin nihon seitetsu-Sangyö seiki jiken [New Japan Steel Sangyö seiki Affair] fifteen employees of Sangyö seiki and nineteen employees of New Japan Steel acquired shares shortly before an announcement of a tie-up between the two companies that boosted the stock price. The Tokyo Stock Exchange investigated and concluded that it would have been a chargeable offence under the newly amended insider trading law except for the fact that the law had not yet come into force. See HIDEAKI KUBORI, INSAIDÂ TORIHIKI KISEI TO KABUNUSHIKAI [INSIDER TRADING REGULATIONS AND SHAREHOLDERS MEETINGS] 6-7 (1989). See also Lu, supra note 29, at 197-98.
Diagram 4 shows, in the first few judgments, the courts levied relatively modest fines. By the mid-1990s, as the financial Big-Bang occurred in Japan, the courts meted out more severe penalties. Usually, the penalties included six-month jail sentences, suspended for three years. Finally, in 2000, in the *Nihon M.I.C.* case, the Tokyo District Court sentenced the accused to an unsuspended six months in prison. This case is currently on appeal to the Supreme Court.153

The distribution of the sentencing data for insider trading violations in Diagram 4 reveals that the application of the law changed in the mid-1990s. The number of cases has steadily increased, albeit from a very low starting point. And although the number of cases is still small compared to the United States, Japan is fast approaching Europe’s level of enforcement. Indeed, if the present trend continues, Japan may well surpass Europe’s level of enforcement. Imposition of prison sentences and profit forfeitures began in 1997, the year of the Big-Bang in the Japanese financial markets—a remarkable coincidence.154 With the unsuspended six month sentence in the *Nihon M.I.C.* case, the trend shows that Japan’s establishment of a securities market watchdog has begun to bear fruit.155


154. This is not necessarily the case, since forfeiture only became an option with a revision of the law in 1997.

155. Although a six month sentence, suspended for three years, may seem lenient, it should be noted that prison sentences in Japan tend to be shorter than in the West as a general rule. For instance, in a recent rape case a Japanese court sentenced a U.S. serviceman to less than three years in jail. In the United Kingdom, there is a mandatory life sentence. On that basis, by Japanese standards an eight month or one year prison sentence for insider trading would be considered a very severe sentence. Airman gets 32 months for rape in Okinawa, *JAPAN TIMES*, Mar. 29, 2002, at http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20020329a2.htm. *See also* SDF officer gets 3-1/2 years, not Five, for Raping Teen, *JAPAN TIMES*, July 31, 2001, at http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20010731a9.htm. In the latter case the prosecutors had only sought a five-year prison term.

The Japanese Supreme Court first addressed insider trading in the *Nippon shōji kabushiki kaisha* case. The defense presented an interesting

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157. Judgment of February 16, 1999, Saikosai (Supreme Court) (53-2 KEIHISHU 111) [author’s translation]. Numerous English and Japanese language reports and comments on this case were published after the ruling.

