Sales Representatives Manual

Volume 1

2019

Japan Securities Dealers Association
Foreword

Financial instruments business operators and registered financial institutions play very important roles as the pipe connecting investors and the market and as intermediaries in the financial markets, and they are entrusted with an important social mission. Accordingly, Sales Representatives engaged in the financial instruments business are required to have a great deal of expertise in financial instruments, as well as a high awareness and consciousness of compliance and strong professional ethics.

Thus, to meet the goals above, the Japan Securities Dealers Association (JSDA) administers the Sales Representative Qualification Examinations in accordance with its self-regulatory rules from the perspective of achieving a suitable level of quality on the part of Sales Representatives, in order to ensure that Sales Representatives who belong to Association Members (financial instruments business operators and registered financial institutions) will respond to the trust placed in them by society and carry out their activities appropriately.

In January 2012, the JSDA revised the qualification requirements for the Sales Representative Qualification Examinations and the content of the examinations to allow persons who do not have the qualification for Class-2 Sales Representative to take the examination for Class-1 Sales Representative.

The present Manuals provide explanations concerning laws and regulations that people engaged in the financial instruments business need to understand, as well as the various products and operations with which they deal in their business. These Manuals are expected to serve as reference materials for such people to acquire the knowledge necessary for acting as Sales Representatives.

The 2019 edition has been edited based on the laws, regulations, rules and systems, etc. in effect or publicly available as of September 1, 2018 in principle, which may be subject to revision in the future.

It should be noted that with the enactment of the Financial Instruments and Exchange Act in 2007, the legal names of entities such as securities companies and exchanges governed by this legislation have respectively been changed to financial instruments business operators, etc. and financial instruments exchanges. However, for the purpose of convenience and ease of understanding, in this text, some explanations have been made using preexisting expressions such as “securities company” or “stock exchange”.

These Sales Representatives Manuals are tentative translations for non-Japanese readers’ reference. Please be aware that the Japanese originals are the authoritative versions. While every effort has been taken to ensure the accuracy of the translations in these Manuals, the translation is mainly based on the available information at the time of publication of Japanese versions and as such may not reflect subsequent developments. No guarantee is made with regard to its accuracy, completeness, applicability or usefulness. Under no circumstances will the JSDA be liable for any direct, indirect, incidental, special, or consequential loss or damage caused by reliance on the content of these Manuals.

February 2019

Japan Securities Dealers Association
# Volume 1

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Chapter 1
Basic Knowledge Concerning Securities Markets

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(1) Functions of Financial Markets

Each economic entity collects, supplies and invests funds when engaging in economic activity. This causes the trade of funds between those who supply (lenders) and those who demand (borrowers), and funds are transferred. The place where such transactions occur is the financial market.

Between economic entities, the total amount of funds in supply equals the total amount of funds in demand, but between different sectors of the economy, the amount of funds in supply and demand do not necessarily correspond to each other. The shortage and surplus of funds corresponds to the difference between total savings and investments in each sector of the real economy. If there is a shortage of funds in a sector, the total amount of investments is greater than that of savings, while in the case of a surplus of funds in a sector the total amount of investments is less than that of savings.

Postwar Japan experienced a long trend in which a surplus of funds (excess savings) was present in the household sector, while a shortage of funds (excess investment) was seen in the corporate and government/public sectors. Since fiscal year 1998, however, the corporate sector has been showing a tendency of excessive savings (see Chart 1-1).

(2) Classification of Financial Markets

Financial markets can be classified into several types depending on the participants, contract terms, traded assets, and methods of transactions (see Chart 1-2).

Focusing on the participants of transactions, financial markets are largely divided into market-type transaction markets where an unspecified number of participants engage in transactions, and negotiation-based transaction markets where transaction takes place between specified participants such as depositors and banks or companies and banks. The market-type transaction markets are referred to as financial markets in a narrow sense.

Financial markets in a narrow sense are categorized according to the contract term of transaction, into short-term financial markets (one year or less) and long-term financial markets (more than one year). Short-term financial markets are further classified into interbank markets where only banks and other specified participants are eligible for transactions, and open markets where general companies may also take part in transactions. On the other hand, long-term financial markets are largely classified into bond markets, equity markets and financial derivatives markets.

Negotiation-based transaction markets include loan markets, deposit markets and foreign exchange markets.
Chapter 1. Basic Knowledge Concerning Securities Markets

Chart 1-1  Surplus/Shortage of Funds by Sector

(Source) Bank of Japan, “Basic Figures of the Flow of Funds (Preliminary Figures, 1st Quarter 2018)"

Chart 1-2  Classification of Financial Markets in Japan

Financial markets (in a broad sense)

Market-type trading markets (financial markets in a narrow sense)

Short-term financial markets

Interbank markets

Call markets
Bill markets, etc.
Bond gensaki markets
CD markets
CP markets
Treasury discount bill (TDB) markets
Cash-secured bond lending transaction markets (repo markets)
Short-term interest rate derivatives transaction markets (OIS markets)
JGB markets
Municipal bond markets
Government-related agency bond markets
Straight bond markets
Convertible bond (CB) markets
Bond with share options (WB) markets
Financial bond markets
Futures markets
Options markets

Long-term financial markets (securities markets, capital markets)

Bond markets

Equity markets

Financial derivatives markets

Negotiated trading markets

Loan markets, deposit markets, foreign exchange markets, etc.

Options markets

Open markets

Loan markets, deposit markets, foreign exchange markets, etc.

CD markets

Cash-secured bond lending transaction markets (repo markets)

Short-term interest rate derivatives transaction markets (OIS markets)

Bond gensaki markets

Call markets

Bill markets, etc.
Two Channels of Financing

The channels through which funds flow from suppliers (lenders) to demanders (borrowers) can be classified into (i) financial institutions or (ii) the securities markets. In channel (i), banks and other financial institutions supply funds in the form of loans to those who need funds. In channel (ii), funds are supplied through the issuance of stocks and bonds (see Chart 1-3).

Channels of funds are also classified into indirect or direct financing, depending on whether financial intermediaries are interposed between the final lenders and final borrowers of funds. Individuals (final lenders) supply funds to companies, etc. (final borrowers) by buying securities issued by the latter via securities markets. This is called direct financing. On the other hand, in the case of indirect financing, individuals (final lenders) supply funds to banks by depositing their money, and banks then extend loans to companies, etc. (final borrowers), using such deposits. With indirect financing, it is the financial intermediary that bears the risk of recovering the funds, while for direct financing, it is the final lender (investor) of the funds that bears this risk.

Thus, direct financing and indirect financing generally correspond to the flow of funds via securities markets and the flow of funds via financial institutions. However, if banks, using funds deposited by individuals (final lenders), buy securities issued by companies, etc. (final borrowers) on the securities markets, this flow of funds is categorized as indirect financing. In this scheme, financial institutions invest cash accepted from suppliers of funds in securities (bonds, commercial paper or securitized products, etc.) traded on open markets, rather than lending the funds directly to companies. This is also called “market-type indirect financing.”

The role of the financial and securities markets is not only to reallocate funds (intermediation), but also includes various functions such as providing liquidity, the conversion of short- and long-term funds, reallocation of assets and income as well as distribution of risk. In these markets, institutions (financial institutions, securities companies) play the role of collecting
funds from suppliers (households, etc.) and distributing these funds to those who are in need of them (corporations, etc.) under various systems and rules in order to ensure that fund transactions are secure, fair, and efficient.

The financial mechanisms, systems and structures that include the structure of the markets and various systems and customs that were designed to realize the smooth and efficient flow of such fund transactions, and further such matters as the ratio of direct and indirect financing, are referred to in their entirety as the financial system.

1.3 Banks and Securities Companies

Entities such as financial instruments exchanges and securities companies exist as the core of a securities market, and a number of laws and regulations have been established, aimed at the sound development of the national economy and investor protection. While financial institutions such as banks collect, manage, and invest funds at their own responsibility and then return the profits to the supplier of funds (depositors) in forms such as interest, securities companies promote and provide various types of information for investment, and the decision to acquire securities and the responsibility for that decision rests solely with the supplier of funds (the investor).

Consequently, the focus for financial institutions, such as banks, is on the credibility and the sound management of each institution, while the focal points of the foundation of a securities market are the disclosure system, which is designed to ensure the freedom and transparency of transactions, and the presence of “market rules” designed to ensure fair market transactions. (For details, see “2-5. Investor Protection and Depositor Protection”).

