CONTENTS

Volume XX April 1975 Number 1

Articles:

The Ateneo Law Journal

Published twice during the academic year by the students of the Ateneo de Manila University, College of Law.

SECURITIES REGULATION IN JAPAN AND THE PHILIPPINES: A COMPARATIVE ANALYSIS OF REGISTRATION SYSTEMS

RICARDO V. PUNO, JR.*

A comparative analysis of securities law in Japan and the Philippines is useful for several reasons. In the first place, both countries based their systems on the American model, specifically the Federal Securities Act of 1933 and the Federal Securities Exchange Act of 1934.[1] In the case of the Philippines, certain portions of the Uniform Securities Act, the paradigm for present state blue sky laws, were also adopted.[2] Moreover, both the Philippines and Japan imported the U.S. law and placed the local version alongside their civil law systems. The Civil Code still constitutes one source for interpreting concepts or defining rights found in the securities laws.[3] Thus, for example, civil law notions of fraud, contracts and sales may play an important part in the future development of a body of cases applying various civil liability provisions or expanding their scope. Unlike in the United States, both Japan and the Philippines have unitary legal systems and, hence, do not have problems of multiple federal and state registrations or overlapping jurisdictions. Independent evolution of Philippine and Japanese securities law has resulted in two rather different systems. As such, they are interesting today as examples of variations of the basic American pattern.

* A.B., LL.B. (Ateneo), LL.M. (Harvard), Cand. for the S.J.D. degree (Harvard); Professor in Corporation Law and practising lawyer.

[1] M. TATSUTA, SECURITIES REGULATION IN JAPAN 6 (1970). [hereinafter "Tatsuta"]; Yokoyama, *Securities Regulation and Portfolio Investment in Japan; The Role of the Investment Banker in* CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE FAR EAST 81 (R. Allison ed. 1972); Sibal, *Defects and Loopholes in the Securities Act*, 5 Lawyers' J. 487 (1937); Yabyabin, *The Securities Act and Trading*, in ASPECTS OF PHILIPPINE CORPORATION LAW 282 (M. Lopez-Campos ed. 1966).

[2] Sibal, *supra* note 1.

[3] *Infra*, text at notes 8-13.

A cautionary note is appropriate at the outset. It bears emphasis that comparison of the two systems is not made against a background of identical political, cultural and economic environments. Japan is an industrialized country; the Philippines is a developing nation. Japan's capital market is much larger in terms of the number of participants and the amounts involved.[4] Nevertheless, one country can learn from the other. Popular participation, so-called "people's capitalism," is a relatively recent phenomenon in both countries.[5] Insofar as securities regulation aims at preventing fraud and establishing an orderly market for securities, the general principles would seem to have universal application. The experience of different countries in responding to changing business conditions and uncovering fraudulent devices should be helpful to other countries.

It should be noted, finally, that Japan has replaced the United States as the Philippines' largest trading partner.[6] This relationship could in the future take the form of more substantial capital movements. Securities laws would then assume greater importance and perhaps be as essential as a knowledge of each other's corporation law, and foreign exchange or foreign investment regulations. This article, however, will not treat of international aspects of securities regulation in Japan and the Philippines. This subject itself deserves a separate discussion. What we attempt here is to provide a better understanding of the fundamental legal concepts and structures found in the regulatory systems of the two countries. With this background, a study of the international aspects should be more meaningful.[7]

---

[4] For a description of the Japanese stock market, with relevant figures, see JAPAN SECURITIES RESEARCH INSTITUTE, SECURITIES MARKET IN JAPAN 1973 16-43. [Hereinafter "Securities Market in Japan"]

With respect to the Philippines, *see generally* R. EMERY, THE FINANCIAL INSTITUTIONS OF SOUTHEAST ASIA 437-443 (1970); R. GATICA AND A. GATICA, MANUAL OF PHILIPPINE SECURITIES (1972 ed.); SECURITIES AND EXCHANGE COMMISSION ANNUAL REPORT 1972-73 4-5.

[5] Tatsuta at 2; Securities Market in Japan 5.

[6] CENTRAL BANK OF THE PHILIPPINES, TWENTY-FOURTH ANNUAL REPORT 35 (1972).

[7] In Japan, acquisition by foreigners of stock in Japanese corporations has been completely liberalized as of May 1, 1973. A number of foreign issuers have also been permitted to list their stock in Japanese exchanges. *See*: M. TATSUTA SECURITIES REGULATION IN JAPAN 9-11 (Addendum 1973) [Hereinafter "Tatsuta Addendum"]; Thorpe, *The Sale of U.S. Securities in Japan*, 29 Bus. Law. 411 (1974); Ishikuzu, *"Foreign Stocks Debut in Tokyo"* in 82 Far Eastern Economic Review 47 (December 31, 1973); D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN 232-233 (1973).

Japanese law has also been reformed in connection with the program to "internationalize" Japanese securities markets. Among these reforms are a law which permits foreign securities firms to do business in Japan and a Ministerial Ordinance which permits the sale of foreign investment company shares. LAW ON FOREIGN SECURITIES FIRMS (Law No. 5 of 1971) (Japan Securities Research Institute 1971). Ministerial Ordinance No. 78, 1972, 6 EHS LAW BULLETIN SERIES MH 1 (F. Nakane ed. 1973).

The Legal Framework

The principal source of securities law in Japan is the Securities Exchange Law (Law No. 25, 1948), as amended, and as supplemented by cabinet rules and ministerial ordinances.[8] In the Philippines, it is the Securities Act of 1936 and administrative rules thereunder.[9] In both countries, however, the specific statutes are not the only sources of law. In Japan, other sources include: special laws like the Securities Investment Trust Law; the corporation law part of the Commercial Code; customary commercial law, in the absence of provisions in special laws and the Code; and the Civil Code.[10] In the Philippines, the Commercial Code has largely been repealed by special statutes and has little significance today for securities regulation. Instead, other sources of Philippine securities law would be the Corporation Law, the Investment Company Act of 1960 and various other special laws.[11] The Civil Code is also important because the Securities Act specifies that rights and remedies provided therein are in addition to existing rights and remedies.[12] The Civil Code itself allows resort to its provisions in case of deficiencies in special laws.[13]

The governmental body which administers securities law in Japan is the Securities Bureau of the Ministry of Finance. The major laws it is concerned with are: the Securities Exchange Law, the Law on Foreign Securities Firms (Law No. 5, 1971), the Securities Investment Trust Law (Law No. 198, 1951), and the Certified Public Accountant Law (Law No. 103, 1948).[14] Its Philippine counterpart is the Securities and Exchange Commission, a body which has considerably more responsibility than the U.S. Securities and Exchange Commission. It is charged with administration of around 17 laws, among which are the Securities Act, the Corporation Law, provisions on partnership in the New Civil Code, the Investment Company Act and the Financing Company Act. In addition, it performs functions under several other laws whose administration is vested in other governmental bodies.[15]

---

[8] An English translation of the Securities Exchange Law of 1948 [Hereinafter "J.S.E.L."] appears in 6 EHS LAW BULLETIN SERIES MA 1 *et seq.* (F. Nakane ed. 1973). References in this paper are to this translation unless otherwise indicated.

Amendments adopted in 1971 are reflected at appropriate sections of this discussion. *See* THE 1971 AMENDMENT TO THE SECURITIES EXCHANGE LAW (Law No. 4 of 1971) (Japan Securities Research Institute 1971).

There has been no substantial amendment of the Law since 1971. Letter of M. Tatsuta to author, April 2, 1974.

[9] Commonwealth Act No. 83, as amended, 2 Philippine Permanent and General Statutes 71 [Hereinafter "P.S.A."].

[10] Tatsuta at 6.

[11] CORPORATION LAW, Act No. 1459, 1 Philippine Permanent and General Statutes 103. INVESTMENT COMPANY ACT, Republic Act No. 2629, 3 Philippine Permanent and General Statutes 1139.

[12] P.S.A., Art. 37.

[13] CIVIL CODE OF THE PHILIPPINES, Republic Act No. 386, Art 18.

[14] Securities Market in Japan, *supra* note 5, at 189.

[15] THE S.E.C. PRIMER 4-5 (1973).

This article will examine the following aspects of securities regulation in Japan and the Philippines: (1) the scope of the registration requirements; (2) prospectus requirements; (3) procedure for registration; (4) reporting requirements; (5) regulation of brokers, dealers and underwriters; (6) protection of investors.

Coverage and Exemptions

Unless exempt or offered in exempt transactions, securities may not be sold by means of public offering or secondary distribution in Japan unless they have been registered.[16] Likewise, unless exempt or offered in exempt transactions, Philippine law requires as a condition to their sale that "speculative securities" be licensed and that other securities be registered.[17] We will examine how the two laws define: (1) securities; (2) exempt securities; (3) exempt transactions.

A. Definition of Securities

Under the Japanese Securities Exchange Law, the following are securities: (1) national government bonds; (2) local government bonds; (3) notes issued by a corporation pursuant to specific statutes; (4) secured or unsecured corporate debentures; (5) investment certificates issued by a corporation organized under special law; (6) stock certificates and subscription warrants; (7) trust certificates of a securities investment trust or a loan trust; (8) foreign securities of similar nature to the foregoing. The ninth category is any instrument designated by cabinet rule to be a security; however, no such rule has yet been promulgated. A "right to be represented" in any of the securities enumerated is also deemed a security.[18]

This enumeration is apparently fairly restrictive. The absence of the catch-all phrase, "any interest or instrument commonly known as a security," and of the term "investment contract," both found in the American law, removes from coverage of the Japanese law various instruments which either are included in the definition or have been held to be securities under U.S. law. Some examples of these are: interests in such ventures as condominiums and gruit groves; voting trust certificates; limited partnership interests; fractional undivided interests in oil, gas or other mineral rights; pre-incorporation certificates or subscriptions and interim certificates.[19]

In contrast, the Philippine Securities Act, after a rather lengthy enumeration of specific securities, includes within the definition "certificates or instruments evidencing beneficial interest in title to property, profits or earnings, or any other instruments commonly

[16] J.S.E.L., Art. 4(1); Tatsuta at 22.
[17] P.S.A., Secs. 4, 9, 2(a) and (b).
[18] J.S.E.L., Art. 2(1) and (2); Tatsuta at 17.
[19] *See* Tatsuta at 17-18.

known as a security."[20] The term "securities" is bound to have as wide an interpretation in the Philippines as it has in the United States. However, Philippine law contains a variation of the phrase "evidence of indebtedness" which is found in American law. The phrase is not reproduced in the Act. Promissory notes are securities under the Act if the proceeds from the sale are to be used to further a business enterprise and the notes are accompanied by a promise that purchasers will participate in profits of the enterprise or benefit from its success.[21] A contract for the sale of land on a deferred payment or installment plan is also a security.[22]

It should be noted that a recent Presidential Decree, without amending the existing provision in connection with promissory note, has included within the definition of securities all "commercial papers evidencing indebtedness of any person, financial or non-financial entity, irrespective of maturity, issued, endorsed, sold, transferred or in any manner conveyed to another, with or without recourse, such as promissory notes, repurchase agreements, certificates of assignments, certificates of participations, trust certificates or similar instruments."[22-a] The provision is obviously intended to regulate the market in short-term commercial paper. Because of the rather loose and over-broad wording of the provision, however, it is likely to give rise to numerous problems of interpretation.