Japanese language sources include: Insaidâ torihiki jiken jôkoku shin hanketsu (saisanban heisei 11.2.16) [Insider trading case’s final appeal (Supreme Court, Third Circuit, February 16, 1999)], 1671 HANREI JIHÔ 45 (1999) [author’s translation]; Kuniji Shibahara, Nippon shōji kabushiki insaidâ torihiki jiken saikōsai hanketsu no kentô [An examination of the Supreme Court’s decision in the Nippon Shōji case], 1525 SHÔJI HÔMU 56 (1999) [author’s translation]; Takashi Nonoue, Shōken torihiki hōjō no insaidâ torihiki kisei (shōken torihiki hō 166 jō) ni kansuru hatsu no saikōsai hanketsu ni tsuite [Regarding the first Supreme Court judgment relating to the regulation of insider trading (Securities and Exchange Law article 166)], 52 HÔRITSU NO HIROBA 54 (1999) [author’s translation]; Takashi Nonoue, Insaidâ torihiki kisei ni kansuru hatsu no saikōsai hanketsu [Regarding the Supreme Court’s first judgment relating to insider trading regulation], 1521 SHÔJI HÔMU 12 (1999) [author’s translation]; Saikin no saiban dōkō, Nippon shōji kabushiki insaidâ torihiki jiken jōkoku shin hanketsu [The judgment of the final appeal of the Nippon Shōji insider trading case], 182 SHIRYOYAN SHÔJI HÔMU 212 (1999) [author’s translation]; Tokuya Shinatani, Shōken torihiki hō 166jō 2kō 4gō no kaihaku [An examination of Securities and Exchange Law article 166(2)(4)], 1154 JURISTO 87 (1999) [author’s translation]; Saikōsai, insaidâ torihiki ni kanshite hatsuhanban [The Supreme Court’s first judgement regarding insider trading], 1152 JURISTO 4 (1999) [author’s translation].
argument, noting that the government indicted their client on October 14, 1994, just two days before the International Organization of Securities Commissions conference, to be held October 16-22, 1994, in Japan was to commence. The defense claimed their client was being made a scapegoat by the Japanese authorities in order to avoid international criticism that Japan was an “insider’s heaven.” It is hard to substantiate such claims—it could have been a genuine case of coincidence. However, the timing of the indictment suggests that placating foreign critics may well have been a factor in the decision to prosecute.

The Nippon Shôji case however, was initiated in 1994, before the Japanese Big-Bang and the turning point noted above. Since the 1996 Economic White Paper, the case law clearly demonstrates Japan’s increasing determination to crack down on insider trading. The increased prosecutions and stiffer penalties reflect a change in philosophy with regard to insider trading. The creation of an independent watchdog, the gradual expansion of the law prohibiting insider trading, and the increasing enforcement of that law indicates that the government has developed a real desire to tackle the issue.

D. Post-bubble Blues

Events of the last decade suggest that Japan has adopted a new philosophy of regulation. The incremental but important revisions to the prohibition since the early 1990s coupled with the creation of an independent watchdog and the ever increasing frequency of cases indicate that Japan has developed a serious desire to enforce its insider trading prohibition.

The driving force behind the apparent shift in the underlying rationale for regulation from *tatemae* to *honne*, is arguably the fundamental readjustment of the Japanese economic model, which began in the mid-1990s. After its economic bubble burst in 1992, Japan entered into what has now been sometimes termed as “the lost decade”—a quagmire of anemic growth,

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158. *Jôkoku shuisho* ([hôkokin gawa] [Appeal from the defendants side to the Supreme Court], Feb. 26, 1998, *Heisei 9 nen (a) dai 1232 gô* (Case number (a) 1232, 1997), reprinted in 182 SHIRYOBIAN SHÔJI HÔMU 212, 227 (1999) [author’s translation].

deflation and frequent recession.\textsuperscript{160} This economic crisis sparked fundamental reforms of Japan’s economic model, with the Hashimoto administration initiating the financial sector reforms set out in the 1996 Economic White Paper and the subsequent Big-Bang.

A major consequence of these reforms has been the breakdown of the keiretsu system and its accompanying economic model.\textsuperscript{161} First, as a result of falling asset prices after the collapse of the bubble economy and the capital adequacy ratio requirements of the Bank for International Settlements, many Japanese banks found that they had to sell their share holdings in order to raise capital. Second, banks are required to follow the so-called five percent rule, which holds that generally a financial institution may not hold more than five percent of any one particular corporation’s stock.\textsuperscript{162} As various banks merged they found themselves with holdings in excess of five percent and have consequently been forced to reduce holdings to comply with the rule. This has contributed to the unraveling of the cross-share holding structure of the keiretsu and has thus hastened their demise. And third, opening competition for financial services between banks and securities companies led to the collapse of the convoy system, further limiting the financial industry’s ability to maintain the keiretsu system.\textsuperscript{163}