As described above, the processes and procedures of banks and securities differ, but both types of entities serve as intermediaries between lenders and borrowers and enable the reallocation of funds. The securities market lacks a payment settlement function, which is considered an important function of banks, and the securities markets serve as an important element of the financial system, within the context of the financial markets in the broad sense of the term (see Chart 1-4).
Section 1. Financial System and Securities Markets

Chart 1-4 Japanese Financial Institutions

1 What Are Securities?

Although the terms “securities” and “negotiable securities” are used extremely broadly, in law they can be classified as being either “securities” or “certificates”. In general, the “securities” are securities that express property rights, and the execution or transfer (assignment) of those rights as stated on the certificate thereof is carried out. The “certificates”, however, are securities that are simply proof of certain facts. In other words, while the rights are embodied in the instrument in the case of securities, the certificates themselves can only be used as evidentiary materials to prove the existence of these rights.

Securities can be classified according to the economic contents of the property rights they represent, such as commodity securities, which embody the right to request a certain product or service; monetary securities, which embody the right to demand cash; and capital securities, which embody the rights of the provider of capital, such as the right to demand payment of income (see Chart 1-5).

In the narrow sense of the term, however, the term “securities” indicates capital securities that are the objects of trading in a securities market. The characteristics of these capital certificates are that, generally, they are fungible, they can be divided into specified units, and they are marketable (i.e., negotiable). In particular, shares and bonds are the objects of investment by individuals and a means to procure funds for corporations, and consequently, they play significant roles in the growth of modern economic society.

In general, when someone mentions securities, or negotiable securities, they mean these capital securities.

<table>
<thead>
<tr>
<th>Chart 1-5 Classification of Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Securities</strong></td>
</tr>
<tr>
<td>Commodities securities</td>
</tr>
<tr>
<td>Monetary securities</td>
</tr>
<tr>
<td>Capital securities</td>
</tr>
<tr>
<td>Securities accompanying various rights in relation to investments, such as stock and bond certificates, etc.</td>
</tr>
</tbody>
</table>
Primary and Secondary Markets

(1) Primary Market and Secondary Market

The securities market is classified into the primary market and the secondary market from a functional perspective.

The primary market is a market where new securities that are issued for the purpose of raising capital are first obtained by investors, either directly from the issuer or through a broker (underwriter = securities company, or financial institutions including banks, etc. for public bonds such as JGBs). The term “primary market” refers to the collective process by which newly issued securities are acquired by investors from issuers, and consists of the three parties of (i) issuers of securities, (ii) investors, and (iii) brokers. It is a market in the abstract sense since it does not exist as a specific marketplace such as the financial instruments exchanges that exist in the secondary market.

The secondary market, on the other hand, is a market where the securities that have already been issued and obtained by primary investors are then sold on (traded) to a second or third investor.

The trading methods and other features of the primary and secondary markets are very different. In the former, negotiated transactions are conducted between concerned parties, while in the latter, most of the trading is on the exchange market and is based on sophisticated trading methods.

Sometimes, secondary distribution of already-issued securities has aspects similar to the new issuance of securities: selling pressure exists because a large volume of securities is sold at one time and there exists an information gap between the seller side and investors, etc. Accordingly, under the Financial Instruments and Exchange Act (hereinafter referred to as “FIEA”), secondary distributions of already-issued securities for which the solicitation is similar to that of new issuances are required to make the same statutory disclosure as an offering of newly-issued securities.

(2) Interrelationship of Two Markets

The primary market and the secondary market are inextricably linked.

For example, if there were no active secondary market to liquidate securities held by investors, investors would not be able to invest in securities with any peace of mind. The result would be that new securities could not be issued. Since it is because of their liquidity that securities can be newly issued, the size of the primary market is affected by the level of activity in the secondary market. Moreover, the price of a security on the secondary market is as a benchmark when new securities are issued, since this price is a direct indication of the demand and supply by investors for that security.

As such, a secondary market that conducts price formation fairly and continuously, and also possesses the ability to easily liquidate securities (high liquidity), is indispensable for the primary market to function. Both markets are interconnected.
Exchange Markets and Over-the-Counter Market

The secondary market is a generic name for the place where issued securities are traded (distributed) among securities companies and investors. It is classified into the financial instruments market established by the financial instruments exchanges (financial instruments exchange market and other markets. Trading conducted on the former market is called “trading on exchange,” and on the latter includes the over-the-counter market and the PTS (proprietary trading system) operated by securities companies.

A trading on exchanges is a highly organized trading in terms of systems and technics for trading. Persons who can trade on the financial instruments exchanges are limited to securities companies with certain qualifications (the trading participant system), and shares traded on the exchanges are limited to the stock of corporations that meet certain criteria (the listing system). Various rules are enacted such as the Articles of Incorporation, Business Regulations, Securities Listing Regulations and Brokerage Rules to ensure that a large volume trades will be executed without impediment and that fair prices will be formed, which includes the rule that trades are executed under the principle of competitive bidding within a certain time period. Trading is also under the strict supervision of the Financial Services Agency and the financial instruments exchanges.

While trading on exchanges constitutes the main secondary market for stocks, exchange trades account for only a minor portion of the secondary market for bonds. This is because the number of issues of bonds is extremely numerous, and it is impossible to trade all issues on the exchange.

The securities traded on a financial instruments exchange are limited to those that satisfy a certain listing criteria, and securities that do not satisfy such criteria are traded outside of a financial instruments exchange. Such transactions are conducted as negotiated transactions between securities companies or between customers and securities companies through their offices (counters). Hence these transactions are called “over-the-counter transactions.”

While transactions at an exchange are conducted pursuant to the rules and regulations promulgated by the financial instruments exchange, over-the-counter transactions are conducted pursuant to the rules and regulations established by the Japan Securities Dealers Association (hereinafter referred to as the “JSDA”).

Moreover, since investment risk is extremely high in over-the-counter transactions (transactions in unlisted stocks, etc.), the JSDA rules prohibit Association Members (financial instruments business operators, etc. which are members of the JSDA) from soliciting investment in over-the-counter securities, except in prescribed cases.

The Proprietary Trading System (PTS) is a securities trading system operated by authorized securities companies. As a result of the amendment to the Securities and Exchange Law (hereinafter referred to as “SEL”; currently, “Financial Instruments and Exchange Act”) in 1998, PTS trading was included in the scope of securities business.

With a view to facilitating the supply of risk money to emerging and growth companies, an
equity-based crowdfunding system was introduced in May 2015 as a means of financing through the issuance of unlisted stocks. At the same time, from the viewpoint of supporting financing for locally-based companies, etc., a shareholders community system was established to promote trading of unlisted stocks and financing for unlisted companies. Both systems allow securities companies to engage in solicitation of investment, under limitations on the method and scope of solicitation. In addition, the Phoenix issues system was established, separated from the former Green Sheet issues system abolished at the end of March 2018, as a platform where the JSDA provides investors with the opportunity for cashing out the delisted shares they hold.

2 4 Financial Instruments Business

(1) Functions of Securities Companies

Securities companies play a role as an intermediary for securities transactions on primary and secondary markets. In the process of issuing securities, they serve as go-betweens for the issuer and investors and help the issuer raise funds, while selecting the issuer in consideration of risk, thus contributing to effective allocation of financial resources. On secondary markets, securities companies are expected to protect investors by handling securities trading between investors appropriately and fairly and promoting the distribution of securities.

The major functions of securities companies are as follows.

(i) Commissioned sale and purchase (Brokerage)

Securities companies accept orders from investors to sell or buy securities (e.g., stocks and bonds) and place these orders to secondary markets.

(ii) Proprietary trading (Dealing)

Securities companies sell and buy securities using their own funds in the same manner as general investors.

(iii) Underwriting and secondary distribution (Underwriting)

Underwriting consists of the following activity: when companies and the national or local governments issue new shares or bonds, securities companies buy all or part of the issued shares or bonds for the purpose of reselling them on the market, while promising to acquire those left unsold. Securities companies carry out the same operation targeting existing securities, which is called secondary distribution.

(iv) Dealing of public offering and secondary distribution (Selling or Distribution)

Securities companies solicit investors to buy new securities that will be newly issued or securities that have already been issued. Unlike the underwriting function, securities companies are not required to acquire those left unsold.

(v) Other functions

In addition to the functions above, providing services in relation to merger and acquisition of businesses is recently becoming more important as a function of securities companies.
Originally, securities were invented and developed to be a means of financing that connects lenders with borrowers. There are a plethora of instruments of varying characteristics and types, from those that have features such as a right to participate in management and demand dividends as is the case with stocks, to instruments that have features such as a right to claim a fixed interest over a prescribed period as is the case with bonds, and even those that combine the features of both.

Based on the characteristics of these securities there has been a wide range of possibilities for products and services that securities companies may provide. The advances in information technology have been a notable factor in encouraging securities companies to engage in the financial services industry more actively, and there are increasing developments in securitized products, as well as products and services that resemble the products offered by banks.