For purposes of the registration requirements, Philippine law also contains a definition of "speculative security." As noted above, this class of securities requires licensing and not mere registration. Generally, these securities include those: (1) where unusual profit is promised to promote sales; (2) where value depends on proposed development rather than existing tangible assets; (3) where sales commissions of more than 5% are offered; (4) where elements of risk and speculative profit predominate over reasonable certainty or safety; (5) securities of companies which include as a material part of its assets intangibles such as patents and goodwill; (6) securities of companies in the business of developing mineral properties.[23] The foregoing, however, will not be deemed speculative securities if the issuer can meet certain income tests.[24]

[20] P.S.A., Sec. 2(1).
[21] *Id.*
[22] *Id.*
[22-A] Presidential Decree No. 678, AMENDING SEC. 2 OF COMMONWEALTH ACT NO. 83, AS AMENDED, OTHERWISE KNOWN AS THE SECURITIES ACT, effective April 2, 1975, Sec. 1.
[23] P.S.A., Sec. 2(b).
[24] P.S.A., Sec. 2(b)(1). The issuer should have been in continuous operation for not less than three years and should have had average earnings, during the two-year period next prior to the close of its last fiscal year preceding the offering, as follows: in the case of interest-bearing securities, not less than 1½ times the annual interest charged thereon and upon all other outstanding interest-bearing obligations of equal rank; in the case of preferred stock, not less than 1½ times the annual dividend requirements on such preferred stock and on all other outstanding stock of equal rank; in the case of common stock, not less than 50% upon all outstanding common stock of equal rank together with the amount of common stock then offered for sale reckoned upon the price at which stock is then offered for sale.

B. Exempt Securities

Securities which are exempt from registration under Japanese law are all the items specifically enumerated in the definition of a security with the exception of stock certificates or subscription warrants, unsecured corporate debentures and convertible debentures. A "temporary" exemption granted in 1953 for *secured* debentures is still in the books. Other securities may be exempted by cabinet rule.[25]

Securities exempted under the Philippine Securities Act are similar to those exempted under the U.S. Securities Act. Hence, the following are exempt: government securities; bank securities; securities of building and loan associations and similar institutions; certificates issued by a receiver or by a trustee in bankruptcy; insurance or endowment policies, annuity contracts or optional annuity contracts; securities exchanged by the issuer with existing security holders exclusively, provided that no commission or other remuneration is paid for soliciting such an exchange.[26] This last exemption, of course, does not cover rights offerings.

There are significant differences between American and Philippine law in this connection. There is no exemption in the Philippines for securities issued in exchange for outstanding securities, claims or property interests, or partly in such exchange and partly for cash.[27] The Philippines exempts certain securities of foreign governments with which the country has diplomatic relations, whereas the U.S. does not.[28] The American exemption for short-term notes is not found in the Philippines, an apparently deliberate omission in view of specific conditions to including promissory notes within the definition of a security.[29] In addition, Presidential Decree 678 expressly provides that all "commercial paper" (as defined therein), including those of short-term maturities, must be registered.[29-A] The exemption for securities of eleemosynary institution operates differently. In the Philippines, the charitable associations must be given a permit by the National Treasurer, while

[25] J.S.E.L. Art. 3; Tatsuta at 19-21.
[26] P.S.A., Sec. 5.
[27] SECURITIES ACT OF 1933, Sec. 3(a)(10), 15 U.S.C.A. §77c(a)(10).
[28] P.S.A., Sec. 5(3).
[29] SECURITIES ACT OF 1933, Sec. 3(a)(2), 15 U.S.C.A. §77c(a)(2).
[29-A] Sec. 2 of Presidential Decree No. 678, reads as follows:

"Sec. 2. Section 4 of Commonwealth Act No. 83, as amended, is hereby amended by inserting an additional paragraph thereto, which shall read as follows:

Notwithstanding the provisions of the preceding paragraph regarding exemptions, and any other provision of this Act or other existing laws, commercial papers as defined in Section 1 hereof shall be registered in accordance with the rules and regulations that shall be promulgated by the Securities and Exchange Commission. after approval by the Monetary Board which shall also have the power of suspension in the enforcement of these provisions, it being understood that such rules may provide for opened registration provided certain limits be made in the public interest and for the protection of investors. The rules may also provide exemptions from registrations of interbank call loans under such guidelines as may be necessary in the interest of the public."

the U.S. law requires merely that the association be "exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes" and that "no part of the net earnings inure to the benefit of any person."[30]

C. Exempt Transactions

As noted earlier, the crucial concepts which trigger the application of the Japanese Securities Exchange Law are "public offering" and "secondary distribution." A public offering is "a solicitation as against unspecified many persons, with a uniform term, to acquire new securities to be issued."[31] A secondary distribution is defined similarly except that it refers to issued securities. A secondary distribution may occur when, for instance, a large shareholder disposes of his shares through the market.[32] With limited exceptions, the Commercial Code of Japan prohibits corporations from acquiring their own stock and, hence, corporations do not usually hold treasury stock from which sales can be made.[33]

Registration is not required if the offering is otherwise than by way of public offering or secondary distribution, no matter how large the amount involved. Although loosely referred to as the "private offering" exemption, it does not resemble the U.S. concept exactly. Analysis usually focuses on whether the offering is to *many and unspecified* persons. As to the numerical test, the rule of thumb adopted by the Minister of Finance is 50 offerees.[34] The term "unspecified" is interpreted more broadly than the opposite word "specified" might suggest. An offering to existing shareholders, employees and clients is not deemed to be to specified persons because these persons may change from time to time.[35] The offering is to a class of persons or to persons meeting certain requirements, rather than to definite named individuals. On this basis, rights offerings are viewed as directed to unspecified persons and if the numerical test is met, the registration requirement would apply.[36] Since public offerings and secondary distributions are defined to encompass solicitations of many *and* unspecified persons, Prof. Tatsuta acknowledges that a private offering may theoretically occur when offerees are unspecified, or alternatively, when they number less than 50.[37] His view, however, is that it is more practical to require both that the offerees be specified and that

[30] P.S.A., Sec. 5(9); SECURITIES ACT OF 1933, Sec. 3(a)(4), 15 U.S.C.A. §77c(a)(4).
[31] J.S.E.L., Art. 2(3); Tatsuta at 23. The translation is Prof. Tatsuta's. The translation in 6 EHS LAW BULLETIN, *supra* note 8, at 2 is as follows: "The term 'of offering of securities' in this law shall mean to solicit many and unspecific persons for their offer to acquire securities to be newly issued under uniform terms."
[32] J.S.E.L., Art. 2(4); Tatsuta at 24-25.
[33] CODE OF COMMERCE, Art. 210. English translation at THE JAPAN BUSINESS LAW RESEARCH INSTITUTE, THE NEW COMPANY LAW OF JAPAN 58 (Japan Business Law Series Vol. XI, Part One, 1966).
[34] Tatsuta at 24.
[35] *Id.* at 23-24.
[36] *Id.*
[37] *Id.* at 28.

they be few. It should be noted that the intent of the purchaser is immaterial. In other words, the availability of the exemption will not depend, as it does in the United States, on whether the buyer has taken the stock for investment and not with a view to distribution.

Offerings of small amount are also exempt from registration. The 1971 amendment to the law defined this to mean a public offering or secodary distribution in an amount less than ¥100 million measured by the aggregate issuing or selling price. In determining the value of the offering, distributions made within the preceding two years are counted.[38]

Under the law in effect prior to the 1971 amendments, it was specifically provided that transactions by persons other than "an issuer, one who makes a secondary distribution, underwriter or securities company" were exempt from both registration statement and prospectus delivery requirements.[39] This provision was patterned after Section 4(1) of the Federal Securities Act of 1933. Probably in an attempt to adapt Section 4(2) of the Act to local legislation which was meant to cover both initial offerings and secondary distribution (unlike the 1933 Act which is intended to regulate issuance rather than trading of securities), the Japanese law also exempted transactions by "an issuer or one who makes a secondary distribution other than by way of public offering or secondary distribution.[40] It was clear enough that a portion of this provision was meant to cover "private offerings," but it was an interesting problem to explain what was meant by transactions by "one who makes a secondary distribution *other than by way of secondary distribution.*"

The law as amended no longer contains the above provisions. Instead, it affirmatively imposes the registration statement and prospectus delivery requirements upon the issuer, the secondary distributor, the underwriter and securities company. It further refers to transactions by these persons in connection with a public offering or secondary distribution.[41] The question then is whether the exemption for transactions by persons other than those listed still subsists. It would seem that it does. It would seem too that the requirements apply only if the persons engage in public offerings or secondary distributions, just as under the old law.

If this interpretation is correct, then the same definitional problems existing under the old law remain today. The difficulty centers on the definition of "issuer," "one who makes a secondary distribution," and "underwriter."

---

[38] J.S.E.L., Art. 4(1); Tatsuta Addendum at 1-2.

[39] J.S.E.L., Art. 15, as in effect before the 1971 Amendments. For English translation of text, *see* FINANCIAL COMMISSIONER'S OFFICE, MINISTRY OF FINANCE, GUIDE TO ECONOMIC LAWS OF JAPAN 726-727 (1950); Tatsuta at 30.

[40] *Id.*

[41] J.S.E.L., Art. 15(1) and (2).

An issuer is defined as any person who issues or proposes to issue any security.[42] There is no expansion of the term to include controlling persons, as there is under U.S. law. A "secondary distributor" or "one who makes a secondary distribution" is not expressly defined although the law, as noted above, defines a secondary distribution. There are two possibilities, as Prof. Tatsuta suggests.[43] It can either apply to (1) a large shareholder or to (2) one who actually distributes the security to the public such as an underwriter. Prof. Tatsuta favors the first view as being "more reasonable." He states that it corresponds with the U.S. idea of a "controlling person." Indeed, viewing the term in this light would make the requirement even stronger than the American requirement because the large shareholder or controlling person would always have to register even if he does not sell through an underwriter and irrespective of his intention in purchasing the securities. Further, under the old law (and, conceivably, under the present law), this view made possible the conclusion that the phrase, "one who makes a secondary distribution other than by way of secondary distribution" refers to transaction between a large shareholder and an underwriter.[44]

The problem in accepting Prof. Tatsuta's view is evident when one examines the definition of underwriter. He translates the definition under the law thus: "any person, who in connection with an issuance of a security and for a commission, reward or other consideration in excess of the usual distributor's commission, purchases from an issuer, with a view to distribute, all or a part of the securities, or contracts with an issuer to purchase the unsold part of the security, or makes arrangements on behalf of an issuer for a public offering or secondary distribution of a security or participates directly or indirectly in a public offering or secondary distribution of a security."[45]

The entire definition seems to be qualified by the phrase "in connection with an issuance of a security." The question then is whether there can ever be an underwriter for a secondary distribution.[46] It should be noted again that "issuer" is not qualified to include controlling persons. Therefore, a person who underwrites or sells securities for a controlling person is not a statutory underwriter and would not be bound by registration statement and pros-

---

[42] J.S.E.L., Art. 2(5).

[43] Tatsuta at 32.

[44] *Id.*

[45] *Id.* at 33. The translation in 6 EHS LAW BULLETIN SERIES, *supra* note 8, at 3 is ". . . a person who, at the occasion of issuance of securities, acquires the whole or part of the securities concerned from the issuer of such securities with a view to selling the same, or enters into a contract to acquire the remainder, when there is no other person than himself to acquire such securities, or who handles offering or secondary distribution of securities on behalf of the issuer, or any other person who participate [sic] directly or indirectly in the offering or secondary distribution of securities and receives a commission the amount of which being in excess of the amount of commission, remuneration or any other consideration payable customarily to a securities distributor."

[46] *See* Tatsuta at 32-33.

pectus delivery requirements. Moreover, since acceptance of Prof. Tatsuta's view that the secondary distributor is the large shareholder would mean exemption of the transaction between that shareholder and the underwriter, there would be no one bound by the requirements. Prof. Tatsuta argues that the legislative intent was probably to cover underwriting of issued securities and points to the use of the words "secondary distribution" in the definition itself. But it is difficult to explain away the rather unambiguous qualifying phrase and the use of the word "issuer." Of course, if one accepted the second alternative meaning of the phrase "one who makes a secondary distribution," it would make no difference what the definition of underwriter stated. This latter interpretation would definitely include a person who acquires a controlling block of shares from the owner for purposes of public sale.[47] But the result of this would seem to be even more anomalous because the large shareholder would himself be exempt and, not being an issuer, could sell without registration if he made sales direct to the public rather than through an underwriter. Moreover, the ghost of "one who makes a secondary distribution other than by way of secondary distribution," laid to rest by our acceptance of Prof. Tatsuta's view, would rise again to make its nonsensical presence felt.

