

FACT SHEETS

Fifth Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative

June 29, 2006

OVERVIEW

The U.S.-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) is undertaken by both Governments to enhance growth by improving market opportunities and freeing businesses from cumbersome regulation. Established in 2001 by President Bush and Prime Minister Koizumi as a key component of the U.S.-Japan Economic Partnership for Growth, both Governments exchange annual recommendations and, following working and high-level discussions, prepare this annual Report to the Leaders to document progress.

This year's 76-page Report to the Leaders lists important measures taken by Japan in key sectors such as telecommunications, information technology, intellectual property rights, medical devices and pharmaceuticals, financial services, agriculture, competition policy, transparency, legal reform, commercial law, and distribution. This progress will help lower barriers to business, enhance transparency, open new markets, strengthen the competitive environment, and speed regulatory decisions.

It remains important for Japan to strengthen its move toward regulatory reform in the coming months and years, as these measures have benefited consumers and businesses while spurring economic growth. This Fifth Report to the Leaders also highlights several areas where Japan is considering further reform that will fulfill these important objectives.

TELECOMMUNICATIONS

Background: As Japan's telecom market continues to offer some of the world's most advanced broadband services, the Japanese Government has begun to grapple with next-generation policy issues. These include facilitating competitive opportunities for new technologies and business models as well as ensuring new entrants are not impeded by issues related to the legacy of former public monopolies. The United States has urged the Japanese Government to demonstrate its continuing commitment to ongoing reform in this sector by taking steps to address high interconnection rates, adhere to a policy of technology-neutrality in licensing, and remove other impediments in both the wireline and mobile markets. The United States also seeks further improvements in transparency, technologically-neutral licensing, and measures to ensure regulatory independence with particular respect to decisions related to wireless services.

Progress: The United States welcomes the significant steps the Japanese Government is taking to spur growth and encourage competition in the telecommunications sector, including:

- Reexamining the legal framework of Japan's telecommunications and broadcasting sectors, including the structure of the dominant carrier (NTT), and how competitors can be ensured fair access to essential facilities of NTT's network to ensure meaningful competition in an era of convergence;
- Enabling three new market entrants to provide wireless services in the 1.7GHz and 2GHz bands, thus stimulating competition in a sector characterized by high rates and low network usage;
- Working toward major revisions of guidelines for Mobile Virtual Network Operators (MVNOs), thus strengthening the ability of licensed operators to lease, sub-lease, and exchange spectrum with other service providers as a secondary market;
- Continuing to reduce fees NTT East and West charge competitors for access to their fixed network by phasing out fixed costs charged to competitors that distorted rates for wholesale access;
- Affirming the revision of the universal service mechanism to subsidize telecommunications service in high-cost regions will adhere to WTO Reference Paper principles such as transparency and competitive neutrality (i.e., ensuring that any universal service program does not disadvantage carriers competing with NTT, which currently has exclusive rights to such subsidies);
- Welcoming new wireless broadband technologies (e.g. WiMax) and considering future frequency allocations for such technologies in a transparent manner;
- Moving forward on completion of a Mutual Recognition Agreement with the United States for telecommunications equipment, to promote more efficient trade; and
- Examining the possibility of adopting a streamlined "Family Approval" approach to conformity assessment procedures for wireless LAN antennas.

INFORMATION TECHNOLOGIES

Background: Japan's New IT Reform Strategy, which was adopted by the IT Strategy Headquarters on January 19, 2006, makes an important contribution to the Government's ongoing efforts to promote the use of IT and e-commerce throughout Japan's economy. The United States encourages Japan to continue its work to strengthen intellectual property rights (IPR) protection in the digital age, while cultivating an environment in which IT and e-commerce can flourish by eliminating rules and practices that hinder their full development, enhancing private-sector input and participation in policy making processes, and implementing additional measures to ensure open and vigorous competition. The two Governments also resolve to undertake joint measures to strengthen global IPR protection and enforcement.