(2) From Securities Business to Financial Instruments Business

As a result of the “Financial System Reform Act” of 1998, the securities business was changed from the licensing system to the registration system. Under the registration system, an entity that meets the legal requirements is registered unless it is an entity subject to one of the reasons for rejection. As a result, the businesses conducted by a securities company have become more diverse and have been deregulated, with the abolition of the duty to engage exclusively in a single type of business and with the expansion of the securities business. Moreover, the scope of concurrent businesses that a securities company can operate has also been greatly expanded, with the exception of activities that contravene the public interest or for which risk management presents an onerous burden.

In September 2007, the SEL, the law governing the securities business, was amended, and the Financial Instruments and Exchange Act (FIEA) came into force. The FIEA regulates the traditional securities business together with activities such as financial futures transactions, under the large category of “financial instruments business.” It also changed the designation “securities company” to “financial instruments business operator.” The business activities of a financial instruments business operator have expanded beyond the previous scope of business of a securities company (see Chart 1-6).
## Chart 1-6 Scope of Financial Instruments Business

<table>
<thead>
<tr>
<th>Category</th>
<th>Business Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial instruments business</td>
<td>Type I financial instruments business • Sales and purchase of securities, and intermediary, brokerage or agency services therefor (excluding deemed securities); market transactions of derivatives or foreign market transactions of derivatives, and intermediary, brokerage or agency services therefor • Intermediary, brokerage or agency services for commodity-related market derivatives transactions; brokerage for clearing thereof • Over-the-counter derivatives transactions, intermediary, brokerage or agency services therefor; brokerage for clearing thereof • Wholesale underwriting of securities • Operation of PTS (proprietary trading system) • Securities, etc. management business</td>
</tr>
<tr>
<td>Financial instruments business</td>
<td>Type II financial instruments business • Handling of public offering and private placement of beneficial interests in investment trusts managed under instructions from the settlor and equity interests in collective investment schemes • Sales and purchase of deemed securities, and intermediary, brokerage or agency services therefor; public offering, etc. of deemed securities • Market transactions of derivatives or foreign market derivatives transactions, intermediary, brokerage or agency services therefor (excluding those related to securities), etc.</td>
</tr>
<tr>
<td>Investment advisory and agency business</td>
<td>• Providing advice on investment decisions under investment advisory contracts • Agency or intermediary services for the conclusion of investment advisory contracts or discretionary investment contracts</td>
</tr>
<tr>
<td>Investment management business</td>
<td>• Investment of property under discretionary investment contracts or contracts for entrustment of asset investments • Investment of property invested or contributed from holders of investment trust beneficiary certificates • Investment of property contributed from holders of beneficial interests in trusts or equity interests in collective investment schemes</td>
</tr>
</tbody>
</table>

## 2.5 Investor Protection and Depositor Protection

The principle of investor protection is the basis of public regulation of securities markets and the financial instruments business, but the characteristics and specifics of investor protection in the securities market differ from those of depositor protection at financial institutions such as banks.

For example, depositor protection is fulfilled if an individual deposits JPY1 million in a bank, and at maturity the bank pays the depositor the promised interest along with the original
JPY 1 million. Thus, the basis of depositor protection is to avoid the risk that a bank would not be able to return the deposit due to its insolvency. The focus is on the credibility and soundness of bank management. If circumstances under which the bank would not be able to return the deposit were to arise, deposits, in particular small accounts, will be protected through a bank merger or by the depository insurance system.

If a securities investment is made in fixed instruments such as debt securities, and if they are held to maturity, then the principal and interest can be collected in the same manner as in the case of a bank deposit. If, however, they are sold prior to maturity, an investor would gain profits or suffer losses depending on the market price. Stocks on the other hand present uncertainty because there is no maturity period and dividends depend on revenues of the companies. In some cases, no dividend will be paid. Moreover, the principal is not guaranteed since the market price constantly fluctuates.

Investor protection under the FIEA does not mean a guarantee of the price of the securities in which investment is to be made, or a promise of stock dividends. It requires that the issuing company accurately disclose its financial status, etc. so that the investors can decide whether to invest in the company or not. Furthermore, it also includes the requirements that securities companies and the financial instruments exchanges involved in securities trading conduct their businesses appropriately, and that price formation on securities markets be conducted in a fair and equitable manner.

In short, investor protection, in principle, means enabling investors to obtain accurate and prompt information regarding securities investments, and protecting investors from unfair trading. On this basis investors make investments at their own discretion and responsibility, with any resulting gains or losses being realized by the investor. This is the so-called “principle of self-responsibility.” As such, when soliciting investment it is necessary to understand that investor protection is not a guarantee of the principal invested, unlike depositor protection. There is no advance promise or guarantee of profits or losses.

Self-Regulatory Organizations

Some organizations of firms engaged in the financial instruments business carry out activities beyond the range of so-called trade associations. These organizations have been granted broad-based authority under law, and have established detailed regulations including articles of incorporation and various rules which extend to the form and method of business. These organizations are called “self-regulatory organizations” (SROs).

Major self-regulatory organizations in Japan at present are the financial instruments exchanges, the Japan Securities Dealers Association and the Investment Trust Association, etc. All of these are bestowed by the FIEA with the attributes of a self-regulatory organization. Self-regulation through these organizations is a major pillar of the regulation over the financial instruments business, together with regulation by the supervising authority (the Financial Services Agency).
Major Securities-Related Institutions

The following is a description of major securities-related institutions in Japan.

(1) Securities and Exchange Surveillance Commission

As discussed above, the schemes used in regulating the securities markets and the financial instruments business can be categorized into public regulations and self-regulation.

Formerly, the Securities Bureau of the Ministry of Finance (now the Financial Services Agency) was the entity responsible for public regulation in Japan, and Japan’s securities industry administration was centered on the protection and development of the securities business by restricting competition, and focused on preventative oversight and administration. While the securities markets and securities business flourished under this type of regulatory scheme, this system was identified as one of the causes for several so-called securities scandals—such as the summer of 1991, when a securities company was found to have compensated investor losses—leading to more vigorous market enforcement. As a result, a new regulatory body called the Securities and Exchange Surveillance Commission (SESC) was established as an external bureau attached to the Ministry of Finance under the SEL amendments in May 1992. After the reorganization of the Japanese central government that took place in January 2001, the SESC was established and currently is part of the Financial Services Agency.

The SESC is granted compulsory investigation power on conduct that is detrimental to fairness in the marketplace such as insider trading, loss guarantees and loss compensation provided by securities companies, market manipulation, and false statements in securities filings, and offenders are accused with the crime investigation authorities. The SESC is also granted on-site inspection powers to monitor compliance by securities companies and self-regulatory organizations with transaction rules, and when it uncovers violations of these rules in relation to the disposition given by a self-regulatory organization to its member that violates laws or regulations, the SESC can recommend that the Prime Minister, Commissioner of the Financial Services Agency or the Minister of Finance impose an administrative action.

Furthermore, the SESC is delegated the authority to conduct investigations of the state of compliance with regulations to ensure the fairness of transactions in connection with the activities conducted by financial institutions such as banks (e.g., regulations concerning firewalls between banks and their securities subsidiaries).

The SESC has become increasingly active in its operations, conducting periodic inspections of securities companies and financial institutions, making accusations against offenders to the crime investigation authorities, and issuing recommendations on administrative actions. It has also increased its number of personnel.

(2) Japan Securities Depository Center

The Japan Securities Depository Center (JASDEC) is the only central securities depository in Japan which collectively conducts settlement and management of securities other than JGBs. It
provides the book-entry transfer services for securities such as shares, corporate bonds and beneficial interests in investment trusts in accordance with the Act on Book-Entry Transfer of Company Bonds, Shares, Etc.

Since it began operations in 1991, the JASDEC has played the leading role in carrying out securities settlement system reform, and achieved the digitization of certificates for various types of securities including non-government bonds such as short-term corporate bonds; medium- and long-term corporate bonds and municipal bonds; beneficial interests in investment trusts; and shares. The digitization of securities has made it possible to (i) reduce costs for the issuance, deposit and delivery of certificates, (ii) speed up the settlement process, (iii) perform straight-through-processing (STP) (Note 1) from contract to settlement, (iv) reduce settlement risk through the introduction of the delivery-versus-payment (DVP) (Note 2) method, and (v) reduce the risk of paper certificates being lost or stolen. All of these positive results have worked to facilitate the distribution of securities and enabled companies to reduce costs for issuing securities.

An outline of the book-entry transfer system is as follows:

(i) All procedures including issuance, distribution and redemption as well as various corporate actions (e.g., share splits), are processed by way of entries recorded in the book-entry account registry (Note 3);
(ii) Dividend payments for shares, etc. can be received at a single deposit account with respect to all issues, or via securities companies; and
(iii) Principal and interest of general bonds are paid to investors depending on the balance of their account via the account management institution.