Can the dilemma somehow be solved by resort to the last person mentioned in the list of covered persons, that is, a securities company? This requires the assumption that the use of the separate term "underwriter" in the Securities Exchange Law is surplusage, that an underwriter is necessarily a securities company, or that a securities company would include those who are not statutory underwriters. A "securities company" is defined as a *stock corporation licensed* by the Finance Minister to engage in the *securities business* which includes underwriting.[48] But the law does not define "underwriting" and if we refer back to the definition of underwriter we are again confronted with the problem of whether it includes issued securities within its scope. Moreover, underwriting is included in the definition of "securities business." It is at least arguable that one who does not engage in it as a business would not have to procure a license although a large block of shares obtained from a controlling shareholder is being publicly sold. Another point relevant to this discussion is the question of the function of another qualifying phrase in the definition of an underwriter which requires payment of "a commission, reward or other consideration in excess of the usual distributor's fee." It can be read, according to Prof. Tatsuta, as modifying the entire definition or only that portion which refers to one who "participates directly or indirectly in a public offering or secondary distribution of a security."[49] His view is that it modifies only the cited phrase and not the entire definition. Thus, one who purchases from an issuer with a view to distribute securities need not receive an underwriting commission to be considered a statutory underwriter. Unless he engages in this activity often enough to make it look like he is doing it for a business, however, he would not have to secure a license as a securities company. In sum, statutory underwriters are not necessarily securities companies and the latter phrase is not broad enough to cover those who are strictly not statutory underwriters.

[47] *Id.* at 32.
[48] J.S.E.L., Art 2(9).
[49] Tatsuta at 34. *But see* translation at note 45.

There are interesting conceptual problems in this aspect of Japanese law. But, apparently, no administrative or court cases have arisen to test these concepts.

The focus in the Philippines is on the "sale" of a security. No sales, unless of exempt securities or in exempt transactions, may be made without registration or licensing of the securities, as the case may be.[50] A sale is defined broadly enough to include offers to sell, whether oral or written.[51] The most important exceptions to this requirement are "small issues" and "isolated transactions."

Small issues are those whose aggregate amount is ₱200,000 or less.[52] Application for exemption must be made with the Philippine SEC by any corporation which intends to make an offering of unissued shares. Under certain circumstances, the SEC will grant an exemption for issues exceeding ₱200,000 in value.

The provisions of the Philippine Securities Act do not apply to an "isolated transaction" in which any security is sold by or for the owner provided the sale is not in the course of repeated and successive transactions by the owner or his representative and the latter persons are not underwriters of the security.[53] There is no statutory definition of an "isolated transaction" but the Commission noted in one early opinion that it would depend on particular circumstances: "A sale is not deemed an isolated one where it bears such relation to other similar sales occurring sufficiently over the same time as to constitute one of a series of associated acts for the promotion of the same project. The sale by any of the members of all his interest in [a mining] association to one person on a particular date clearly falls within the term 'isolated transaction.' "[54] In spite of the use of the term "owner" in the statutory provision, it would seem that one sale by an issuer of its securities to a particular person would be exempt. Also, a single sale by a shareholder to a specific person would be exempt if the shareholder is not a mere conduit for the sale of shares to the ultimate buyer. Under the cited opinion, separate sales by several shareholders would also be deemed isolated transactions if they occur at different times and the sales are not made pursuant to a plan of distribu-

[50] P.S.A., Sec. 4.
[51] P.S.A., Sec. 2(e).
[52] P.S.A., Sec. 4(b); *Requirements and Procedures for Mergers and Exemptions from Registration Requirements Under the Securities Act* Para. (B), in SEC REQUIREMENTS AND PROCEDURES 54-56 (1971).
[53] P.S.A., Sec. 6(c).
[54] 1 S.E.C. BULLETIN 216 (1941) in R.T. OBEN AND R.A. OBEN, 2 COMMENTS ON COMMERCIAL LAWS OF THE PHILIPPINES 280-281 (1972).

tion. In the last two cases mentioned, it can be argued that the total amount sold by the shareholders need not be ₱200,000 or less since this limit applies only to the issue of securities and not to subsequent sales.

As is evident in the foregoing discussion, the "isolated transaction" exemption is similar, but not equivalent, to the "private offering" exemption in Japan. Further, whereas in Japan it is a public offering or secondary distribution which brings the Securities Exchange Law into play, it can be said that in the Philippines the principal consideration is whether a "non-isolated transaction" is involved. When the phrase "public offering" is used in the Philippine Securities Act, it is in contradistinction to an isolated transaction. Therefore, it does not have the same meaning as understood in Japan, or for that matter in the United States. The Federal Securities Act of 1933 exempts transactions "not involving any public offering."[55] The tests for availability of this private offering exemption are not as harsh as those for isolated transactions.

Unlike the Japanese law, there is no exemption in the Philippines for transaction by persons other than an issuer, one who makes a secondary distribution, an underwriter or securities company. Nor has the counterpart American exemption for "transactions by persons other than the issuer, underwriter or dealer" been reproduced. All persons who sell in repeated and successive transactions would be subject to the Philippine Securities Act assuming the security is not an exempt security and that it is not otherwise sold in an exempt transaction. Thus, for example, an ordinary investor who has purchased shares would be able to make one sale, but subsequent sales would necessitate registration of the security.

In addition to the two exemptions which have already been noted, the other statutory exemptions are important enough to be noted:[56]

1. The sale by or for a pledge holder or mortgagee of a security pledged in good faith as security for a bona fide debt. This refers principally to foreclosure sales by pledgees in the ordinary course of business.

2. Judicial, executor's or guardian's sales and sales by a receiver or trustee in insolvency or bankruptcy.

3. Bonds secured by mortgage upon real estate or tangible personal property but only if the entire mortgage and the bonds are sold to a single purchaser at a single sale.

4. The issue of securities in exchange for other securities of the issuer pursuant to a shareholder's right of conversion. The converted security must have been registered or licensed, unless exempt, and the underlying security must be of a class "entitled to registration and licensing" under the Act.

5. Exchanges of shares of consolidating or merging corporations.

[55] SECURITIES ACT OF 1933, Sec. 4(2), 15 U.S.C.A. §77d(2).
[56] P.S.A., Sec. 6.

6. The sale of securities to a bank, savings institution, trust company, insurance company, broker or dealer (provided actually engaged in buying and selling securities) or to *any corporation.* Surprising as it may seem, the SEC policy appears to be to exempt sales by one corporation to another corporation provided the purchasing company's charter permits it to make such an investment.[57]

7. The distribution of stock dividends to shareholders.

8. The issuance of securities to holders or creditors incident to bona fide reorganization of the issuing company, either in exchange for securities of holders or claims of creditors or partly for cash and partly in exchange for the securities or claims of holders and creditors.

9. The issuance of additional capital stock of a corporation sold or distributed by it to its own stockholders exclusively, where no commission or other remuneration is paid or given directly or indirectly in connection with the sale or distribution of such increased capital stock. As to whether this provision exempts rights offerings to existing shareholders, a distinction should be made as a consequence of an early opinion by the SEC Commissioner.[58] If the underlying stock in the rights offering comes from authorized but unissued stock, the issue is not exempt. It would be exempt if the original capital has been increased in accordance with the Corporation Law and sales of additional stock are made to existing stockholders.

10. Pre-incorporation subscription for shares of a proposed corporation when no commissions are paid in connection therewith and the only purpose of soliciting subscriptions is to comply with legal requirements with respect to minimum capitalization. Under the Corporation Law, 20% of a company's authorized stock must be subscribed and 25% of the subscription must be paid.[59] There seems to be no limit on the amount of the subscription that may be sold as long as the total amount does not exceed 20% of the authorized capital. The Federal Securities Act in the United States does not contain a similar exemption and if pre-organization subscriptions are sold in a public offering, both those certificates and the stock eventually issued after the corporation is formed would be subject to registration.[60]

The Philippine Securities Act contains an exemption for unsolicited broker's transactions executed upon customer's orders, but not the solicitation of such orders. This has been interpreted as not applying to original issues of corporations sold through

[57] 7 S.E.C. BULLETIN 9, 11 (1973).
[58] P.S.A., Sec. 6(d); *Opinion of the SEC Commissioner,* September 19, 1946 in R.T. OBEN AND R.A. OBEN, *supra* note 54, at 281-282.
[59] Act No. 1459, Sec. 9, *supra* note 11.
[60] L. LOSS, SECURITIES REGULATION 457 (Student Ed. 1961). As the Philippine SEC itself has recognized, this exemption could result in the "flagrant use of stock assignments" for pre-incorporation subscriptions. However, the only SEC rule on the matter requires that stock assignments be negotiated only through the same broker who purchased the stock involved. *See Rule Limiting Use of Stock Assignments,* and purpose clause thereto, in SEC RULES AND REGULATIONS 47 (1973).

brokers.[61] This position is consistent with the view in the U.S. that the exemption is limited only to the broker's part of the transaction and does not extend to the selling customer.[62] In the U.S., if the selling customer is not exempt (when, for instance, he is an issuer, dealer or underwriter), the exemption is not available. Moreover, if the broker had reasonable ground to believe that the selling customer was not exempt, he would violate the law by participating in a non-exempt transaction.[63] The Philippine provision has further been limited to isolated transactions; repeated and successive sales by the owner through the broker would remove the exemption even if the broker has done no solicitation. It should be noted that the word "broker" is defined in the Securities Act while "underwriter" is not. The question of when a broker becomes an underwriter, an important issue in the U.S., would not arise in the Philippines.[64]

Under Japanese law prior to the 1971 amendment, an exemption was provided for "transactions by a securities company executed upon a customer's order, excluding the solicitation of such orders."[65] The term "securities company" is defined broadly enough to include dealers as well as underwriters and it could be argued then that unsolicited transactions executed by a dealer or an underwriter were exempt.[66] This exemption no longer appears in the law as amended. Hence, the relevant question for determining applicability of registration statement and prospectus delivery requirements is whether the securities company engages in a public offering for the issuer or in a secondary distribution for a shareholder.

Prospectus Requirements

An important difference between Japanese and Philippine securities law relates to prospectus requirements: in the latter there is no requirement that a prospectus be delivered at or before the sale of a security.

When securities are sold by way of public offering or secondary distribution, Japanese law requires that a statutory prospectus be delivered at or prior to the sale.[67] In addition to sales by means of private offerings or in small amounts, sales between securities companies are exempt from prospectus delivery requirements.[68] The requirements apply to sales of an unsold portion of a registered offering if the securities are not listed on a securities exchange and for a period of three months after the effective date of the registration statement.[69]

[61] P.S.A., Sec. 6(i).
[62] LOSS, *supra* note 60, at 698.
[63] *Id.*
[64] *Id.* at 700-701.
[65] Sec. 15, as in effect prior to 1971 amendment. *supra* note 39.
[66] J.S.E.L., Arts. 2(8) and (9).
[67] J.S.E.L., Art. 15(2).
[68] *Id.*
[69] J.S.E.L., Art. 15(3).