Progress: The United States welcomes the significant steps the Japanese Government is taking to create effective IT, IPR, and e-commerce policies, including:

- Launching new initiatives with the U.S. Government to combat trade in counterfeit and pirated goods through intensified bilateral, regional, and multilateral action in Asia and the world;
- Seriously reviewing changes in Japan's Copyright Law, including possible implementation of a statutory damages system and extended term of protection for sound recordings and all copyrighted works;
- Improving compliance with Japan's Privacy Act by cooperating with the U.S. Government to hold a major public forum in June 2006;
- Clarifying that companies will not be subject to penalties if they do not adhere to the voluntary privacy guidelines of individual ministries;
- Undertaking new measures to promote the introduction of innovative IT solutions for medical records and the processing of medical receipts;
- Preparing to submit legislation in FY2007 that will promote the effective utilization of new intellectual property by expanding the scope of Japan's Bayh-Dole system and making it possible for contractors to possess ownership rights to IP created through government-sponsored IT projects, including software;
- Increasing awareness of technological measures to combat spam in the context of Japan's Constitutional Secrecy of Communications and the Telecommunications Business Law;
- Addressing online hazards (phishing, spam, and fraud) by cooperating with the U.S. Government to hold the U.S.-Japan Financial Technology Seminar in April 2006;
- Ensuring transparency in the administrative rulemaking process as outlined in the revised Administrative Procedures Act and that interested parties are provided meaningful opportunities to contribute to the development of IT and e-commerce regulations and guidelines;
- Recognizing the importance of obtaining stakeholder input if and when the Network Security Standards for Measures, released in December 2005, are changed in substance;
- Strengthening financial institutions and infrastructure by conducting surveys of IT use and establishing a working group to discuss electronic receivables and new electronic settlement services; and
- Taking steps to more clearly define and limit liability in IT-related procurement contracts.

MEDICAL DEVICES AND PHARMACEUTICALS

Background: An aging population and shrinking tax base are challenges for Japan's healthcare budget. The number of people 65 and older is projected to increase from 1 in 5 today to 1 in 4 by 2015, while a falling birthrate is causing a decline in the population. With relatively fewer workers to generate revenues to fund healthcare for the elderly, Japan is taking steps to modify its healthcare system. Japan will consider the value of innovation, the role of the market, and the need for timely provision of innovative products when making any changes to its reimbursement pricing system for medical devices and pharmaceuticals. In this regard, Japan has noted the strong opposition of the U.S. Government to any system by which reimbursement prices of drugs and devices could be changed every year. The U.S. Government continues to urge Japan to consider the long-term benefits to its people and its finances from greater use of innovative devices and drugs that speed recoveries, enabling patients to leave hospitals sooner while easing the burden on taxpayers. Japan also is working to improve its regulatory system to expedite the introduction of advanced devices and drugs.

Pricing progress: Significant new steps Japan has taken or will take on pricing issues include:

- Easing prerequisites and raising the range of drug premiums, and creating a pediatric drug premium;
- Enabling drug firms to discuss their products' benefits at initial Drug Pricing Organization meetings;
- Reviewing industry studies on the effects of Japan's regulatory and distribution systems on medical-device sector costs;
- Increasing the frequency of health insurance listings for innovative "C2" medical devices;
- Granting premiums to innovative diagnostic products; and
- Refraining from cutting prices for most blood products.

Regulatory progress: Significant new steps Japan has taken or will take on regulatory issues include:

- Expanding the staff of the Pharmaceuticals and Medical Devices Agency to speed reviews;
- Increasing the variety of metrics used to track drug reviews;
- Improving the drug consultation process and facilitating clinical trials to help attain simultaneous global development of drugs;
- Establishing a system to facilitate regulatory approval for "partial changes" in medical devices;
- Clarifying the applicability of quality system audits to medical device suppliers and sterilizers;
- Creating a study group with industry participation on the manufacture and supply of blood products;
- Working with industry to establish a system to provide information to consumers from the National Institute of Health and Nutrition's database on nutritional supplements; and
- Improving transparency of the regulatory system for cosmetics and quasi-drugs.