(Notes) 1. Straight-through-processing (STP) means electronic (computerized) processing of the series of clerical procedures on securities markets, from the contract to payment and delivery of securities transactions.
2. Delivery-versus-payment (DVP) is a method of settlement of securities whereby securities are delivered on condition of the concurrent payment of the price. This is designed to avoid the risk that the party in a securities transaction who delivered funds or securities is unable to acquire the corresponding securities or funds from the other party.
3. A book-entry account registry is a statutory registry set up by a book-entry transfer institution or account management institution to manage a customer’s rights relating to shares, general bonds, etc.

(3) Investor Protection Fund

The Investor Protection Fund is a fund that carries out activities that include indemnifying customers for losses incurred on cash and securities under deposit when a securities company fails, and thereby strives to achieve investor protection and maintains their trust in the securities
industry.

With the Financial System Reform Act of 1998, the Deposit Securities Indemnity Fund (incorporated foundation), which had previously been organized as a voluntary incorporated foundation, was reorganized under the former SEL as a corporation. Following this, in 2010, it became a corporation authorized by the Prime Minister pursuant to the provisions of the FIEA.

Claims eligible for indemnity cover customer assets on deposit (including deposits, deposit securities, guarantees, margin money and margin securities, cash and securities received in deposit as part of related businesses, etc.), excluding institutional investors or other professionals, up to a maximum limit of JPY10 million per customer.

(4) Japan Securities Finance

Japan Securities Finance Co., Ltd. is a stock company licensed by the Prime Minister pursuant to the FIEA.

The following are the major functions of Japan Securities Finance Co., Ltd.:

(i) Lending the cash or securities needed in the settlement of margin transactions by utilizing the settlement scheme of the financial instruments exchange market operated by a financial instruments exchange or the settlement scheme of the over-the-counter securities market operated by an authorized financial instruments firms association;
(ii) Borrowing and lending securities, or intermediary or agency service therefor;
(iii) Lending money to financial instruments business operators; and
(iv) Lending money to customers of financial instruments business operators.

(5) Bank of Japan

The Bank of Japan (hereinafter referred to as the “BOJ”) is the central bank of Japan established in 1882. It plays three major roles as: (i) the issuing bank (issuing Bank of Japan notes); (ii) banks’ bank (conducting transactions with financial institutions such as taking deposits and lending money); and (iii) the government’s bank (handling treasury money, issuing JGBs, and handling foreign exchange trade as entrusted by the government). The BOJ also provides a JGB settlement system whereby it handles the transfer of JGBs via book entries.

The BOJ was established as an institution independent from the government, and its independence has been enhanced as a result of the revision to the Bank of Japan Act in 1997. The revised Act provides that the BOJ carries out activities for the purpose of (i) achieving price stability through currency and monetary control, thereby contributing to the sound development of the national economy, and (ii) ensuring the smooth and stable operation of the settlement system, thereby contributing to the stabilization of the financial system.

In order to achieve these purposes, the BOJ implements monetary policy measures including: (i) policy interest rate operation (setting the standard interest rates on loans extended to private financial institutions); (ii) open market operation (controlling the volume of funds through buying...
and selling bonds and bills, thereby affecting market interest rates; and (iii) reserve requirement ratio operation (causing financial institutions to increase or decrease their payment reserves and affecting their lending). Recently, open market operation is taking on more importance. The BOJ’s buying and selling of bonds and bills have an increasing influence on the bond prices and market interest rates.

3 Development of Securities Markets in Japan

3.1 Securities Markets Before World War II

(1) Birth and Development of Securities Markets in Japan

The first issuance of Japanese securities is said to have taken place in London in 1870 in the form of U.K. sterling-denominated government bonds. The government subsequently issued various public bonds such as the retirement allowance bond and the unemployment bond given to the former samurai class as well as the Shinkyu (New and Old) government bonds to assume the debts of local Han, and the need for a fair pricing system for these bonds grew. In 1873, the First National Bank was established as the first stock company in Japan. Subsequently, the government enacted a new “Stock Exchange Decree” in May 1878, and the Tokyo and Osaka stock exchanges were incorporated based on this decree. The decree provided that stock exchanges were to be organized as stock companies and two types of transactions were permitted. One was the “cash transactions” (spot trading) (genba torihiki in Japanese), and another was the “time transactions” that was a type of futures transaction (teiki torihiki in Japanese) incorporating a traditional method for trading in rice that was called “ledger entry rice trading” (chouaimai torihiki). Brokers (securities companies today) could trade on their own account as a dealer or as a broker on contract for others.

In 1893, the Stock Exchange Act was enacted. This became the basic law covering regulations of stock exchanges during the pre-war period. In 1904, 112 companies were listed on the Tokyo Stock Exchange and total capitalization reached approximately JPY390 million.

Meanwhile, after Osaka Railroad Corporation issued the first corporate bonds in Japan in 1890, the issuance of corporate bonds became popular gradually and JGBs were issued more actively.

The stock market achieved substantial growth as a result of the development of the heavy chemical industry during World War I and into the post-war period, while the bond market developed gradually from the Taisho period (beginning in 1912) through the early part of the Showa period (beginning in 1926). Both of these markets began their development in earnest from Showa.

The Japanese securities industry began with floor traders (“nakagainin”) on the stock
exchanges that were established by the 1878 Stock Exchange Decree. Initially, their main activities were in the secondary market for stocks and bonds and they were particularly active in the stock market. Some companies expanded into the work of issuing securities during the latter half of the Meiji era, and from the middle of the Taisho era they came to be called securities companies, during a period when they made rapid growth and development as wholesale underwriters of corporate bonds, together with banks and trust companies.

(2) Securities Markets Under the Wartime Economy

A controlled economy gradually emerged as Japan moved steadily into a wartime footing beginning with the outbreak of war between Japan and China which began in 1937. Both goods and funds were controlled and the securities market was gradually brought under the purview of these regulations.

The financial controls emphasized procuring funds to increase production capacity and allocation of funds to military industries. This in turn promoted the development of the indirect financing system where banks served as the main participants. The primary bond market had already been regulated by the Temporary Funds Adjustment Act of 1938, and the securities market turned sluggish as a result of extensive government control through restrictions on dividends, capital increases and issuances. In 1942, the Wartime Finance Corporation was established, and subsequently, the Japan Securities Exchange Act was enacted in 1943. This established the Japan Stock Exchange as a quasi-governmental entity, bringing the secondary stock market under government control.

3 2 Post-War Development of Securities Markets

(1) Post-War Securities Markets

In post-war Japan, stocks were distributed widely among the general population with the development of the securities democratization movement as a result of economic democratization policies such as the dissolution of the zaibatsu system and the enactment of antitrust regulations. In 1948, the SEL was enacted, and the following year securities exchanges (currently financial instruments exchanges) reopened. Additionally, the Securities Investment Trust Act was enacted in 1951, triggering a renewal of the Japanese securities markets away from the structure that had prevailed before the war period. However, the development of the securities markets was unable to cope with the surge in Japanese economic growth and resulted in a crash in the securities markets around 1965.

With the amendments to the SEL in 1968, the Japanese securities industry once again experienced growth as various improvements took place. The amendments included the adoption of a licensing system for securities companies and improvements made to securities exchange trading methods.

Although a short period of recession followed, the securities markets in general experienced
steady growth thereafter, and the environment of the securities markets changed drastically, including the high level of government bond issuance and progress made in financial liberalization and internationalization.

(2) Progress in Liberalization and Internationalization of Finance

A report compiled by the Japan-U.S. Yen-Dollar Committee was released in May 1984. This prompted Japan to declare the internationalization of its domestic market and the adoption of financial liberalization. This reflected the fact that the Tokyo market had attracted international attention as one of the world’s three major financial centers along with London and New York.

The bond futures market was established on the Tokyo Stock Exchange in October 1985, following which various derivatives markets have been created, including the stock futures market, the stock index futures market, and the stock index options market.

Triggered by the economic bubble in the latter part of the 1980s, the size of the Japanese stock market expanded to the point where at one time it surpassed even that of the New York market on the basis of the total market capitalization of listed companies to become the largest in the world. Thereafter, however, the Tokyo stock market stagnated as the Japanese economy faced an extended recession, financial institutions had been accumulating non-performing loans and their financial positions deteriorated, and the country faced frequent scandals in the financial and securities industries.

With the bursting of the bubble economy, the issue of paying compensation to investors for their losses was publicized as a securities scandal in 1991. In July of the following year, the Securities and Exchange Surveillance Commission was established. In addition, the so-called “sokaiya” (hecklers at a stockholder’s meeting) incident took place in 1997, in which securities companies secretly paid profits to sokaiya. Amid such incidents, the face of the securities industry also underwent significant changes, with ongoing development of new financial products and services and the expansion of international activity. Concurrently, the introduction of IT systems and the automation of the securities business are making rapid progress.