A prospectus is defined in Japan as "any instrument given to the public, for the purpose of a public offering or secondary distribution, containing explanations as to the business of the issuer of the security to be offered."[70] The definition includes only written instruments. Further, it does not, as in the United States, include circulars or advertisements by radio or television.[71] Any instrument which meets the definition must contain the information required by law which is generally the same data provided in the registration statement.[72] Since the 1971 amendment, when offers were allowed during the period prior to the effective date of the registration statement, preliminary prospectuses, whether full or summary, have been allowed.[73] However, no actual sale may be made until after the effective date at which time a *full statutory* prospectus must be delivered to the purchaser.[74]

The Philippine Securities Act does not require the delivery of a prospectus to a purchaser. Nor, indeed, does it define a prospectus although the word is used in several places in the Act, particularly the liability provisions. The Act evidently relies more on the availability to public inspection of the registration statement and of periodic reports filed with the Commission rather than on delivery of prospectus to investors. Philippine law does not prohibit the use of a prospectus but if one is used, misrepresentations therein would be subject to legal sanctions such as revocation of the registration or license covering the security, as well as to damage suits by purchasers.[75] As a matter of policy, however, the SEC now requires submission, and prior approval, of a prospectus in case of public offering of securities. In addition, an SEC rule requires prior approval of all advertisements or circulars which directly or indirectly promote sales of securities.[76]

Registration Procedure

The Japanese Securities Exchange Law imposes the duty to register upon the issuer whether distribution is by way of public offering or secondary distribution. Hence, if an issuer refuses to register the shares, a secondary distributor would not be able to sell his shares if an exemption is not otherwise available.[77]

Registration is accomplished by filing a registration statement with the Ministry of Finance. At the same time, the statement must be filed with the stock exchange where the security is listed or with a securities dealers' association if an unlisted security is deemed by Cabinet Order as being similar to a listed security "in

[70] J.S.E.L., Art. 2(10). Tatsuta at 50-51. The translation is Prof. Tatsuta's.
[71] SECURITIES ACT OF 1933, Sec. 2(10), 15 U.S.C.A. §77b(10).
[72] J.S.E.L., Art. 13. Tatsuta at 51.
[73] J.S.E.L., Art. 13(3); Tatsuta Addendum at 3.
[74] J.S.E.L., Art. 15(2); Tatsuta Addendum at 3.
[75] P.S.A., Secs. 12, 20(a)(4), 30(a).
[76] *Rules Governing the Dissemination of News, Tips or Rumors About the Issuer Corporation or Its Securities*, approved September 8, 1969 in SEC RULES AND REGULATIONS 45 (1973).
[77] J.S.E.L., Art. 4(1); Tatsuta at 45.

respect of marketability."[78] Under the 1971 amendment and concomitant with the new provision permitting offers (but not sales) of the security immediately after filing and throughout the pre-effective period, copies of the registration statement are open to public inspection at the Ministry and at offices of the exchange or of the association as soon as they are filed.[79]

Information to be provided in the prescribed registration form is divided into two parts.[80] Issuers who have complied with continuous disclosure requirements complete only the first part which refers to information required in a prospectus. Among other things, this includes: a description of the registrant, its shareholders, officers, directors, auditors, employees; a description of the registrant's business and its financial condition; the plan of public offering; use of proceeds of the offering; compensation to incorporators; assets contracted to be obtained after incorporation; and terms of secondary distribution. The second part of the prescribed form requires more detailed information and must be completed by issuers who have not complied with continuous disclosure requirements. Under the 1971 amendments, if an offering must be made before determination of the issuing price, items such as the final price and underwriting terms may be stated in a subsequent amendment to the registration statement.[81] Under new regulations, the prospectus need not be attached to the registration unless it is a preliminary summary prospectus which is used during the pre-effective period. Other documents which are no longer required to be attached to the registration statement include underwriting agreements, trust deeds and merger agreements.[82]

The effective date of a registration statement is the 31st day "after the acceptance by the Minister of Finance of the registration statement filed."[83] The Minister may order amendments if any change has taken place with respect to a material fact contained in the statement or attached documents or when the statement is defective in form or inadequate or incomplete as to the facts stated therein. In such a case, the period begins to run on the day the Minister accepts the amendment.[84]

The waiting period may be shortened or accelerated if the Minister deems the contents of the registration statement to be "readily understandable" to the public.[85] At present, however, acceleration is usually not granted.[86] The Minister may also issue a stop order suspending the effectiveness if the registration statement contains a material false statement or omits a material fact. The stop order is withdrawn when an appropriate amendment

[78] J.S.E.L., Art. 6.
[79] J.S.E.L., Art. 25.
[80] Tatsuta Addendum at 2.
[81] J.S.EL., Art. 5.
[82] Tatsuta Addendum at 2.
[83] J.S.E.L., Art. 8(1).
[84] J.S.E.L., Art. 7.
[85] J.S.E.L., Art. 8(3).
[86] Tatsuta at 47.

statement has been filed.[87] Whether the amendment is "appropriate" is left to the Minister's discretion. Hence, while Japanese law contains no provision for revocation of a registration after its effectiveness, the suspension can in effect be permanent. Under the 1971 amendment, the Minister may extend the waiting period before effectiveness or even issue a stop order in case of registration statement filed by the issuers within one year from the date of the deficient statement.[88]

The stop order has rarely been used in Japan.[89] Prior to 1965, the practice was for registrants to submit drafts of registration statements before formally filing them and for the Finance Ministry to review the submitted documents preliminarily.[90] This practice, and the lack of publicity given to preliminary advice to correct documents, apparently resulted in a certain amount of complacency on the part of registrants. It was discontinued in 1965 and the threat of a public stop order rather than private informal advice has probably helped to persuade registrants to be more careful in drafting the registration statements.[91]

While the Securities and Exchange Law clearly limits the Minister's authority to order amendment of the registration statement without issuing a stop order to the pre-effective period (that is, after the effectiveness of the registration statement, amendments may be mandated only by stop order), there seems to be no restriction on his power to issue the stop order *before* the statement becomes effective. Similar provisions in the U.S. Securities Act have been interpreted to permit the SEC to issue stop orders *either* before or after the effective date.[92] Although this interpretation has apparently not yet been tested in Japan, its adoption is probably called for now that *offers* are allowed right after filing of the registration statement.

Under the Philippine Securities Act, registration may be accomplished by the issuer or by any dealer interested in the sale thereof.[93] Theoretically then, the issuer's participation in the registration process need not be procured and the law recognizes this possibility by referring in other provisions to the "person filing" the registration statement.[94] As a practical matter, though, it may be difficult for a dealer to comply with requirements unless it is affiliated with a controlling shareholder.

Registration under the Act comprises three steps: (1) the filing of a sworn registration statement in the offices of the Securities Exchange Commission; (2) payment of the prescribed fee; and (3) publication of the filing in the prescribed manner.[95] As noted

[87] J.S.E.L., Art. 10(1) and (3).
[88] J.S.E.L., Art. 11(1).
[89] Tatsuta at 48.
[90] Tatsuta at 46.
[91] *Id.*
[92] LOSS, *supra* note 60, at 303.
[93] P.S.A., Sec. 7(a).
[94] *See* P.S.A., Secs. 7 and 8.
[95] P.S.A., Sec. 7, last para.

above, the law requires registration of non-speculative securities and licensing of speculative securities. The licensing procedure is exactly the same as that of registration except that the Commission is required to make certain findings before granting the license.[96]

The contents of the registration statement are prescribed in SEC Form No. 1. The information required includes: a description of the general character of the issuer's business; names and addresses of the issuer's directors, chief executive officer, financial and accounting officer; names and addresses of the underwriters; capitalization of the issuer; uses of the proceeds of the offering; the amount of the offering and estimated net proceeds; price of the security proposed to be offered; legal, engineering, certification and other charges in connection with the offering; amount of cash to be paid as promotion fees, or of capital stock to be set aside as promotion stock; and a statement of all stock issued from time to time as promotion stock. Among documents required are: an income statement for the last fiscal year; a balance sheet as of 60 days before its date; copies of articles of incorporation, by-laws, the security itself and any prospectus, advertising or communication to be used for the offering.[97]

The issuer must pay a filing fee of 1/10 of 1% of the maximum aggregate offering price, but in no case less than ₱50 or more than ₱1,000.[98] The Commission then arranges for publication at the applicant's expense of a notice in two newspapers of general circulation, one in English and another in Spanish, once a week for two consecutive weeks.[99] The notice recites the fact of the filing and the date set for hearing of the application. The notice also informs interested parties that copies of the statement as filed are available for public inspection. The registration statement takes effect seven days after the two-week publication period.[100] During this seven-day period, the hearing is usually held and an examiner of the Commission makes a recommendation based principally on his judgment as to "the financial condition of applicant and accounting requirements involved."[101] In the case of newly-organized companies, the SEC may conduct an ocular inspection of their principal offices "to see their physical layout, the number of their employees and volume of their work, both administrative and technical, the present activities in their principal offices, etc."[102] Assuming no opposition by a hearing examiner, a registration statement becomes effective on the 21st day after filing. There is no provision for acceleration of the effective date.

There is no provision in the Securities Act for an SEC order directing amendment of the registration statement prior to its effectiveness. Apparently, action is simply withheld on the application until corrections are made or a dispute with an objecting examiner is resolved. The law does provide a procedure for suspension or revocation of the registration which works much like a stop order.[103] Like a stop order, the procedure may be invoked before or after effectiveness of the registration statement. If it is used in the pre-effective period, "revocation" would of course amount to a prohibition on future sales. The process is triggered by an SEC opinion that the information contained in the statement filed "is or has become misleading, incorrect, inadequate or incomplete, or the sale or offering for sale of the security may work or tend to work a fraud."[104] On the basis of this opinion, the SEC may require further information of the registrant and suspend the right to sell the security pending further investigation. If a suspension is ordered, the Commission must give a "prompt hearing to the parties interested." The suspension of the right to sell is not publicized although it is binding upon persons against whom it is directed.[105]

After the hearing, the Commission determines whether revocation is appropriate because the issuer:

1. Is insolvent; or
2. Has violated any of the provisions of the Securities Act, or any order of the SEC of which the issuer has notice; or
3. Has engaged or is about to engage in fraudulent transactions; or
4. Is in any other way dishonest or has made any fraudulent representations in any prospectus or in any circular or other literature that has been distributed concerning the issuer or its securities; or
5. Is of bad business repute; or
6. Does not conduct its business in accordance with law; or
7. Has its affairs in an unsound condition; or
8. Has his enterprise or business based upon unsound business principles.[106]

It should be noted that a distinction is made between the grounds which authorize the SEC to order an investigation and suspension and the findings which it must make to convert the suspension into a revocation. An incomplete or incorrect statement may entail a suspension but it will not necessarily lead to revocation if the issuer can establish that none of the eight conditions enumerated above apply to him.

A person filing a registration statement does not ordinarily volunteer the representation that its security is a speculative security. The law provides that at the time of the filing of the registration statement the SEC must by order determine that the security is speculative and so advise the issuer or filing dealer.[107] The same procedure as registration would then be followed but the SEC will not issue a license unless it finds that:

96 P.S.A., Sec. 9.
97 P.S.A., Sec. 7(a); *Requirements and Procedures Relative to Applications for Registration of Securities Under the Securities Act* [Hereinafter "Procedures"], I(1), in SEC REQUIREMENTS AND PROCEDURES 49 (1971).
98 P.S.A., Sec. 7; *see* Procedures I(2).
99 P.S.A., Sec. 7; *see* Procedures I(4).
100 P.S.A., Sec. 7; *see* Procedures I(9), at 50.
101 Procedures I(7), at 50.
102 Procedures IV(1), at 51-52.
103 P.S.A.,, Sec. 8.
104 *Id.*
105 *Id.*
106 P.S.A., Sec. 12.
107 P.S.A., Sec. 7, last para.

1. The issuer is of good repute; and
2. The sale of the security would not be fraudulent and would not tend to work a fraud upon the purchaser; and
3. The enterprise or business of the issuer is not based upon unsound business principles.[108]

The SEC may impose conditions on the grant of the license. Further, it fixes by order the amount of commissions or other remuneration to be paid in connection with the offering. Every permit or license contains a notice in bold type that its issuance does not constitute a recommendation or endorsement of the securities being offered.[109]

Unlike in Japan, there can be no offers of any kind or form of the security prior to the effective date of the registration statement. As defined in the Securities Act, a sale includes every disposition or attempt to dispose of a security or interest in a security for value.[110] Further, a sale includes "a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a subscription or an offer to sell, directly or by an agent, or by a circular, letter, advertisement or otherwise."[111] What about preliminary negotiations between an issuer and an underwriter, a situation expressly excepted by the U.S. Federal Securities Act from the definition of a sale?[112] In Japan, the 1971 amendments make it clear that offers may be made after filing of the registration statement and underwriting negotiations would presumably not be objectionable after that event. The question is still doubtful as to the pre-filing period. Prof. Tatsuta, even before the 1971 amendments, was of the opinion that preliminary negotiations with underwriters would be permitted "in the light of the purpose of the registration system which purports to protect investors and relates only to public offerings and secondary distribution."[113] The rather expansive definition of "sale" in the Philippine Securities Act makes it difficult to take the same position as a matter of law. In practice, however, the Philippine SEC would probably not object to the negotiations, especially because disclosure of the names and addresses of the underwriters of the offering is required in the registration statement.[114]

Reporting Requirements

An important aspect of the disclosure philosophy embodied in the two systems under examination is that information about the issuer be available to the public and that this information be as current as possible. The prospectus requirements under the Securities Exchange Law of Japan have already been noted.[115] In addition, the Law requires certain issuers to file "periodic reports," semi-annual reports and current reports.