FINANCIAL SERVICES

Background: Japan made progress in implementing its December 2004 "Program for Further Financial Reform" over the past year. The Program signals a shift in focus from "ensuring financial system stability" to "promoting financial system vitality" through deregulation to boost the ability of financial institutions to offer a wider range of services quickly. Under the Program, the Financial Services Agency (FSA) set forth an aggressive, wide-reaching work schedule with the aim to carry out financial reforms in key areas including distribution, pricing, advertising, market conduct, user protection, corporate governance, disclosure, and risk management by 2007. The reforms, involving numerous laws, regulations and guidelines, aim to ensure Japan's future as a highly advanced "financial services nation" and a "regional financial hub." Major steps taken this year include the adoption of Japan's new Financial Instruments and Exchange Law. The Governments of the United States and Japan have agreed to a continuing dialogue on implementation of the Program for Further Financial Reform.

Progress: Significant new steps taken by the Government of Japan to open financial markets and increase the transparency of the financial regulatory process over the past year include:

- Reviewing money lending business laws from March 2005 and issuing an FSA Round Table Interim Report on April 21, 2006, indicating that the Round Table generally agreed both that "Gray Zone" should be abolished and that money lenders' utilization of lenders' exchanges should be promoted to raise the accuracy of credit examination;
- Pledging to consider e-notification as one method of providing documents to borrowers under the Money Lending Business Law;
- Enacting the Financial Instruments and Exchange Law in June 2006 under which investment advisors, investment trust management companies, and securities companies will be supervised as financial firms under one unified cross-sectoral law;
- Recognizing the value of Japan's Defined Contribution (DC) pension system in terms of retirement income security, labor mobility, and investor education as well as endeavoring to continuously improve that system by reviewing the Defined Contribution Pension Law in October 2006, taking into account input from interested parties;
- Implementing the Amended Administrative Procedure Law in April 2006, which established a public comment process as a statutory procedure, setting a minimum public comment period of 30 days; and
- Improving transparency of the legislative process for the Financial Instruments and Exchange Law by providing formal and informal opportunities for public comment and opinion exchange with representatives of associations related to foreign financial institutions and committing to a public comment process for adoption of the implementing regulations.

COMPETITION POLICY

Background: A well-structured competition policy – supported by a strong and effective Antimonopoly Act (AMA) and enforcement policy – will provide great benefits to Japanese consumers and the business community, and will promote the health and dynamism of the Japanese economy. Japan's implementation this year of major revisions of the AMA enacted in 2005 is already having a significant impact on the competitive environment. The Japan Fair Trade Commission (JFTC) has also taken steps to ensure that its enforcement actions are applied in a fair and transparent manner, steps that will go a long way in gaining support for the JFTC's mission by both the public and the business community. Although bid rigging – often aided by government officials – continues to be a significant problem in Japanese public works projects, Japan has started to take measures that may begin to address this problem in a serious way.

Progress: Significant new measures Japan has taken or will take to address these problems include:

- Introduction of an AMA Leniency Program that encourages firms to report the existence of cartels and bid rigging agreements to JFTC;
- Active use by JFTC of its new criminal investigation powers, including in a 2006 investigation of bid rigging on construction of waste disposal facilities that resulted in criminal accusations against 11 companies and 11 individuals;
- Greater fairness in JFTC investigatory processes, including allowing proposed recipients of cease-and-desist orders and surcharge orders to review evidence obtained by JFTC and to present their views and evidence to JFTC before the order is issued, and allowing proposed recipients of warnings to submit their views and evidence to JFTC before a warning is issued;
- Establishment by the Ministry of Land, Infrastructure and Transport (MLIT) of an administrative leniency program that complements the JFTC Leniency Program by cutting in half the period of suspension from bidding for companies that were admitted to JFTC's Leniency Program;
- Doubling by MLIT of the minimum period of suspension from bidding for firms that commit a second bid rigging violation within ten years, with the minimum suspension for serious AMA violations increasing to 12 months;
- Issuance of a Cabinet Decision in May 2006 that will help prevent bid rigging by expanding the open bidding system, strictly implementing suspensions from bidding for firms engaging in bid rigging, and making further efforts to eliminate government-led bid rigging; and
- Measures that start to address government-led bid rigging that results from conflicts of interest stemming from Japan's *amakudari* retirement system, such as MLIT requests to its senior officials to refrain for five years from seeking employment with companies that had contracts for MLIT construction projects.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