Further, the Financial Structure Reform Act was enacted in June 1992, and in July 1993, three bank-affiliated securities companies were founded. This as a turning point enabled the realization of the affiliation system in which mutual market participation became possible for banks, trust banks, and securities companies through subsidiaries in different businesses.

### Post-War Financial System and Japanese Big Bang

(1) Japanese Big Bang

During the regular session of parliament in the fall of 1996, then Prime Minister Ryutaro Hashimoto unveiled a plan to restore Japan by the year 2001 as a major player—along with London and New York—in the international financial and capital markets. This is the so-called “Japanese Big Bang” plan.
The term “Big Bang” originally refers to the great explosion that is said to have been the genesis of the creation of the universe. This term was used in October 1986, in the United Kingdom, in referring to its securities system reform. The actual details of the Big Bang in the UK were (i) the liberalization of stock trading commissions; (ii) the abolition of a system (single capacity system) which separated brokers and jobbers who are members of a stock exchange; (iii) the liberalization of capital participation to exchange members; (iv) the introduction of a computer platform, SEAQ (Securities Exchange Automatic Quotation System), and (v) establishment of a new Financial Services Act. These changes served to overhaul the entire securities trading system in England.

In response to Prime Minister Hashimoto’s plan, the Financial System Reform Act that includes amendments to 22 financial related laws including the SEL, the Securities Investment Trust Act and the Banking Act was passed the Diet in June 1998 (entering into force on December 1, 1998).

This Japanese Big Bang was designed to thoroughly deregulate the financial sector and achieve vibrant competition, thereby revitalizing the Tokyo financial and capital markets which had suffered a decline as a result of the extended recession, and to achieve a shift to a market oriented competitive system.

(2) Financial System Reforms and Subsequent Developments

The Financial System Reform Act (1998) completely deregulated stock brokerage commissions and eliminated the obligation to concentrate trades in listed stocks on an exchange. It also reintroduced a registration system, marking a break from the former licensing system for supervision and regulation of the securities business, and the scope of business descriptions of securities companies was also enlarged. Concepts of competition were introduced to the markets themselves so that the formerly subordinate OTC markets were given the same status as exchange markets. Moreover, investment trusts now included a corporate-type structure, as well as private placement investment trusts and real estate investment trusts. Thereafter, these instruments could be sold by banks themselves at their teller counters. As this, the reform in the securities market through the Japanese Big Bang substantially exceeded even the financial and securities reforms put in place by the Supreme Commander for the Allied Powers after World War II and the reforms enacted in response to the securities meltdown of 1965.

The Japanese Big Bang includes three principles: (i) Free - a free market based on market principles (liberalization of such things as market entry, products and pricing); (ii) Fair - a transparent and credible market (clarity and transparency of rules, investor protection); and (iii) Global - a global market constantly anticipating the future (legal, accounting, and supervisory systems responsive to globalization). Chart 1-7 maps the financial system reforms since the Japanese Big Bang and the subsequent developments.

Since 2002, the expansion of securities sales channels became a major pillar in the financial system reform. This reflects the regulators’ stance to strengthen the trend of “savings to investments” using bank channels as the sales of investment trusts by banks which began in 1998 had largely increased its share afterwards.
In the UK the Big Bang was a reform of the securities system, which mainly centered on financial instruments exchanges. However, the Japanese financial system faced various problems - such as successive failures and scandals among financial institutions including banks, an accumulation of a large volume of bad debts, delays in creating new financial techniques in response to globalization, and the tendency toward financial hollowing-out, which made it necessary to undertake a more drastic overhaul while concurrently continuing to ensure stability.

For this reason, the Japanese Big Bang plan went beyond reforming the securities system, and in contrast to the reform implemented in the UK, has taken on a strong characteristic of being a financial reform as well.

<table>
<thead>
<tr>
<th>Year</th>
<th>Expanding choices for investors/asset managers</th>
<th>Promoting competition between intermediaries, improving service quality</th>
<th>Making the markets more efficient, fair, and transparent</th>
</tr>
</thead>
</table>
| 1998 | Apr.: Securities transaction taxes/exchange taxes lowered  
Sep.: Direct payroll payments by comprehensive securities account became possible  
Dec.: Introduction of corporate type and privately placed investment trusts, launch of investment trust sales at bank counters, etc.  
Dec.: Ban on OTC securities derivatives lifted  
Dec.: Ban on PTS* lifted | Apr.: Stock brokerage commissions deregulated for transactions of listed stock for over JPY50 million, and full liberalization of OTC stocks  
Dec.: Shift from license system to registration system for securities companies | Dec.: Duty to concentrate all trades on the exchange abolished  
Dec.: Regulation regarding unfair trading practice, etc. introduced |
| 1999 | Apr.: Securities trading taxes/exchange taxes abolished | Mar.: Ban on Financial Holding Companies lifted  
Oct.: Removal of regulation on the scope of business for trust subsidiary of securities companies  
Oct.: Full liberalization of stock trading commissions | |
| 2000 | Nov.: Ban on REITs lifted | | |
| 2001 | Jun.: Introduction of exchange traded funds(ETFs)  
Oct.: Ban on treasury stock lifted  
Nov.: Revision of capital gains taxes | Apr.: Ban on entity conversion of the securities exchanges into stock companies lifted | |
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>Sep.: Deregulation of offices concurrently operating banking services and securities business</td>
</tr>
<tr>
<td>2003</td>
<td>Nov.: Reduction of taxes on individual’s dividends or capital gains, opening of specified accounts</td>
</tr>
</tbody>
</table>
| 2004 | Apr.: Lowering of minimum capital requirements for securities companies, investment trust companies, and investment advisors (to JPY50 million)  
      | Apr.: Introduction of securities intermediary business (restriction on banks lifted in December)  
      | Dec.: Conversion of JASDAQ into exchange |
| 2005 | Oct.: Sale of investment trusts by post offices deregulated |
| 2006 | Jun.: Shift from license system to registration system for asset management business |
| 2007 | Aug.: NEO established by JASDAQ  
      | Sep.: Enhancement of self-regulatory functions of exchanges  
      | Sep.: Overarching regulation on financial instruments that have a strong investment-driver nature introduced (FIEA put into effect) |
| 2008 | Jun.: Diversification of listed exchange traded funds (ETFs)  
      | Jun.: Firewall regulations among securities company, banks and insurance companies reviewed  
      | Jun.: Expansion of scope of business for banks and insurance companies  
<pre><code>  | Jun.: Creation of a professional market |
</code></pre>
<table>
<thead>
<tr>
<th>Year</th>
<th>Expanding choices for investors/asset managers</th>
<th>Promoting competition between intermediaries, improving service quality</th>
<th>Making the markets more efficient, fair, and transparent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>Jan.: Digitalization of stock certificate Jun.: Establishment of TOKYO AIM exchange by Tokyo Stock Exchange (TSE) Jun.: Ban on cross-entry between financial instruments exchange and commodity exchange lifted Jun.: Introduction of public regulation on credit rating companies Aug.: Establishment of a specified non-profit organization specialized in financial ADR services</td>
<td></td>
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<tr>
<td>2010</td>
<td>Apr.: Management integration between Osaka Securities Exchange (OSE) and JASDAQ</td>
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<td></td>
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<tr>
<td>2011</td>
<td>Jun.: Two-year extension of measures to reduce taxes on individual’s dividends or capital gains</td>
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<tr>
<td>2012</td>
<td>Jan.: Japan Exchange Group founded through management integration between the TSE and the OSE</td>
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<tr>
<td>2013</td>
<td></td>
<td></td>
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<tr>
<td>2014</td>
<td>Jan.: Introduction of NISA (tax-exempt investment accounts) program</td>
<td>Feb.: Publication of Japan’s Stewardship Code by FSA</td>
<td></td>
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<tr>
<td>2015</td>
<td></td>
<td></td>
<td>Jun.: TSE’s introduction of Corporate Governance Code, requiring listed companies to submit corporate governance reports.</td>
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<tr>
<td>2016</td>
<td>Apr.: Introduction of Junior NISA (tax-exempt investment accounts for minors) program</td>
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<tr>
<td>2017</td>
<td></td>
<td></td>
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<tr>
<td>2018</td>
<td>Jan.: Introduction of Dollar-Cost Averaging NISA</td>
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</table>

* PTS refers to Proprietary Trading System.
Establishment of the Financial Instruments and Exchange Act

The Japanese Big Bang in finance and subsequent revisions to the financial system and the securities markets have caused major changes in the nature of securities markets in Japan. With the progress of the financial systems reform, unrestricted entry into each of the sectors in the financial services industry has begun to occur, as has the providing of a wide variety of financial products and services.