[108] P.S.A., Sec. 9.
[109] *Id.* The sales commission permitted usually does not exceed 5% of the value of the securities, although the law allows as much as 10%. Yabyabin, *The Securities Act and Trading*, in ASPECTS OF PHILIPPINE CORPORATION LAW 290 (M. Lopez-Campos ed. 1966).
[110] P.S.A., Sec. 2(e).
[111] *Id.*
[112] SECURITIES ACT OF 1933, Sec. 2(3), 15 U.S.C.A. §77b(3).
[113] Tatsuta at 44.
[114] P.S.A., Sec. 7(a)(4).

The Japanese periodic report roughly corresponds to the annual report required under the U.S. Securities Exchange Act. The use of the term "periodic" reflects the fact that most Japanese corporations have semi-annual accounting periods although the number of companies using annual periods is apparently increasing. Periodic reports must be filed by issuers of the following securities: listed securities; securities unlisted but registered with an association of securities firms; securities to be registered with the Ministry in connection with a public offering or secondary distribution. The report is due within three months after the expiration of each accounting period. The information required corresponds to the first part of the registration statement which generally contains data in the prospectus. The report must be accompanied by financial statements of any material subsidiaries, or alternatively, by a consolidated financial statement.[116]

Semi-annual reports are filed by issuers who are subject to the periodic report requirement and who have accounting periods of one year. The report must contain summary financial statements.[117]

Current reports are filed by issuers subject to the periodic report requirements when any of the following events occur: a foreign public offering or secondary distribution of the issuer's securities other than non-convertible debentures; when directors or shareholders resolve to issue securities of ¥100 million or more other than through a public offering, or when the issue is made abroad; changes in the issuer's parent company, or in subsidiaries having a 10% relationship with the issuer in terms of sales, assets or stated capital; changes in shareholders holding 10% or more of the issuer's shares; a calamity which damages 1% or more of the value of the issuer's assets.[118]

The report is filed, aside from the Ministry, with the exchange where the security is listed and with the association where registered. The reports, wherever filed, are open to public inspection as soon as they are received.[119] All financial statements submitted with reports must be audited by certified public accountants with the exception of the summary financial statement accompanying the semi-annual report.[120]

The net effect of the reporting requirements is to update prospectus-type information at least once every six months. An important aspect of the Japanese statutory scheme is that the Finance Minister may issue an order to file an amendment statement in

[115] See text at notes 67-74.
[116] J.S.E.L., Art. 24; Tatsuta at 35; Tatsuta Addendum at 4.
[117] J.S.E.L., Art. 24-5(1).
[118] J.S.E.L., Art. 24-5(2); Tatsuta Addendum at 4-5.
[119] J.S.E.L., Art. 25(1).
[120] J.S.E.L., Art. 193-2; Tatsuta Addendum at 4.

connection with required reports.[121] An issuer which has filed an amendment statement must give public notice of the filing in a daily newspaper which reports current affairs. The amendment statement must be filed with the appropriate exchange or securities association.[122] Under the 1971 amendments, the Minister may issue a stop order with respect to any registration statement of a company which has filed a defective report. He may also extend the waiting period for effectiveness of any other registration statement which might be filed by the same issuer within one year from the date the amendment statement was filed.[123]

Other portions of the Japanese law which improve the quality and currency of information available to the public are the provisions with respect to proxy solicitations[124] and tender offers.[125]

In the Philippines, issuers of registered or licensed securities are required to file: an annual financial statement; an annual General Information Sheet; and current reports.

Issuers of registered or licensed securities must file an *annual financial statement* with the SEC.[126] These statements consist basically of a balance sheet and related profit and loss statement. Under 1973 Commission rules, other disclosures are required in cases of companies listed in stock exchanges, or with permits to sell shares or with at least 20 stockholders.[127] The rules require information relating to, among other things, transactions with affiliates, changes in financial position, changes in accounting methods, the 20 largest stockholders and earnings per share. An implementing SEC circular further specifies that the statement is deemed filed only upon issuance of a "confirmation receipt" by the Commission after examination of the submitted materials.[128] If found deficient by the SEC, the statements are either totally rejected or supplementary reports are required. The statements are due by February 15th of each year, where the fiscal year ends on December 31st, or by the 45th day after the end of the fiscal year which does not coincide with the calendar year.[129] An extension of 30 days may be applied for before the due date upon payment of a compromise penalty of ₱50 for unlisted securities and ₱100 for listed securities. The statements filed must be duly audited and certified by an independent certified public accountant.[130]

[121] J.S.E.L., Arts. 24-2(1), 24-5(3).
[122] J.S.E.L., Art. 24-2(3).
[123] J.S.E.L., Art. 24-3(1), 11(1).
[124] J.S.E.L., Art. 194; Tatsuta at 60-62.
[125] J.S.E.L., Arts. 27-2 through 27-8; Tatsuta Addendum at 7-9.
[126] *Rules Requiring the Keeping of Accounting Records and Filing of Annual Financial Statements by Corporations*, approved March 26, 1958 in SEC RULES AND REGULATIONS 31 (1973).
[127] *Rules on Form and Content of Financial Statements* effective July 1, 1973 in SECURITIES AND EXCHANGE COMMISSION ANNUAL REPORT 1972-73 8-9.
[128] *Id.* at 9.
[129] *Rules Prescribing the Penalties for Non-Filing or Late Filing of Annual Financial Statements*, approved April 27, 1970 in SEC RULES AND REGULATIONS 49 (1973).
[130] *Id.*

A General Information Sheet must be filed with the Commission within 30 days after the annual stockholders' meeting. A 10-day extension is granted only for "very justifiable reasons." The filing must be accompanied by a copy of the minutes of the meeting electing the directors or officers duly certified to and sworn by the corporate secretary. The information required includes: names of elected directors and officers; the corporation's capital structure; its line of business; business address and telephone.[131] This requirement, which was instituted in 1971, is aimed at no more than allowing the SEC to keep posted on key changes in the company's personnel and keeping stockholders informed of the company's "organizational and operational status."[132]

Current reports are specifically required of issuers of registered or licensed securities. A 1973 SEC rule requires that these issuers make "reasonably full, fair and accurate disclosure of every material fact relating to or affecting it which is of interest to investors." Materiality is defined as any fact which "induces or tends to induce or otherwise affect the sale or purchase of its securities" and generally includes an "important event or happening." Disclosure must be made by the company immediately after occurrence of the material event in any of two ways: (1) publication in a newspaper of general circulation in the Philippines, furnishing the SEC with a duplicate copy of the release; or (2) filing of a written notice with the SEC and a duplicate copy with the exchange where the security is listed, the exchange then "informing the newspapers concerning the matter." The new rule places an affirmative responsibility on companies to monitor newspaper reports of its business operations or activities. If a misleading release based on reports coming from sources other than the issuer or its officers is published, the company must take immediate corrective measures.[133]

Apart from the above requirements, exchanges usually require reports from issuers of listed securities. Thus, the listing agreement in one exchange requires the issuer to publish once a year and submit to its stockholders at least 15 days before the annual meeting the following: (1) a consolidated balance sheet showing assets and liabilities at the end of the year; (2) a consolidated income account for the previous year; and (3) an analysis of surplus account covering the fiscal year. The exchange is furnished with 50 copies of these documents.[134]

The public availability of reports filed by the issuer is subject to qualifications. The issuer may object to public disclosure of information contained in the records. The SEC, after due notice

[131] *Rules Requiring the Filing of Information Sheet by Domestic Corporations*, approved March 17, 1971 in SEC RULES AND REGULATIONS 79 (1973).
[132] *Id.*
[133] *Rules Requiring Disclosure of Material Facts by Corporations Whose Securities Are Listed in Any Stock Exchange or Registered/Licensed Under the Securities Act*, approved February 8, 1973 in SEC RULES AND REGULATIONS 102-104 (1973).
[134] THE MAKATI STOCK EXCHANGE 9 (1973).

and hearing, denies such an objection if it finds that disclosure is required "in the public interest or for the protection of investors."[135] Even where the records are made publicly available, their dissemination is further limited only to persons with "legitimate interest."[136] Further, the right to inspect is denied "when the inspection is sought for purposes of harassment or merely to satisfy curiosity or to further any improper or useless purpose."[137] The SEC routinely charges a fee of ₱2 for requests to examine records on file. Copies of records on file may be furnished to persons "with legitimate interest" for a fee of ₱2 per page.[138] Exemptions from public disclosure are not usually granted by the SEC, particularly if the security involved is traded on an exchange. In practice, records on file with the Commission are reasonably easy to obtain for examination. However, the lack of a requirement for public availability of documents filed with the SEC on the exchange where a security is traded. the lack of well-defined prospectus requirements and the imposition of fees for examination and copying of filed documents all operate as a practical matter to put these records beyond easy access of the ordinary investor.

Violations of reporting requirements are punishable by fines.[139] The 1973 SEC rules expanding the required disclosures in financial statements also give the Commission the authority to suspend or bar an accountant from practicing before the SEC for false certifications and other violations.[140] In case of failure to timely file reports for two successive times, the SEC may suspend the registration or license covering the security. In case of failure for more than two successive times, the registration or license may be revoked.[141] Under the law, of course, the SEC need not wait for failures to file before suspension or revocation of registration if the statutory bases are established. The suspension/revocation authority results in a rough requirement to update the registration statement regularly while sales of the security are being made. As noted elsewhere in this paper, the suspension process is triggered by, among other things, an SEC opinion that the registration statement has *become* misleading or inadequate.[142] One way by which the Commission attempts to keep itself aware of a company's activities is by "regular check-ups" of records on file on registered securities and by "periodic inspections" of offices of issuers to "ascertain the veracity" of reports submitted.[143] According to an SEC rule, the inspections are in addition to the annual inspection and must not be less than six times a year. This vigorous enforcement program on paper is more likely an ex-

[135] *Amendment to the Rules Requiring the Annual Filing of Corporate Financial Statements by Corporations by Making Them Available for Public Inspection*, approved May 8, 1970, in SEC RULES AND REGULATIONS 50-51 (1973).
[136] *Id.*
[137] *Id.*
[138] *Id.*
[139] *See supra* note 129, at 48; *supra* note 131, at 80; *supra* note 133, at 103.
[140] *See supra* note 127, at 9.
[141] Procedures VI(2)(e), *supra* note 97, at 63.
[142] P.S.A., Sec. 8; *supra*, text at note 104.
[143] Procedures VI(1) and (3), *supra* note 97, at 62-63.

pression of a devout wish rather than a reality. Because of the small size of the Commission staff (approximately 250 employees) one has reason to suspect its ability to competently police the large number of issuers with registered securities.[144]

Unlike in Japan, there are still no laws or administrative rules regulating tender offers. With respect to proxy solicitations, the sole SEC rule on the matter requires that no member of a stock exchange, broker or dealer may give any proxy in respect of any security carried for the account of a customer to a person other than the customer without the latter's express written authorization.[145]

Broker-Dealers, "Investment Houses" and "Securities Companies"

In 1965, the Japanese Securities Exchange Law was amended to substitute a licensing system for the old registration system. The reason, according to Prof. Tatsuta, was that licensing was "better suited to the climate of Japan, enabling the authorities to keep unsound firms from being established and to execute preventive administration more effectively."[146] Key features of the licensing system are the Finance Minister's authority to regulate the number *and locations* of securities companies, and his close supervision of the actual running of the securities business by means of a "correction order."