As the keiretsu structures break down, companies will increasingly turn to the financial markets rather than a keiretsu group financial institution in order to raise capital. Furthermore, banks weakened as a result of bad loans from the bubble are not able to lend money as easily as before. Therefore, the general trend in Japan is towards an increased use of direct rather than indirect financing. This trend originated in the 1980s, but the collapse of the bubble has further accelerated it.\textsuperscript{164} The increasing reliance on financial

\begin{itemize}
\item \textsuperscript{160} Two of the major problems which beset the Japanese economy are the banks’ non-performing loans and deflation. The banks had made loans to companies, often within their keiretsu grouping, secured on assets, the value of which were greatly inflated during the bubble. As asset prices fell the banks found themselves with increasing bad loans. Since corporate bankruptcy is generally discouraged in Japan, the banks have found themselves carrying approximately ¥150 trillion in bad loans. None of the numerous efforts to clean up the banking sector have so far completely solved the problem. See \textit{Trickle Down Pain}, ECONOMIST, May 8, 2003. In addition, deflation effectively lowers wages which in turn discourages investment and spending, further contributing to the economic downturn. See \textit{Heading Down}, ECONOMIST, Mar. 6, 2003.
\item \textsuperscript{161} \textit{Mindset}, ECONOMIST, Oct. 21, 1999, at 71.
\item \textsuperscript{162} Dokusen kinshî hô [Anti-Monopoly Law], Law No. 54 of Apr. 14, 1947, art. 11. There has however, been much debate over this rule. See, e.g., Tokushû: Ginkô no kabushiki hoyû kisei ha hitsuyô ka [Special: Are the rules concerning banks shareholdings necessary], KINYÛ ZAISSEI JIHÔ, June 4, 2001, at 10-27.
\item \textsuperscript{163} See Karaki, supra note 56, at 356-60. Karaki documents the end of the convoy system pinpointing the law allowing banks to start engaging in the securities business, albeit in a limited way, as the “landmark” change.
\item \textsuperscript{164} See Diagram 1, supra. In fact, as Oda documents, the trend towards direct financing, which
\end{itemize}
markets as a source of capital makes it ever more important that those markets are viewed as fair, transparent and liquid. This is because investors are wary of markets that are considered immature and/or are rife with corruption, market manipulation and insider trading.\textsuperscript{165} It has been argued that a prohibition on insider trading is an important part of the package of regulations necessary for a successful stock market.\textsuperscript{166}

Thus at a minimum, it is vital that potential investors at least perceive the markets as being fair and transparent. And the Japanese government, in recognition of this situation, commendably pushed through the Big-Bang reforms and strengthened the insider trading prohibition—reforms that indicate an understanding that the economic model must change in order for the Japanese economy to remain competitive.

V. CONCLUSION

There can be little doubt that initially, the underlying rationale for the prohibition of insider trading in Japan was one of \textit{tatemae}—the prohibition having been forced upon Japan as a precondition for reopening its stock

began in the mid-1980s, was one of the contributory factors to the economic bubble in the late 1980s.

The shift from indirect to direct finance in Japan, especially to heavy reliance on equity finance, resulted in excess liquidity, which was often used to invest in real property and securities. The low cost of raising funds abroad and low interest rates in Japan made this possible. In this frenzy of equity finance, some companies came to be involved in speculation in the securities market, instead of pursuing profit from their primary business. This state of affairs, dubbed the “bubble economy,” naturally did not last long.

\textit{See} Oda, \textit{supra} note 4, at 255.