Nevertheless, the various types of financial instruments were each covered by separate statutes, as illustrated by the SEL covering securities such as stocks and bonds, and the Financial Futures Transactions Act covering financial futures transactions; in consequence, various financial products and investment vehicles that did not fit into the traditional categories and businesses to handle these products and vehicles appeared, which led to calls for a new legal framework that would cover a wide variety of financial instruments in a comprehensive manner.

For this reason, the Financial Instruments and Exchange Act (FIEA) was passed by the Diet in June 2006 and came into force in September 2007 as a complete overhaul of the SEL and other laws. The FIEA sets forth disclosure rules regarding a wide variety of financial instruments as well as regulations concerning businesses that handle these products, thereby seeking to contribute to sound growth in the Japanese economy as well as to the protection of investors, and was enacted to create an environment for the shift from savings to investment as advocated by the government. The main elements of the FIEA are as discussed below.

1) An Overarching Legal Code for Protection of Investors in Financial Instruments with a Strong Investment-Driven Nature

The FIEA is an overarching and comprehensive law covering financial instruments and business operators engaged in financial services, and was enacted in the form of an amendment of the SEL. Under the FIEA, the name of the business entities to be regulated has been changed to “financial instruments business operator,” and the name of an exchange under the law has been changed to a “financial instruments exchange.” Nevertheless, existing names such as “securities company” or “stock exchange” may continue to be used.

The FIEA has broadened the definition of securities, as it deems trust beneficiary certificates overall to be securities, and comprehensively treats equity interests in collective investment schemes as being securities, in addition to, inter alia, JGBs, municipal bonds, corporate bonds, stocks and investment trusts. Moreover, not only transactions in derivatives of securities, but also other types of transactions such as currency and interest swaps as well as transactions in climate derivatives have been placed within the purview of regulation by the FIEA.

In addition, activities such as sale and solicitation of financial products using securities and derivatives transactions, as well as investment advice (investment consulting business), investment management, and management of customer assets are all considered to be areas of the financial instruments business under the registration system, and are subject to overarching regulation. In this manner, the regulation of the investment management business (including the
investment advisory business and the investment trust management business) has been liberalized from a licensing system to a registration system.

The FIEA divides the financial instruments business into the type I financial instruments business (e.g., sales and solicitation of securities that have high market liquidity), the investment management business, the type II financial instruments business (e.g., sales and solicitation of securities that have low market liquidity) and the investment advisory and agency business. The substance of the regulations on entering these respective fields differs depending on their relevant category. Moreover, detailed codes of conduct have been enacted with which business operatives must comply in connection with their respective activities of sales and solicitation, investment advice, investment management and custody of assets.

The FIEA classifies clients into specified investors (professional investors) and general investors (amateur investors). If a customer is a specified investor, conduct regulations such as the duty to deliver a document before conclusion of contract are waived.

Customer protection regulations (sales and solicitation rules) of the same level as under the FIEA now also apply to sales and solicitation activities regarding deposits and insurance that have a strong characteristic of being investments. Financial instruments with a strong characteristic of being investments include foreign currency deposits, derivative deposits, foreign currency denominated insurance and pensions, variable insurance and pensions, designated monetary trusts (of the type that pay dividends based on actual performance), commodity futures transactions, and real estate specified joint enterprise business activities.

(2) Enhancement in Disclosure System

The FIEA has also enhanced the disclosure rules pertaining to financial and corporate information. A listed company is required to file quarterly reports, and is to be audited by a certified public accountant or an auditing corporation. Moreover, following the enactment of the Sarbanes-Oxley Act in America which occurred in July 2002 (known as the Public Company Accounting Reform and Investor Protection Act, or SOX Act), a duty was imposed on listed companies to file internal control reports for each business year, evaluating the effectiveness of their internal control procedures in connection with financial reporting, in order to promote the proper disclosure of financial and corporate information (this portion is referred to as the Japanese SOX Act).

The FIEA has enhanced the system of the public tender offer which was stipulated under the SEL due to the rapid growth in mergers and acquisitions on the part of Japanese companies, and an increase in the number of public tender offers for shares. Moreover, revisions were made to the large volume holding reports as prescribed under the SEL, because large volume stock acquisitions by other companies and investment funds have increased with the growth in corporate mergers and acquisitions.
Establishment of the Corporate Governance Code

Following the “Japan Revitalization Strategy” decided by the Cabinet in June 2013, the Financial Services Agency (FSA) published the “Principles for Responsible Institutional Investors: Japan’s Stewardship Code” in February 2014. This Code emphasizes the “stewardship responsibilities” of institutional investors—to enhance the medium- to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement, or purposeful dialogue—and defines principles to assist institutional investors in fulfilling their stewardship responsibilities. The Code was partially revised in May 2017.

In June 2015, the TSE started the implementation of the principles for corporate governance called the “Japan’s Corporate Governance Code.” This Code was established with the aim of promoting transparent and fair decision-making by Japanese companies and increasing their corporate value over the mid- to long-term. It defines the term “corporate governance” as a “structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the needs and perspectives of shareholders as well as those of customers, employees and local communities.”

The Corporate Governance Code provides that listed companies should engage in constructive dialogue with shareholders even outside the general shareholder meeting in order to contribute to sustainable growth and the increase of corporate value over the mid- to long-term. In this respect, the Corporate Governance Code and Japan’s Stewardship Code act as two wheels on the same axis. Dialogue between management and shareholders (especially institutional investors) based on mutual trust is expected to ensure effective corporate governance and promote mid-to-long-term growth in corporate value.

Under the Corporate Governance Code, listed companies that held an annual shareholders meeting in and after June 2015 were required to submit Corporate Governance Reports to the TSE. In June 2018, the TSE published the revised edition of the Code.

Changes in Circumstances Surrounding Securities Markets

Current Status of Financial Instruments Exchanges

(1) Evolution of Financial Instruments Exchanges

In 1948, the SEL was enacted and securities exchanges (currently financial instruments exchanges) in Japan were reconstituted as membership organizations. Going with this, in May 1949, new financial instruments exchanges were opened in Tokyo, Osaka and Nagoya, in July...
1949, in Kyoto, Kobe, Hiroshima, Niigata and Fukuoka and in April 1950, in Sapporo.

However, as the result of changes in the structure of the economy, the Kobe Stock Exchange was closed in 1967. In March 2000, the Hiroshima Stock Exchange and Niigata Stock Exchange were merged into the Tokyo Stock Exchange (“TSE”), and later, in March 2001, the Kyoto Stock Exchange was merged with the Osaka Stock Exchange (currently “Osaka Exchange”; hereinafter “OSE”).

The Financial System Reform Act of 1998 not only promotes competition among the securities companies that are market intermediaries, but has also introduced the idea of promoting greater competition among securities exchanges. The over-the-counter securities market was repositioned to be on equal footing with the securities exchange market. In addition, the reform abolished the duty of members of an exchange to concentrate trades in listed stocks on that exchange, and completely abolished floor trading, which had been the hallmark of exchanges (in December 1997 by the Osaka Stock Exchange and in April 1999 by the Tokyo Stock Exchange).

Post-World War II, when the financial instruments exchanges reopened, the TSE had around a 60% share, with the OSE comprising 27%. The local securities exchanges had a combined share of more than 10% in the first half of the 1950s. However, in the first half of the 1970s, when companies increasingly moved their headquarters to Tokyo, the share of the TSE began to rise sharply, and the share of other financial instruments exchanges fell accordingly.

As a result, financial instruments exchanges began seeking out different means of survival. Intermarket competition is played out on an international scale encompassing Europe, America and Japan, and the TSE is no exception. While the TSE’s share has risen due to the sheer volume of trades gathered on it domestically, after the burst of the bubble and the decline in stock trading, the number of foreign companies listed on the TSE has decreased from 125 companies at the end of 1991 to six companies at the end of July 2018.

Under the Financial System Reform Act, the traditional securities markets operated by the securities exchanges were renamed “securities exchange markets,” and the over-the-counter market was renamed the “over-the-counter securities market.”

Moreover, until 1998, members of the securities exchange were required to concentrate all trades on the exchange, and trading in listed stocks off the exchange-floor was prohibited. However, this duty was also simultaneously abolished. Accompanying this change, the operation of proprietary trading systems (PTS), under which listed stocks are traded off-market, was included in the definition of the securities business.

In January 2013, the TSE and OSE integrated their business operations, and Japan Exchange Group, Inc. was founded. Following this, the OSE spot markets were integrated into the TSE spot markets in July 2013, and the TSE derivatives markets were integrated into the OSE derivatives markets in March 2014, when the OSE changed its name from the Osaka Securities Exchange to the Osaka Exchange. As a result, the TSE became specialized in spot trading and the OSE in derivatives trading.