The 1965 amendment replaced the term "broker-dealer" with "securities company" so that licensing is now required of companies engaged in the business of a broker, dealer or underwriter. More specifically, only licensed companies, defined to mean stock corporations, may engage in the securities business.[147] There are four categories of licenses, depending on the type of activities engaged in. Separate licenses are required for each type of business. Thus, the first category entitles a licensee to engage in the sale of securities as a dealer. The second refers to: the sale of securities as an intermediary, broker or agent; and the commissioning of a sale order to be executed on a securities exchange as an intermediary, broker or agent. The third category is for underwriting and secondary distribution of securities. The fourth permits the holder to arrange for a public offering or secondary distribution of securities.[148] There are minimum capital requirements which range from ¥1 million to ¥3 billion depending on the type of license, the specific business engaged in, the location of offices and membership on a securities exchange.[149]

[144] *Id.* at 63. *See* SECURITIES AND EXCHANGE COMMISSION ANNUAL REPORT 1972-73.
[145] P.S.A., Sec. 24; *Rules and Regulations Governing Securities, Exchanges and Their Members, Brokers, Dealers, Salesmen and Customers* [Hereinafter "SEC Rules Governing Exchanges"] A-16 in SEC RULES AND REGULATIONS 7 (1973).
[146] Tatsuta at 70-71.
[147] J.S.E.L., Art. 28(1); Tatsuta at 68.
[148] J.S.E.L., Arts. 28(2), 2(8); Tatsuta at 68-69; Securities Market in Japan, *supra* note 14, 106-108.
[149] J.S.E.L., Art. 32(1); Tatsuta at 69; Securities Market in Japan, *supra* note 14, at 104.

In ruling upon an application for a license, the Minister has broad authority. He considers whether the following standards are met:

1) the applicant has sufficient financial status to carry out its proposed business and the prospect for profits is satisfactory;
2) the applicant, with its personnel, has sufficient knowledge and experience to carry out its business fairly and adequately and has good social standing;
3) the proposed securities business is necessary and appropriate in light of conditions in the district where the applicant seeks to conduct business, such conditions referring to the amount of securities transactions, the number of securities companies with offices in the district and other economic circumstances therein.[150]

The license granted by the Finance Minister may be qualified if necessary in the public interest or for the protection of investors.[151] A license is permanent unless suspended or revoked. The causes for such action by the Minister includes: violation of minimum capital requirements; violation of the Securities Exchange Law, and administrative orders thereunder, or of the qualification in the license; conviction of a fine; and insolvency.[152]

The Finance Minister also has the important power to issue a "correction order" which, among other things, requires a securities company to change its method of operation, suspend a part or all of its business for a period not exceeding three months and escrow assets.[153] The correction order is a device aimed at maintaining the financial health of securities companies. Under other provisions of the law and of pertinent regulations, securities companies are required to accumulate certain reserves, limit their debt ratios to ten and to observe certain "standards of soundness" relating to securities held in custody for customers and on inventory, securities lent out or borrowed and to reasonableness of fixed business assets.[154]

The Securities Exchange Law authorizes the Minister of Finance to conduct inspections of securities companies to determine their actual business conditions.[155] Further, securities companies are required to submit business reports including a balance sheet and profit and loss statement within two months after the end of the business year, which for securities companies is legally the period from September until October of the following year.[156]

Salesmen of securities companies must be registered with the Ministry of Finance. The law specifies no special requirements for registration other than bases for disqualification but the practice apparently is to require prospective salesmen to pass an examination administered by the Japan Federation of Securities Dealers

[150] J.S.E.L., Art. 31; Tatsuta at 69-70.
[151] J.S.E.L., Art. 29; Tatsuta at 70. As of the end of September, 1972, there were 259 licensed securities companies with 1,859 offices throughout Japan. Securities Market in Japan, *supra* note 14, at 104.
[152] J.S.E.L., Art. 35; Tatsuta at 71.
[153] J.S.E.L., Art. 54(1); Tatsuta at 72.
[154] J.S.E.L., Arts. 54(1); 56, 57, 57-2; Tatsuta at 73-75.
[155] J.S.E.L., Art. 55; Securities Market in Japan, *supra* note 14, at 113.
[156] J.S.E.L., Art. 52; Securities Market in Japan, *supra* note 14, at 113.

Associations or to complete a training course given by individual associations.[157]

As is evident from the description of the licensing process, the activities of broker, dealer and underwriter are not legally segregated and a company may engage in all of these activities. Segregation exists in two senses, however. There is a prohibition against a securities company acting both as broker and dealer in the same transaction.[158] Moreover, a securities company may not at the same time engage in non-securities businesses such as banking and trust activities.[159] With the approval of the Minister, a securities company may engage in certain activities which are deemed related to the securities business.[160]

In the Philippines, there are, as a result of Presidential Decree 129, two sets of requirements with respect to what in Japan would be collectively termed "securities companies." Brokers and dealers are subject to *registration* requirements under the Securities Act. However, "investment houses," defined in the decree as any enterprise which engages in the underwriting of securities of other companies, are subject to *licensing* and other requirements set forth in the decree.[161] Persons registered as brokers and dealers are not eligible to act as investment houses. However, licensed investment houses may act as broker-dealers and need not procure additional registration as such, although they must comply with the Securities Act in other respects.[162]

The registration of brokers and dealers involves the following steps:

1) The applicant submits an accomplished SEC Form No. 3. The data required include: the principal office of the applicant; location of principal office and all branches in the Philippines; name and style of doing business; names, residences and business addresses of all persons interested in the business as principals, copartners, officers and directors, specifying as to each his capacity and title; the general plan and character of the business;

2) Payment of the required ₱50 fee. A notice is then issued settling the date for a hearing on the application to be held not less than 10 days after publication of the notice once in a newspaper of general circulation at the applicant's expense.

3) On or before the hearing, the applicant must submit the following documents:

a) Five letters testifying to the good repute of the persons named in the application who will administer the business of the applicant, and certifying that those persons are capable of engaging in the business of broker and dealer;

[157] Securities Market in Japan, *supra* note 14, at 115.
[158] J.S.E.L., Arts. 47 and 129.
[159] J.S.E.L., Art. 43; *see* Securities Market in Japan, *supra* note 14, at 108.
[160] *See* Securities Market in Japan, *supra* note 14, at 110.
[161] THE INVESTMENT HOUSE LAW, Presidential Decree No. 129 effective February 15, 1973. Text in 7 S.E.C. BULLETIN 17-18 (1973) [Hereinafter "INVESTMENT HOUSES LAW"].
[162] INVESTMENT HOUSES LAW, Sec. 13, at 22.

b) Certification of a bank relating to the applicant's credit with it;

c) If the applicant is a corporation, a copy of the resolution or the corporate secretary's certification as to the authorization by the board for the President and Secretary to sign the required irrevocable consent to service of process.

4) A surety bond of not less than ₱50,000 for brokers and not less than ₱25.000 for dealers must be posted in favor of the Philippine Government.[163]

If the Commission determines that all steps have been properly taken and that the applicant is of good repute, the registration is granted. Registrations expire on December 31st of each year. Renewals are granted upon written application and payment of the same fees. Further information is not required but renewal applications must be made not less than 30 but not more than 60 days before the first day of the succeeding year. Otherwise, they are treated as original applications and must again go through the steps outlined above.[164]

Registration may be denied or a registration granted may be revoked by the Commission if, after reasonable notice and hearing, it is determined that the broker or dealer has:

1) Violated any provision of the Securities Act or regulations thereunder;
2) Made a material false statement in the application;
3) Engaged in fraudulent sales of securities or fictitious purchases or sales of securities.[165]

While the above does not include insolvency, an SEC rule calls for immediate suspension of insolvent members of a securities exchange until they have settled with their creditors.[166] Further, any insolvent broker or dealer would have "demonstrated his unworthiness" within the meaning of item (3) above. There are no reserve requirements for broker-dealers under the Securities Act, but the indebtedness ratio is limited to 20 times net capital, twice the limit permitted Japanese securities companies.[167]

The registration may be suspended pending the hearing. The suspension, though binding upon persons notified, is confidential and is published only if the order has been violated after notice. It should be noted that the law deems it sufficient cause for denial or cancellation of a registration if an officer or director of any act or omission which would be cause for refusing or revoking the registration of an individual broker or dealer. Suspension or revocation of the registration statement of a broker-dealer also suspends or revokes the registration of all its salesmen.[168]

[163] P.S.A., Sec. 14; Procedures I, *supra* note 97, at 60.
[164] P.S.A., Sec. 14.
[165] P.S.A., Sec. 15.
[166] SEC Rules Governing Exchanges A-10, *supra* note 145, at 6.
[167] P.S.A., Sec. 19(a); SEC Rules Governing Exchanges B-16 to B-18, *supra* note 145, at 18-19.
[168] P.S.A., Sec. 15.

Unlike in Japan, brokers and dealers need not be corporations. Most members of stock exchanges are partnerships or sole proprietorships since all seats are owned by individuals. Indeed, the SEC requires that all members of stock exchanges which are corporations not have more than 10 stockholders. Further, those who own 95% of the outstanding capital stock must file a written undertaking to hold themselves solidarily liable for all liabilities of the company resulting from its brokerage transactions.[169] Hence, the result is to put all entities operating on an exchange on equal footing and a customer need not inquire into the legal form of the firm with which he is dealing.

Brokers and dealers are required to file with the Commission: (1) an annual report certified to by a certified public accountant, within 30 days after the close of the fiscal year;[170] (2) a semi-annual financial statement within 15 days after the semi-annual closing of books.[171] The statement generally includes information as to money balances of all accounts in the bookers of the broker or dealer as well as the market value of all securities under his control. A broker is further required to make a daily report to the Commission of the sales and purchases executed by him.[172]

The Commission conducts inspections of books and records of a broker or dealer from time to time, on a routine basis, and when a formal complaint has been lodged with the SEC against the firm.[173] The SEC staff's inspection involves verification of contents of financial reports, computation of stockholders' equity (including debt ratio) and cash position, verification of margin accounts and credit extensions, examination of trading (dealer's) accounts and stock control ledgers, and random examination of other books and records.[174]

Somewhat more segregation is required in the activities of a broker or dealer than under Japanese law. For instance, when an exchange member acts as a broker and a dealer with respect to the same non-exempt security, he must make written disclosure of that fact to his customer.[175] The member may effect a cross-sale on the floor of the exchange, but he must post himself as a seller for a reasonable period at one minimum fluctuation below his buying limit.[176] There are limitations on a broker's acceptance of discretionary accounts if he also trades on his own account.[177] Similar restrictions are present in over-the-counter transactions.[178] A dealer which also acts as an underwriter may generally not engage in banking functions.[179]

[169] Yabyabin, *Trading in Securities*, in ASPECTS OF PHILIPPINE COMMERCIAL LAW 326 (M. Lopez-Campos ed. 1966).
[170] SEC Rules Governing Exchanges A-9, *supra* note 145, at 3
[171] *Id.*
[172] SEC Rules Governing Exchanges B-11, *supra* note 145, at 17.
[173] P.S.A., Sec. 27; Yabyabin, *supra* note 109, at 293.
[174] Procedures VII, *supra* note 97, at 64-65.
[175] SEC Rules Governing Exchanges A-29, *supra* note 145, at 12.
[176] SEC Rules Governing Exchanges A-26, *id.* at 10.
[177] SEC Rules Governing Exchanges B-9, *id.* at 16.
[178] SEC Rules Governing Exchanges B-21 through B-22, *id.* at 19-20.
[179] *Infra*, text at notes 186 and 187.