Background: Japan has continued to make progress to increase transparency of Government decision making processes, including the implementation of new Public Comment Procedures that will allow greater opportunities for input into regulatory matters as well as a new program to produce English translations of laws and regulations. The U.S. Government believes that stronger measures remain necessary to increase access to and the transparency of advisory groups and other committees that advise the Japanese Government on policy and regulatory issues, and will continue to place a strong focus on this issue. Japan is also moving forward with its Special Zones for Structural Reform initiative, including nationalization of a subset of the zone measures. These steps are helping to improve the environment in Japan for effective business operation and development. Progress was also seen across a variety of other regulatory matters that will benefit consumers while opening new business opportunities, including moves to liberalize the bank sales channel for insurance products and the further streamlining of plant quarantine procedures. The United States and Japan are also committed to continuing cooperation to achieve the full implementation of Asia Pacific-wide transparency standards.

Progress: Details of the progress Japan has made to improve transparency and other government practices include:

- Implementing legislation to strengthen Japan's public comment process, including compelling Ministries and Agencies to fully consider all submitted comments and to make public the text and/or summary of all comments;
- Opening the bank sales channel to sales of more insurance products, with plans to fully lift restrictions by the end of 2007, and ensuring that related consumer protection rules will not favor one product or services supplier over another;
- Enacting legal changes that help level the playing field in the insurance sector by bringing unregulated insurance cooperatives (*kyosai*), in principle, under the supervision of financial services regulators;
- Expanding the number of Special Zones for Structural Reform from 548 last year to 630 this year and applying a total of 64 zone measures nationwide as of March 31, 2006, thus creating greater opportunities for both domestic and foreign companies to operate in an environment more conducive to business;
- Launching a new program in March 2006 to take necessary measures to produce English translations of approximately 200 laws and regulations;
- Taking steps to adopt a more internationally accepted plant quarantine system, including revising quarantine status and inspection practices for four pests;
- Pledging to undertake a transparent review of recent reforms of the Insurance Policyholder Protection Corporation (PPC) in advance of the renewal of the system; and
- Affirming continued cooperation with the United States to achieve full implementation of the Asia Pacific Economic Cooperation (APEC) Transparency Standards in the domestic legal regimes of APEC member economies.

PRIVATIZATION

Background: Japan continues to make progress with the privatization of public corporations. Prime Minister Koizumi's initiative to reform and privatize Japan Post in particular has important implications for competition in Japan's banking, insurance, and express delivery markets. A truly market-oriented approach to the Japan Post reforms is important to secure maximum benefits for the Japanese economy as well as to create undistorted competition. Japan Post privatization is scheduled to begin October 1, 2007.

Progress in Banking and Insurance: Measures Japan is taking to help secure a level playing field in the banking and insurance sectors through reforms to Japan Post include:

- Ensuring that fair access to the post office network is secured, including by allowing the Post Office Company to enter into contracts with private banks and insurers to carry their products and services;
- Preventing cross-subsidization from pre-October 2007 bank deposit and insurance books of business to the new postal financial businesses, including by ensuring related management contracts are on a commercial basis and are subject to Financial Services Agency (FSA) scrutiny;
- Applying the same objective licensing, disclosure, and supervisory requirements, including FSA oversight, to the new postal financial companies as those applied to private sector companies;
- Ensuring transparency in the establishment and operation of the Regional-Social Contribution Fund, and that the Fund will not provide Japan Post successor entities with undue advantages over the private sector;
- Prohibiting deposits received by the Postal Savings Bank and insurance sold by the Postal Insurance Company from October 1, 2007, from being misrepresented as receiving Government guarantees; and
- Employing the principle of ensuring equality of competitive conditions as a criterion to guide the privatization process, including with respect to decisions on expansions in business.