(2) Establishment and Changes of Stock Markets for Emerging and Growth Stocks

In June 1999, NASDAQ America announced that it would create a NASDAQ Japan market
as a part of its global strategy. This encouraged financial instruments exchanges to accelerate their initiatives toward the creation of emerging markets for venture companies in order to survive in inter-market competition.

In November 1999, the TSE established the Market of the High-Growth and Emerging Stocks (“Mothers”) for emerging companies. Subsequently, new markets were established by the OSE (“New Market Section”), NSE (“Centrex” which changed its name from “Growth Company Market”), Sapporo (“Ambitious Market”) and Fukuoka (“Q-Board”) as markets for emerging companies.

In June 2000, NASDAQ partnered with the OSE to establish NASDAQ Japan as a division of OSE. However, NASDAQ Japan was only able to attract a number of initial public offerings that was far below its initial estimates and had accumulated losses as of the end of 2001 of JPY5.3 billion. It finally withdrew from the market in 2002. The OSE, which had partnered with NASDAQ Japan, changed the name of NASDAQ Japan to the Nippon New Market “Hercules” in December 2002 and thus integrated it into “New Market Section.”

Significant changes have also been seen in the over-the-counter markets. The main stocks traded in the over-the-counter market in Japan are issues that are registered under the regulations provided by the JSDA, and over-the-counter managed issues consisting of issues whose registration has been cancelled under the JSDA’s regulations (later including delisted issues) (OTC registered market).

The JSDA launched its “over-the-counter stock market automated system” in October 1991 in recognition of the trend of expansion of stocks into the over-the-counter market led by small and medium sized companies and venture companies. This system is called the JASDAQ system (Japan Association of Securities Dealers Automated Quotation System), following the NASDAQ system (National Association of Securities Dealers Automated Quotation System), which was introduced in 1971 in the U.S.

In response to this expansion and the increased significance of the over-the-counter market, the SEL was amended through the Financial System Reform Act of 1998 to shift the position of the over-the-counter registered market from its traditional function of supplementing the exchange markets to one of equal footing with the exchange markets.

In response, the JSDA which was managing and operating the over-the-counter market has taken measures to improve and expand the market by making several proposals for market reform, including enhancement and improvement of the JASDAQ System; building robust, reliable, efficient and economical infrastructure for settlements; and introducing the system of market making since 1998. In addition, in February 2001, the majority of the management of the JASDAQ market was transferred from the JSDA to the “JASDAQ Securities Exchange, Inc.”

In December 2004, the organization of the JASDAQ market was converted into a stock exchange. The reorganization of the JASDAQ market into an exchange structure has changed the method of listing screening from an indirect screening by the JSDA of the screening conducted by securities companies to a listing screening by the exchange. It is anticipated that this will engender more objective and neutral screening, improving the trustworthiness of the market. Moreover, having the JASDAQ market as an exchange enables independent activities targeted towards
finding companies to be listed. In August 2007, JASDAQ established the NEO market as a market to support companies which have new technologies or a new business model which offers potential for growth.

In December of 2007, the JSDA decided to sell the majority of the shares in its controlled entity the JASDAQ Stock Exchange to the OSE, and in December of 2008 the JASDAQ Stock Exchange became a subsidiary of the OSE. In April 2010, the OSE and the JASDAQ Stock Exchange integrated management, and in October, Hercules, JASDAQ, and NEO were integrated into a new JASDAQ market. Furthermore, as a result of the merger of the OSE’s spot markets into those of the TSE, JASDAQ was also placed under the management of the TSE. Following this, the TSE now operates two markets for emerging companies, Mothers and JASDAQ.

(3) Conversion of Exchanges into Stock Companies

One more noteworthy movement related to the financial instruments exchanges is the trend towards conversion of the exchanges themselves into stock companies. Previously, almost all financial instruments exchanges around the world had been organized as non-profit member corporations. However, as the competition between financial instruments exchanges intensified and they actively expanded their functions, financial instruments exchanges have successively reorganized into for-profit stock companies and have even gone public by listing their own shares. In Europe, led by the Stockholm Securities Exchange’s reorganization to a stock company in 1993, the Frankfurt and northern European exchanges followed suit. Amidst the intensification of global inter-market competition, both the New York Stock Exchange (NYSE) and NASDAQ have converted into stock companies.

In response to these movements, the SEL was amended in 2000 to allow a securities exchange in the form of stock company in Japan. With this, the OSE converted into a stock company in April 2001, followed by the TSE’s conversion in November of 2001, and the NSE in April 2002.

What are the merits of conversion of a financial instruments exchange into a stock company? In general, the status of members and the structure of the decision-making process are different for a member organization and a stock company. A member organization employs a simple majority rule, under which members each possess one vote per person (or firm) irrespective of the amount they contribute. In contrast, a stock company adopts a majority rule based on the number of shares held by each member in proportion to their contribution. To paraphrase, theories of capital are at work under the latter, and members with more capital have more power.

Due to these kinds of differences, where the members are equal in substance and no serious conflicts of interest exist between them, a member organization is more efficient. However, where these assumptions break down, time is needed to balance the interests of all members, potentially causing the decision-making process to grind to a halt.

In addition to the speed of the decision-making process, another reason given for conversion into stock company is flexibility with regard to funds procurement. Given the intensifying competition between financial instruments exchanges and trading systems, survival will become difficult unless flexible financing can be secured.
However, in a member organization, it is necessary to obtain the consent of the members each time funds needed for improvements to the trading system, etc. are procured. If obtaining this consent is difficult, then the member organization will have no choice but to rely on outside loans.

In contrast, a stock company can procure funds from external sources through a capital increase. Also, if the shares of the exchange itself are made public and listed on an exchange, the exchange will have to make a more thoroughgoing disclosure thereby increasing transparency. Moreover, by adopting incentive systems such as stock options, the financial instruments exchange can raise employee morale.

The above are the advantages of the conversion of a financial instruments exchange into a stock company. In contrast, one of the demerits or fears surrounding conversion is the issue of a potential conflict of interest existing in an exchange that is organized as a stock company, between the for-profit nature of a stock company, and the self-regulatory functions for the purpose of achieving fairness and transparency on the exchange.

For this reason, the FIEA which came into force in September 2007 sought to achieve the proper operation of self-regulatory activities of a financial instruments exchange by allowing (i) the self-regulatory functions to be entrusted to a self-regulatory organization separate from the exchange, or (ii) creating a self-regulatory committee that would decide issues concerning self-regulatory activities within the same corporation, in addition to the traditional mechanism of having a self-regulatory division within the exchange.

With these developments, the TSE was reorganized in August 2007 into Tokyo Stock Exchange Group Inc., as a stock company, with its subsidiary, Tokyo Stock Exchange Inc., handling the activities of operating securities exchanges, and its other subsidiary, Tokyo Stock Exchange Regulation Inc. (incorporated in November 2007), handling self-regulatory activities on entrustment from Tokyo Stock Exchange Inc. Following the integration between the TSE and the OSE, Tokyo Stock Exchange Regulation Inc. was renamed Japan Exchange Regulation in April 2014.

(4) Intensification of International Competition

In recent years, there have been many mergers and international alliances of exchanges as a part of inter-market competition. In Europe, in July 1998, just before the European monetary union, the London Stock Exchange and Deutsche Börse (the superior organization of the Frankfurt Stock Exchange, etc.) entered into an agreement regarding a merger between the exchanges, which brought the concept of a uniform European financial instruments exchange merging major exchanges of EU member countries. However, while the Paris, Amsterdam and Brussels financial instruments exchanges made independent moves to merge and form Euronext, and the agreement between the London Stock Exchange and Deutsche Börse was called off.

Meanwhile, in June 2000, 10 exchanges worldwide including the New York Stock Exchange (NYSE) and the TSE announced a “Global Equity Market” (GEM) concept, targeting the linking of trading systems through alliance. However, the GEM concept inherited the complex issue of the adjustment of legislature, information disclosure, language, system, etc. which varied between...
the exchanges, and with the trend of emphasizing the alliance between individual exchanges, no
dramatic movements were observed thereafter.

The National Association of Securities Dealers (at the time; NASD) also entered into alliance
with OSE and established NASDAQ Japan, and sought alliance with the Hong Kong Stock
Exchange. In March 2001, it acquired EASDAQ, a pan-European venture stock market in
Brussels, and established NASDAQ Europe. However, since both initial public offerings and
trading volume remained stagnant, it was reorganized as NASDAQ Deutschland in 2003 through
alliance with the Berlin Stock Exchange, Bremen Stock Exchange, Dresdner Bank, etc.