Salesmen must be registered with the SEC. The application is filed by the broker or dealer on behalf of its salesmen. If the broker-dealer is an exchange member, an application must first be submitted to the exchange which then forwards it to the SEC if it wishes to recommend approval. If the applicant has not been previously registered as a salesman, he is required to pass a written examination administered by the Commission. Registrations expire on December 31st of each year, renewable by payment of the same fee.[180]

As earlier stated, a different set of requirements apply in the case of "investment houses," a term which is defined broadly to cover all entities engaging in underwriting and investment banking activities.[181] The Presidential Decree corrects the situation under the law then prevailing where investment banks were not subject to direct regulation. They were not subject to banking laws since they were technically not "banking institutions." Insofar as they were "dealers" under the broad definition of the Securities Act, they registered as such and were subject to the reporting requirements thereunder. Although the definition of "dealer" has not been amended, the Investment Houses Law has the effect of limiting that definition to non-underwriting activities and giving it a meaning which approaches the counterpart definition under the U.S. Securities Act. In any case, it is clear that the requirements of the new law and SEC regulations pursuant to the law are *in addition* to those under the Philippine Securities Act.

Basically, the law requires that investment houses be registered as such with the SEC which has the authority to grant it a license to operate. Investment houses must be organized as stock corporations and have minimum initial paid-up capital of ₱20 million.[182] A majority of the voting stock must be owned by Filipino citizens and a majority of members of the board must be citizens.[183]

In addition to documents required for ordinary registration as a stock corporation, the SEC requires that the following documents be filed: a statement under oath by the organizers and the proposed managerial staff of their educational background and work experience, as well as information on positions currently held in banking and other financial institutions; a one-year *projected* statement of assets and liabilities; a *tentative* program of operation for one year.[184] On the basis of these documents, the SEC Commissioner, in consultation with the Central Bank, determines

[180] P.S.A., Sec. 14; Procedures II, *supra* note 97, at 60-61.
[181] INVESTMENT HOUSES LAW, Secs. 2 and 3, *supra* note 161; *Basic Rules and Regulations to Implement the Provisions of Presidential Decree No. 129, Otherwise Known as "The Investment Houses Law"*, effective July 13, 1973, Secs. 2(a) and (b), 7 S.E.C. BULLETIN 24 (1973) [Hereinafter "SEC Rules on Investment Houses"].
[182] INVESTMENT HOUSES LAW, Secs. 4 and 8, *supra* note 161, at 18, 21; SEC Rules on Investment Houses, Sec. 3(A), *supra* note 181, at 25-26.
[183] INVESTMENT HOUSES LAW, Sec. 5, *id.* at 19; SEC Rules on Investment Houses, Sec. 3(A), at 25-26.
[184] INVESTMENT HOUSES LAW, Sec. 4, *id.* at 18-19; SEC Rules on Investment Houses, Sec. 3(B), *id.* at 26.

whether registration of the investment house will promote public interest and economic growth and whether there is reasonable assurance that the enterprise will be run "with financial prudence."[185]

The required consultation with the Central Bank brings to light the decree's attempt to coordinate regulation under securities and banking laws. An investment house is specifically prohibited from engaging in banking operations.[186] However, it may engage in "quasi-banking functions" as defined in the General Banking Act with the approval of the Monetary Board, the governing body of the Central Bank. Moreover, the investment house is deemed to be "non-bank financial intermediary" and is subject to further Central Bank regulation.[187]

Once registered as an investment house, a company has broad powers to act as underwriter, whether on a straight, firm-commitment or best-efforts basis, and may participate in a selling group, or otherwise perform functions of a broker or dealer. Further, it may act as financial consultant or investment adviser. It may engage in any other business venture directly or indirectly related to dealing in securities and other commercial papers.[188]

Certain limitations are directed at preserving the financial soundness of investment houses and preventing conflicts of interest among its officers and directors. Hence, underwriting commitments for its own account may not exceed an aggregate amount equal to 20 times its unimpaired capital and surplus.[189] It should not allow this unimpaired capital and surplus to fall below ₱20 million, the minimum capitalization.[190] Further, the SEC may require maintenance of a reasonable contingency reserve.[191] While the house is managing funds, all personnel directly involved in such management may not transact in shares bought and sold for the managed account. Advances to officers, directors and 10% shareholders are allowed only if sufficiently collateralized.[192]

The SEC requires the filing of an annual report, a semi-annual financial statement and quarterly progress reports.[193] Reports on resignations, dismissals or suspensions of officers, directors and managerial staff, and on the filling of vacancies created thereby, must be filed within 15 days after occurrence of the event.[194] The SEC has discretionary power to conduct investigations at any time to determine whether violations of requirements have taken place.[195] Violations are dealt with by suspension or revocation of the license to operate as an investment house and by fines in

[185] SEC Rules on Investment Houses, Sec. 3(C), *id.* at 26-27.
[186] INVESTMENT HOUSES LAW, Sec. 6, *id.* at 19.
[187] INVESTMENT HOUSES LAW, Sec. 12, *id.* at 21-22.
[188] INVESTMENT HOUSES LAW, Sec. 7, *id.* at 19-20.
[189] SEC Rules on Investment Houses, Sec. 8(1), *supra* note 181, at 28.
[190] SEC Rules on Investment Houses, Sec. 8(2), *id.* at 28.
[191] SEC Rules on Investment Houses, Sec. 7, *id.* at 28.
[192] SEC Rules on Investment Houses, Sec. 8(4), *id.* at 29.
[193] SEC Rules on Investment Houses, Sec. 9(A)-(C), *id.* at 29.
[194] SEC Rules on Investment Houses, Sec. 9(D), *id.* at 29.
[195] SEC Rules on Investment Houses, Sec. 13, *id.* at 30.

proper cases. The Monetary Board may issue a cease-and-desist order in case of violations of Central Bank rules and non-compliance therewith subjects the investment house to possible fines.[196]

Protection of Investors

A few preliminary comments are appropriate before discussion of the antifraud provisions of both the Japanese and Philippine securities law. It is evident from an examination of the two systems that greater reliance is placed on administrative action rather than on enforcement of private rights. Inspite of an array of provisions which affirm the right of the investor to protect his rights, there are no significant cases in the two jurisdictions applying those provisions. As will be noted, in some cases, the reason for the lack of private suits may be limitations built into the laws themselves. The reluctance of the Japanese people to resort to litigation has been noted by several writers.[197] The same reluctance is apparent in the Philippines although sociological reasons are probably less important (if the clogged dockets of the courts are any indication) than the lack of public awareness of the availability of legal remedies and the general tendency to run immediately to the Philippine SEC for corrective action. The threat of an SEC investigation is usually weighty enough to put a halt to whatever fraudulent practices have come to light. Actual recovery of losses is another matter. It is possible, although there are no statistical data to support this conclusion, that investors in the Philippines, as is apparently the case in Japan, prefer to regard stock market misfortunes as gambling losses.[198] Also, there may be substance to occasional reports of private settlements in cases of disputes between broker-dealers and their customers. With growing popular participation in the Japanese and Philippine stock markets, however, private enforcement of rights may increase.

A. Japan

1. Civil Liabilities

Japan has a general antifraud provision which is modeled after Section 17 of the Federal Securities Act and Section 10(b) of the Federal Securities Exchange Act. According to Prof. Tatsuta, however, it is rarely used because of its "abstract wording."[199] There is also a general provision which holds an issuer,

196 SEC Rules on Investment Houses, Sec 15, *id.* at 30-31.

197 *See* Kawashima, *Dispute Resolution in Contemporary Japan*, in LAW IN JAPAN 41 (A. von Mehren ed. 1963); Stevens, *Japanese Legal Systems and Traditions* in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE FAR EAST 13-14 (R. Allison ed. 1972); Tatsuta at 5.

198 Tatsuta at 5.

199 Tatsuta at 76, note 37; J.S.E.L., art. 58. Unlike Section 10(b) of the Securities Exchange Act, the Japanese provision is self-operative:

"No person shall commit an act coming under any of 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 contains an untrue statement of a material fact or

secondary distributor, underwriter or securities company liable in damages to a purchaser for violation of registration and prospectus delivery requirements.[200]

An issuer may be held liable in damages to a purchaser of securities in a public offering or secondary distribution in case of false statements or material omissions in a registration statement or prospectus. The purchaser has no right of action if he knew of the falsehood or omission at the time of his acquisition.[201] By virtue of the 1971 amendments to the Securities Exchange Law, the innocent purchaser may also recover from:

1) officers of the issuer in office at the time of the filing of the registration statement, or promoters of the proposed corporation;
2) the owner of the security distributed, that is, the secondary distributor;
3) the certified public accountant or accounting firm which certified the financial statements;
4) the securities company which entered into an underwriting contract with either the issuer or secondary distributor.[202]

The defenses available to persons in the first two categories above are that they did not know, and could not with reasonable diligence have known, of the falsity or omission. The accountant may allege that execution of the certification in question was neither deliberate nor negligent. The underwriter may plead in his defense that he was unaware and could not with due care have known of the falsehood or omission in statements other than certain financial statements.[203]

The damage claim may be brought within one year from discovery of the defect in the registration statement or prospectus, or from the time discovery could have been made with the exercise of reasonable diligence. In any case, the claim must be asserted within five years from filing of the registration statement or delivery of the prospectus to the purchaser.[204]

Purchasers in transactions other than a public offering or secondary distribution may recover only from persons in the first and third categories above in case of falsehoods or omissions in a registration statement.[205] The same persons are liable in case of

any omission to state a material fact necessary to make the statements therein not misleading;

3. To make use of false quotations for the purpose of inducing purchase or sale or other transactions."

Translation from GUIDE TO ECONOMIC LAWS OF JAPAN 743 (Ministry of Finance 1950).

200 J.S.E.L., Art. 16.

201 J.S.E.L., Art. 18; Tatsuta Addendum at 5; THE 1971 AMENDMENT TO THE SECURITIES AND EXCHANGE LAW (Law No. 4 of 1971) 7 (Japan Securities Research Institute 1971) [Hereinafter "The 1971 Amendment"].

202 J.S.E.L., Art. 21(2); Tatsuta Addendum at 5; The 1971 Amendment, *supra* note 201, at 9.

203 J.S.E.L., Art. 21(2); Tatsuta Addendum at 5; The 1971 Amendment, *supra* note 201, at 9.

204 J.S.E.L., Art. 20; The 1971 Amendment, *supra* note 201, at 10.

205 J.S.E.L., Art. 22(1); The 1971 Amendment, *supra* note 201, at 10; Tatsuta Addendum at 5.

false statements or material omissions in a periodic report.[206] The issuer is not liable in these latter cases.