Progress in Express Delivery: Measures to help level the playing field in express delivery include:

- Applying the same aviation security rules and regulations to the new Postal Service Company as those applied to the private sector;
- Subjecting the Postal Services Company to the same land, sea, and air freight transportation laws and ordinances as those applied to private companies; and
- Making disclosures of the postal services business that allow for an objective evaluation to ensure cross-subsidization is not occurring among its services.

Progress in Transparency: Japan will take a number of measures to help ensure transparency, including:

- Creating opportunities for interested parties to exchange views with relevant government officials;
- Recognizing the importance of transparency of the Postal Services Privatization Committee, and implementing ex-ante and ex-post transparency measures related to the Committee's operation; and
- Enhancing transparency by publishing the framework for the Postal Services Holding Company's implementation plan in the summer of 2006.

LEGAL SYSTEMS REFORM

Background: A legal environment that is conducive to providing efficient international legal services to domestic and foreign companies and individuals will contribute significantly to the health of Japan's economy. One of the key factors in ensuring that companies and consumers in Japan have access to cost-effective, timely, and integrated legal services is the assurance of freedom of association between foreign lawyers and Japanese lawyers (*bengoshi*). The 2003 amendments to the Foreign Lawyers Law were a welcome and important step in that direction, but they will have a beneficial impact on the Japanese economy only if they are implemented by both the Ministry of Justice (MOJ) and the Japan Federation of Bar Associations (*Nichibenren*) with the liberalizing spirit that imbued the 2003 legislation. In addition, other impediments to the provision of efficient international legal services remain to be addressed. For example, restrictions on the ability of foreign law firms to establish multiple branch offices in Japan impede the ability to meet the legal service needs of Japanese consumers. Current rules impede the ability of foreign lawyers to represent clients in international alternative dispute resolution (ADR) proceedings that take place in Japan, and discourage foreign lawyers with a long-term interest in providing international legal services in Japan from becoming registered foreign lawyers (*gaiben*).

Progress: Significant new measures Japan has taken or will take to build a legal environment better suited to the global marketplace include:

- Consulting with *Nichibenren* and with *gaiben* on implementation of the Foreign Lawyers Law to ensure that the rules and regulations of *Nichibenren* and the local bar associations are consistent with the Law's intent;
- Reporting to the United States by April 2007 MOJ's findings and any conclusions of its study of whether to permit *gaiben* to form legal professional corporations and of whether to permit foreign law firms to establish multiple branch offices in Japan without forming professional corporations;
- Confirming that *gaiben* are permitted to represent parties in international ADR proceedings taking place in Japan, at least to the extent such representation is not inconsistent with the prohibitions in the Foreign Lawyers Law; and
- Committing to study further whether greater legal certainty can be provided with respect to the ability of *gaiben* to act as neutrals in all forms of ADR taking place in Japan.

COMMERCIAL LAW

Background: A modern commercial law regime that facilitates domestic and cross-border merger and acquisition transactions will promote a robust Japanese economy. The introduction of modern merger techniques in Japanese commercial law, for instance, will do much to bolster the economy by encouraging corporate restructuring and investment. The introduction of strong corporate governance mechanisms will lead to more efficient corporate operations and structures, higher returns to shareholders and, ultimately, a healthier economy. One of the most important preconditions for a good corporate governance system are mechanisms that encourage and facilitate the active exercise of shareholder rights, including active participation by both institutional and small shareholders in proxy voting and accessible legal mechanisms to provide oversight of management and shareholder decisions. The United States welcomes the measures already taken by Japan to modernize its Commercial Law and to encourage active proxy voting by institutional investors. More efforts, however, are required if Japan's commercial law system is to encourage increased investment in Japan, more efficient operations by corporate managers, and higher returns to shareholders.