165. Discussing developing states eager to promote their financial markets, Summe & McCoy state that: “If these developing states hope to attract foreign capital, particularly American capital, it is likely that their governments will need to construct a regulatory environment which corresponds to foreign investors’ notions of how a market should function.” \textit{See} Summe & McCoy, \textit{supra} note 97, at 311. To wit, much has been made of the fact that China’s stock markets are still immature because, among other factors, insider trading is not adequately regulated. \textit{See} Trish Saywell, \textit{Foreign Fund Managers Scrambling into China}, FAR E. ECON. REV., Oct. 4, 2000, at 71; \textit{China Securities Regulator Urges Honesty, Virtue—Report}, DOW JONES NEWSWIRES, Nov. 27, 2000; Sophie Roell, \textit{Decade Later, China Stock Msks Still Face Challenges}, DOW JONES NEWSWIRES, Dec. 18, 2000.

166. There has been much debate over the relative merits of bank-centered versus stock market centered capital markets. It has been argued that capital markets that are bank-centered are better able to monitor management, whereas those that are market centered have weaker monitoring but greater liquidity. Bernard Black conversely argues that: “stock-market-centered capital markets provide strong information disclosure and control of self-dealing—monitoring dimensions for which bank-centered capital markets are often weaker.” Black further maintains that an enforced ban on insider trading, while not absolutely vital to the success of a stock market, will certainly contribute to a stronger market. Bernard S. Black, \textit{The Legal and Institutional Preconditions for Strong Securities Markets}, 48 U.C.L.A. L. REV. 781, 785 (2001). Recent research suggests that a prohibition on insider trading that is actually enforced tends to raise share prices by about five percent, which appears to support Black’s contentions. Utpal Bhattacharya & Hazem Daouk, \textit{The World Price of Insider Trading}, 57 J. OF FIN. 75 (2002).
exchange. The subsequent detoothing of the law and its utter failure to be enforced can be ascribed to a transplant failure. The law was transplanted into a country with an entirely different historical, cultural and socio-economic background from the country from which the law originated. It is not surprising then that the law failed to take root. Japan lacked the context to successfully drive the enforcement and development of the law. An analysis of the events leading to the adoption of the 1988 Amendments, shows that they were clearly enacted as a reaction to the Tateho Affair and to placate foreign and domestic critics.

Since the mid-1990s however, Japan found itself in an economic situation not dissimilar to that of the United States in the 1930s, the very context in which the original prohibition of insider trading was first enacted. Indeed, this changed context allowed, demanded even, that the law be strengthened and enforced. And as such the regulation of insider trading has been taken more seriously and is no longer being treated exclusively as a matter of tatemae designed to placate Westerners.

However, can one therefore conclude, a fortiori, that just because Japan has both strengthened and enforced the law that what was once tatemae has now become honne? Yes and no. On the one hand, the emerging pattern of enforcement and strengthening of the prohibition indicates Japan’s desire to tackle the issue. On the other hand, there is little concrete evidence to suggest that the newfound emphasis for enforcing the prohibition of insider trading is anything more than skin-deep. Certainly in order for its financial markets to successfully drive its economic growth, Japan has recognized that those markets need to be seen as being fair and transparent. Here the evidence points to a shift in the underlying philosophy of regulation from tatemae to honne: there is an honest desire to be perceived to be a fair and transparent market. However, has Japan developed a deep-seated belief that insider trading is malum per se and as such ought to be “legislated out of existence”? No, and absent a sharp economic shock directly precipitated by financial market chicanery, as was the case with the Great Crash of 1929, such a deep-seated belief is unlikely to be formed.

Nonetheless, Japan’s adoption of a new rationale for the prohibition of insider trading, coupled with a new independent watchdog and increased enforcement, is encouraging. If correctly implemented, such reforms should pay great dividends in the future. Having come this far however, the

167. Referring to short sales, which were widely blamed for the Great Crash of 1929, Mr. Thomas Corcoran testified that a great many people felt that the practice ought to be “legislated out of existence.” Hearings on H.R. 7852 and H.R. 8720 Before the House Committee on Interstate Banking and Foreign Commerce, 73d Cong., 2d Sess. (1934) (testimony of Mr. Thomas Corcoran).
government must not rest on its laurels. Rather it must address the challenges facing the regime which include, inter alia, more resources dedicated to finding and punishing those who violate the law.