The measure of damages is the difference between the amount paid by the claimant and either of: (1) the market price of the security at the time the claim is made or, absent a market price, the estimated sale price at the time the claim is made; or (2) the price at which the security was sold.[207]

Damage claims may be brought against persons who engage in the following activities: (1) wash sales; (2) matched orders; (3) to entrust or be entrusted with the foregoing; (4) purchases and sales to manipulate the market price of a security; (5) representations that the security's market price will be changed by manipulation; (6) willful misrepresentation.[208] These provisions, according to Prof. Tatsuta, have not been utilized for two decades because of the difficulty of establishing the intent of the persons accused.[209] The law requires that, as to the first three acts, that there must be proof of creating a misleading appearance of active trading in the security. As to the last three acts, it must be shown that the object was to induce purchases and sales of the security by others.[210]

Stabilization transactions to support prices of a security being sold are permitted, but only under rather stringent conditions relating to the time within which these transactions may be engaged in and the persons who may enter into them.[211]

As in the United States, the law requires that profits from insiders' trading be disgorged. A shareholder may bring a derivative suit to recover the gains derived by directors or 10% shareholders who earned capital gains or avoided suffering loss by selling and buying or buying and selling within a six-month period.[212] For some reason, the duty of insiders, i.e. directors and 10% shareholders, to notify the Ministry of their holdings and changes therein was removed by a 1953 amendment to the law.[213] Detection of the violations was therefore difficult, if not practically impossible. In the 1971 amendments, the reporting requirement was reinstituted, except that it is the issuer who must file a current report of changes in 10% shareholders.[214]

The derivative suit itself is a vehicle which apparently has not been used extensively in Japan because of, among other things,

206 J.S.E.L., Art. 24-4; The 1971 Amendment, *supra* note 201, at 12; Tatsuta Addendum at 5.
207 J.S.E.L., Art. 19; The 1971 Amendment, *supra* note 201, at 7-8.
208 J.S.E.L., Art. 125; Tatsuta at 87.
209 Tatsuta at 87.
210 J.S.E.L., Art. 125; Tatsuta at 87.
211 J.S.E.L., Art. 125(3); Tatsuta Addendum at 6-7; Securities Market in Japan, *supra* note 14, at 92-94.
212 J.S.E.L., Art. 189; Matsumoto, *Management Responsibility to Minority Shareholders in Japan: Derivative Suit in East-West Melting Pot*, 18 N.Y.L.F. 370-371 (1972).
213 Tatsuta at 111, note 5.
214 *Supra*, text at note 111.

difficulties in civil procedure.[215] There is no pretrial system of discovery or interrogatories equivalent to the U.S. system. It has been remarked that Japanese law does not encourage derivative suits through compensation to shareholders and their attorneys.[216]

2. Administrative Action

The Finance Minister's power to issue stop orders and amendments in the case of misstatements and omissions in the registration statement and periodic reports has already been noted.[217] The authority to extend pre-effective waiting periods of other registration statements filed within a one-year period in case of misstatements in a previous registration statement or in a periodic report has been discussed.[218]

In addition, the Ministry has the power to impose administrative sanctions in case of the following acts by securities companies, their officers and employees:

1) soliciting orders by giving an affirmative judgment that the price of the security will rise or fall;
2) soliciting orders with a promise that the company will compensate a customer for his losses;
3) false and misleading representations in connection with a transaction;
4) solicitations with promises to offer certain benefits;
5) manipulating prices by a series of transactions;
6) settling the company's own balance derived from its counter-sale against the customer's margin transaction by another counter-sale;
7) an officer or employee taking advantage of special information obtained through his position for selling or purchasing securities or solely for the purpose of lucrative speculation.[219]

The above grounds are similar to the bases for civil liability noted above. The advantage of going the route of administrative action is that proof of intent or purpose is not required and the Minister is thereby given more discretion to order sanctions against the offenders.[220]

As part of the Minister's supervisory power over securities companies, he is given the authority to mediate any dispute over a securities transaction.[221] The Minister may propose an agreement. If one or both refuse to accept the proposal, the negotiations may be made public except for business secrets.[222] A securities company which fails to fulfill his obligations under the agreement may be suspended for as long as six months.[223]

Securities companies which are members of a securities exchange are subject to disciplinary action under rules of the exchange. The Minister exercises direct power in the sense that

215 Matsumoto, *supra* note 212, at 395.
216 *Id.* at 393.
217 *Supra*, text at notes 84, 87-92, 121-123.
218 *Supra*, text at notes 88 and 123.
219 J.S.E.L., art. 50; Tatsuta at 76.
220 Tatsuta at 87-88.
221 J.S.E.L., Arts. 157-164.
222 J.S.E.L., Arts. 160, 162, 164.
223 J.S.E.L., Art. 163.

he may revoke or suspend the license of an exchange which fails to discipline is members. In addition, revocation of the license of the securities company by the Minister would necessarily mean disqualification as an exchange member since possession of a license is a pre-requisite to membership.[224]

3. Criminal Liability

The law prescribes fines and imprisonment for various violations including: false statements in registration statements, prospectuses and securities reports; engaging in securities business without a license; false statements in tender offer documents. The fines may be as high as ¥300,000 and the imprisonment as long as three years.[225]

B. Philippines

1. Civil Liabilities

There are two principal actions by investors under the Philippine Securities Act: (1) an action by a purchaser against a seller for a sale made in violation of the Act or wherein the purchaser relied upon a false and misleading statement with respect to material facts contained in a document filed with the SEC;[226] and (2) an action by an investor against a person who has engaged in certain manipulative acts or made false and misleading statements.[227]

In the first type of action, the sale is voidable at the purchaser's option and he may sue the seller and the latter's directors, officers and agents if they participated in the transaction. The purchaser may recover the price paid, with interest, together with court costs and attorneys' fees. The limitations of this action are as follows:

1) The purchaser must tender the securities in question;
2) The action must be brought within two years from the *date of the sale* regardless of when the purchaser became aware of the violation or misstatement;
3) The purchaser may not bring the action if he has refused a written offer by the seller to take back the securities and refund the full purchase price with interest.[228]

In the second type of suit, the offensive acts are the same manipulations earlier noted in the Japanese law, i.e. wash sales, matched orders, market rigging, etc.[229] In addition, the action may be brought against any broker, dealer, seller or buyer who knowingly makes a false and misleading statement as to any material fact to induce the transaction.[230] Stabilizing transactions

[224] J.S.E.L., Art. 90; Tatsuta at 83-84.

[225] See J.S.E.L., Arts. 197-210; The 1971 Amendment, *supra* note 201, at 24-29.

[226] P.S.A., Sec. 30(a).

[227] P.S.A., Sec. 20(e).

[228] P.S.A., Sec. 30(a).

[229] P.S.A., Sec. 20(a). Subsections (b) and (c), which refer to violations with respect to puts, calls, straddles and options are not self-operative. While the second type of action authorizes suits for violations of SEC rules in connection with these transactions, no such rules have been promulgated to date.

[230] P.S.A., Sec. 20(a)(4).

are not made *per se* unlawful under this provision. Under a later provision in the Securities Act, "artificial measures of price control" must have prior approval of the SEC which will grant approval only if investors are benefited by the stabilizing transactions.[231]

Suit may be brought by any purchaser or seller of a security at a price which was affected by the prescribed acts. The claimant may recover actual damages, costs and attorneys' fees. The action must be brought within one year from discovery of the violation and, in any case, within three years thereof.[232]

The two suits may be distinguished from one another. Although both cover instances of misrepresentations by a seller, only the second covers those by a buyer. The first type covers a broader range of violations than the second which is limited to manipulative acts specifically enumerated. However, the second seems more favorable to the investor in that: it provides a cause of action for the defrauded seller as well as a defrauded buyer; it does not require tender of the security involved; the offender may not defeat the suit by offering to take back the security; and the statute of limitations is more liberal. The difficulty with the second type of suit, as with the Japanese provision, is that it requires proof of intent to induce purchases and sales of a security or to create a false picture of the market for the security.

Philippine law also requires disgorgement of profits from insider trading by an issuer's officers, directors and 10% shareholders.[233] It differs from the American provision in that it seems to require proof of "unfair use of information." Unlike Japanese law, reporting of 10% holdings and changes therein has always been required under the Securities Act. The Act does not specifically authorize a shareholder's derivative suit, as the Japanese provision does, but the cause of action is clearly made to belong to the corporation. The derivative suit has been expressly recognized as a matter of case law.[234] As in Japan, there have been relatively few derivative suits in the Philippines.[235] There are no special procedural rules governing the litigation and the complaining stockholder is therefore not assured of the corporation's assistance in financing the suit or of being reimbursed for attorneys' fees not covered by the court's grant.

As in the U.S. law, controlling persons are liable jointly and severally with controlled persons that are held liable under the Act.[236] Further, contracts made in violation of the Act are void as regards the rights of any person who made or engaged in the

[231] P.S.A., Secs. 20(a)(6), 21-A.

[232] P.S.A., Sec. 20(e).

[233] P.S.A., Sec. 26.

[234] *Pascual v. Del Saz Orozco* 19 Phil. 82 (1911); 3 A. AGBAYANI, COMMENTARIES AND JURISPRUDENCE ON THE COMMERCIAL LAWS OF THE PHILIPPINES 478 (1970).

[235] Cagampang, *The Fiduciary Duties of Corporate Directors Under Philippine Law*, 46 Phil. L.J. 578 (1971).

[236] P.S.A., Sec. 29.

performance of the contract, as well as any non-party to the contract who acquired rights under it with knowledge of the illegality.[237]

2. Administrative Action

The SEC's power to suspend or revoke registrations or licenses of securities and registrations of broker-dealers has already been noted at various parts in this paper. Violations of law and SEC rules are punishable by fines.

The Commission does not have the authority to mediate disputes which the Japanese Minister has. However, procedural rules governing hearings and investigations before the SEC give the Commission the discretion to direct the parties to appear before it for a preliminary conference to consider the possibility of an amicable settlement. The Commission's authority in this connection is not as broad as the Finance Minister's.[238] Moreover, the Commission has full discretionary power to conduct investigations of actual or potential violations of the Securities Act or rules thereunder.[239] It may also bring an action in a proper court for issuance of a permanent or temporary injunction against prohibited acts or practices. Upon application of the Commission, the court may also issue a mandatory injunction commanding any person to comply with the Act or an SEC order.[240]

The Commissioner may ask the court to hold a person who has disobeyed an SEC subpoena in contempt.[241] The SEC also has summary power to hold a person in contempt if he so misbehaves as to interrupt a hearing or investigation or if, being present at a hearing, he refuses to be sworn as a witness or respond to a question when lawfully required to do so.[242]

Exchanges must adopt rules for disciplining members as a condition to their registration by the SEC. Unlike the Japanese Minister, the Commission has the direct power to suspend for not more than 12 months or expel from the exchange a member who has violated the Act.[243]

3. Criminal Liability

Any willful violation of the Act may subject a person to a fine not exceeding ₱20,000 and/or imprisonment of not more than two years.[244]

---

237 P.S.A., Sec. 38.

238 Rules of Procedure Governing Hearings and Investigations in the Securities and Exchange Commission Rule 7, in SEC RULES AND REGULATIONS 69 (1973). Note that the preliminary conference is discretionary upon the Commission. In civil suits, the Rules of Court prescribe *mandatory* pretrial proceedings. RULES OF COURT Rule 20. For an unofficial compilation, see THE REVISED RULES OF COURT IN THE PHILIPPINES (3d ed. 1972).

239 P.S.A., Sec. 31(a).

240 P.S.A., Sec. 31(d) and (e).

241 P.S.A., Sec. 31(b).

242 Republic Act No. 1143, Sec. 1(a). 3 Philippine Permanent and General Statutes 620.

243 P.S.A., Secs. 17(b), 28(a)(2).

244 P.S.A., Sec. 40.

Summary and Conclusion

This article has noted several differences between Japanese and Philippine securities law. Some major points of differences may be emphasized:

1) The focus of the Japanese Securities Exchange Law is on public offerings and secondary distributions, while that of the Philippine Securities Act is on repeated and successive ("non-isolated," as we called it) sales.

2) As a consequence of this difference in focus, the "private offering" exemption has different meanings in the two countries.

3) The definition of a security is considerably broader in the Philippines and covers a wider range of instruments than in Japan.

4) Philippine law establishes a distinction between speculative and non-speculative securities, the former requiring licensing and not mere registration. Japanese law makes no such distinction.

5) Japanese law seems to exempt transactions by persons other than issuers, secondary distributors, underwriters and securities companies. There is no comparable exemption in the Philippines.

6) Japanese law imposes prospectus delivery requirements in case of a public offering or secondary distribution. This requirement is absent in the Philippines.

7) Japanese law permits offers to be made right after filing of a registration statement and before its effective date. No offers may be made in the Philippines until the registration statement is effective.

8) Philippine law does not provide a procedure for amendment of a registration statement before its effectiveness. The Japanese Minister is authorized to order amendment of defective registration statements before the effective date.

9) The kinds of periodic reports required to be filed by issuers, and the contents of those reports, are different in the two systems.

10) Japan has a licensing system for persons engaged in the securities business and the Minister has extensive supervisory power over securities companies. The Philippines has a "two-tier" system — a registration system for brokers and dealers, and a licensing system for "investment houses." But even in the licensing system, the Philippine SEC does not have as broad a power as the Japanese Minister.

11) Japanese law allows the Finance Minister to mediate disputes involving securities companies. The Philippine SEC has less extensive authority under its procedural rules to explore the possibility of an amicable settlement by means of a preliminary conference between the parties.

It is obvious that the two systems are now quite different from their American model. At the very least, this should serve