Progress: Significant new measures Japan has taken or will take to improve corporate performance and governance include:

- Planning to implement on May 1, 2007, the new Corporate Code provisions permitting the use of triangular mergers using foreign shares and other modern merger techniques, and to put in place rules on the tax treatment of such transactions before that date;
- Amending the Securities and Exchange Law to enable persons making tender offers to withdraw or modify their offers in response to certain anti-takeover measures, and to require the board of directors of target companies to publicly disclose their position regarding the tender offer, including the basis for their position;
- Promulgating Corporate Code implementing regulations that require companies to disclose to shareholders annually any anti-takeover measures adopted and an explanation of why such measures do not undermine shareholder interests and are not motivated by the self-interests of senior officers;
- Ensuring that Article 821 of the Corporate Code (dealing with quasi-foreign companies) will not adversely affect the operation of foreign companies that are registered in Japan and are conducting their operations in a lawful manner, and promising to positively consider amending the Corporate Code if necessary to prevent such adverse effects;
- Taking measures to promote active proxy voting by institutional investors, including by encouraging the Investment Trust Association of Japan to amend its rules to require mutual fund managers to disclose the results of their proxy voting records; and
- Recognizing the importance of enhancing corporate governance of listed companies in Japan, including adoption of Tokyo Stock Exchange (TSE) rules requiring listed companies to publish their corporate governance structures, including whether they have outside directors or have adopted anti-takeover measures, and providing for a company's delisting where anti-takeover measures seriously harm the rights of shareholders.

DISTRIBUTION

Background: Ensuring that obstacles between producer and consumer are minimized is key for any efficient distribution channel. Such obstacles can be regulatory in nature, or can come in the form of high fees and other bottlenecks due to lack of competition at ports, airports, and at other points in the channel. The United States is encouraged that progress is being made to turn Japan's busiest commercial airport – Narita – into an attractive travel hub in the Asian region as well as a key destination for air cargo and express services. The privatization of Narita has been instrumental in creating a stronger competitive basis for helping to moderate landing fees and improve other services, and cost-conscious businesses are depending upon further progress to be made at Narita and at other Japanese airports to stay competitive. Regulatory issues ranging from customs procedures to inspection and registration procedures for vehicles also have a bearing on the bottom line, and the United States continues to urge Japan to undertake ambitious regulatory reform in these and other areas in order to lower distribution costs that can negatively affect overall consumer welfare and business vitality. Other measures, such as steps to facilitate expanded use of credit, debit and ATM cards, also benefit consumer choice at the retail level.

Progress: Significant measures Japan has taken or will take in these sectors include:

- Implementing reduced landing fees at Narita International Airport in 2005, which were accepted by the International Air Transport Association;
- Recognizing that the planned expansion of Runway B at Narita Airport will be undertaken in an efficient, cost-conscious manner;
- Opening of the new Terminal 1 Wing at Narita airport, which could lead to a further moderation in airport user fees, to be set in accordance with ICAO transparency and other principles;
- Starting a new "One-Stop Service" for Motor Vehicle Registration that provides online application services for registering new vehicles in certain locations, which will be expanded to all locations on an online basis by 2008;
- Amending the Road Transportation Vehicle Law to ease the ability of parties to check owner information in vehicle distribution by 2008, as well as interim steps easing registration procedures for transfers of large vehicle fleets;
- Taking steps to limit credit and debit card fraud in Japan to create a healthy credit card market in Japan, including stronger measures and cooperation between police authorities and customs and immigration authorities to prevent importation of false cards by criminal groups;
- Passing legislation allowing for use of credit cards for procurement of local government services, and other steps that are expanding government usage of credit cards; and
- Ensuring transparency in the introduction of new rules that will limit the scope of potential land use for large-scale stores, and confirming that these rules will not be implemented in a manner that would limit such stores in a manner similar to Japan's previous market demand and supply adjustment system.