Initiatives towards the reorganization of trading systems worldwide were taken, such as the
merger of NYSE and Euronext, the merger of the Chicago Mercantile Exchange (CME) and the
Chicago Board of Trade (CBOT), and the merger of OMX, which has securities exchanges in
Sweden and Finland, with NASDAQ. All these events took place in April 2007.

In December 2012, the Intercontinental Exchange (ICE), an online exchange of commodity
futures and options based in Atlanta Georgia in the United States, took over NYSE Euronext.
Further, in June 2014, with a view to concentrating its management resources in derivatives
trading, the ICE spun off Euronext (mainly for spot stock trading), and made an initial public
offering (IPO) of its stock.

In Japan, the TSE entered into a business alliance for the operation of the trading system with
the NYSE in January 2007, and opened the TOKYO AIM Exchange, a market for professionals
targeting the developing markets of Japan and Asia, in alliance with the London Stock Exchange
in June 2009. Subsequently, as a result of the termination of the alliance between the TSE and the
London Stock Exchange, TOKYO AIM Exchange became the TSE’s wholly owned subsidiary in
March 2012 and changed its name to TOKYO PRO Market in July of the same year.

These trends of international alliance between financial instruments exchanges aim to
respond to the vitalization of competition between markets worldwide or the rise of ECN
(electronic communications network), and to build a link between the markets to enhance
competitiveness through merger of multiple markets, establishment of new markets, mutual
listing, standardization of trading systems, formation of order routing systems and information
network. International intermarket competition that has been conducted mainly in the US and
Europe is recently affecting exchanges in Asia and Japan.

4 2 Changes in Competitive Environment Surrounding Securities
Companies

(1) Downsizing of Securities Industry

After the burst of the bubble and the subsequent prolonged slump in the securities markets,
the commission revenue which had been the main source of revenue for securities companies have
dropped, and the number of business outlets of securities companies and the number of people
employed in the securities industry have decreased. Two factors are largely responsible for these
developments. First, around the time of the complete deregulation of commissions in October
1999, a number of online dealers entered the market in rapid succession, causing a rapid and steep decline in the level of commissions. The second is that large city banks that had for some time wanted to enter the securities retail business acquired second tier securities companies, and proceeded to combine/close business outlets and reduce their workforces.

As shown in Chart 1-8, the number of securities companies operating in Japan (Association Members) has been declining since it peaked at 322 at the end of 2008, and fell to 268 at the end of June 2018. Such downward trend has been especially prominent regarding the number of foreign securities companies, which decreased from 50 in 2001 to 10 at the end of June 2018.

In addition, while the number of securities companies business outlets was over 3,000 in 1991 at the peak, this number stood at 2,145 at the end of June 2018. Also, the number of people employed in the securities industry (the number of officers and employees of securities companies) declined from a peak of more than 170,076 (at the end of June 1991) by nearly half to about 94,993 by the end of June 2018.

<table>
<thead>
<tr>
<th>Month/year</th>
<th>Number of head offices (Association Members)</th>
<th>Number of other offices</th>
<th>Total number of business outlets (incl. head offices)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 2008</td>
<td>322 (28)</td>
<td>2,014 (4)</td>
<td>2,336 (32)</td>
</tr>
<tr>
<td>Dec. 2009</td>
<td>307 (25)</td>
<td>1,947 (2)</td>
<td>2,254 (27)</td>
</tr>
<tr>
<td>Dec. 2010</td>
<td>299 (23)</td>
<td>1,921 (1)</td>
<td>2,220 (24)</td>
</tr>
<tr>
<td>Dec. 2011</td>
<td>290 (22)</td>
<td>1,907 (1)</td>
<td>2,197 (23)</td>
</tr>
<tr>
<td>Dec. 2012</td>
<td>271 (17)</td>
<td>1,867 (0)</td>
<td>2,138 (17)</td>
</tr>
<tr>
<td>Dec. 2013</td>
<td>258 (16)</td>
<td>1,848 (1)</td>
<td>2,106 (17)</td>
</tr>
<tr>
<td>Dec. 2014</td>
<td>253 (16)</td>
<td>1,854 (2)</td>
<td>2,107 (18)</td>
</tr>
<tr>
<td>Dec. 2015</td>
<td>252 (13)</td>
<td>1,878 (2)</td>
<td>2,130 (15)</td>
</tr>
<tr>
<td>Dec. 2016</td>
<td>260 (11)</td>
<td>1,882 (2)</td>
<td>2,142 (13)</td>
</tr>
<tr>
<td>Dec. 2017</td>
<td>265 (10)</td>
<td>1,919 (2)</td>
<td>2,184 (12)</td>
</tr>
<tr>
<td>Jun. 2018</td>
<td>268 (10)</td>
<td>1,877 (2)</td>
<td>2,145 (12)</td>
</tr>
</tbody>
</table>

(Note) The numbers in parentheses represent numbers pertaining to foreign corporations (the number of their principal offices in Japan is included in the number of head offices) and are included in the respective numbers above.

(Source) Japan Securities Dealers Association

(2) Deregulation of Stock Brokerage Commissions

As part of the financial system reform, stock brokerage commissions were deregulated. One of the factors that prompted the deregulation of commissions was the vociferous complaints lodged against securities companies when the scandals concerning loss compensation were uncovered together with the high profits earned by securities companies during the bubble era. Fixed commissions were singled out as a primary cause of these scandals, leading to the deregulation of the commissions on stock trades.
In April 1994, the commissions on large transactions of over JPY1 billion were deregulated. Thereafter, commissions were further deregulated for transactions of over JPY50 million in April 1998, and then finally commissions were totally deregulated in October 1999.

Looking at the trend in commission levels post-deregulation, some online securities companies offer commissions of less than 0.1% of those published by traditional dealers, although this depends on the transaction amount. This is a product of the intense price wars that developed as a result of the successive entry into the market of online securities companies targeting individual investors.

(3) New Entry into and Reorganization of the Securities Industry

In Japan, entities engaged in banking operations and those engaged in securities operations had been separated under Article 65 of the SEL. However, the Financial System Reform Act enacted in June 1992 enabled banks, trust companies, and securities companies respectively to launch businesses in the other two industries as well in July 1993 via their subsidiaries formed for the respective industrial sectors. Initially, 19 securities companies were formed as subsidiaries of banks. At the time, stock brokerage was excluded from the scope of operations that banks’ securities subsidiaries may engage in, and firewalls were required to be set up between banking operations and securities operations.

The restrictions on the scope of operations of banks’ securities subsidiaries were abolished in phases. These subsidiaries are now allowed to engage in stock brokerage. The firewall regulations were also eased, which led to the lifting of the ban in September 2002 on banks and securities companies from setting up joint outlets. Against such background, major banks (generally called

![Chart 1-9 Number of Members Handling Online Securities Trading and Percentage of Membership Handling Online Securities Trading Out of Total Membership](image)

(Note) The percentage is rounded off to one decimal place.
(Source) Japan Securities Dealers Association, “Survey Report on Online Securities Trading (as of the end of March 2018)”
mega banks) pursued realignment and strengthening of their securities subsidiaries by adding domestic securities companies to their corporate groups or forming alliance with foreign securities companies.

In December 1998, the Financial System Reform Act changed the securities business from a licensing system to a registration system. This has enabled free entry into the securities industry as long as a minimum capitalization requirement of JPY100 million was satisfied. Moreover, in April 2004 the minimum capitalization was reduced to JPY50 million in order to encourage more new entrants to appear.

In October 1999, brokerage commissions were completely deregulated, and from around that time, online securities companies handling orders for stock trading at low prices by utilizing the Internet emerged, followed by the entry of leading securities companies into the online securities trading business. The number of dealers offering online services was 73 and the number of online accounts was 24.94 million as of the end of March 2018 (see Chart 1-9 and Chart 1-10). In addition, the percentage of online securities trading accounted for 21.1% of the total brokerage stock trading in the second half of fiscal 2017 (the period from October 2017 through March 2018) (see Chart 1-11).

As individual investors are the major customers of online securities trading, the rate of trading commissions declined to below 0.1% of the trading price. In this low-margin, high-volume industry, there were movements toward consolidation, leading some online securities companies to establish a firm position. The expansion of online securities trading also has a significant impact

<table>
<thead>
<tr>
<th>Chart 1-10</th>
<th>Number of Online Securities Trading Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>(10,000 Accounts)</td>
<td></td>
</tr>
<tr>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td>1,800</td>
<td></td>
</tr>
<tr>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>600</td>
<td></td>
</tr>
<tr>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

(Note 1) The number of accounts with balances starts from the end-March 2008 survey.
(Note 2) The percentage is rounded off to one decimal place. The number of accounts is rounded off to the nearest 10,000.
(Source) Japan Securities Dealers Association, “Survey Report on Online Securities Trading (as of the end of March 2018)”
on the management of medium to small-sized securities companies that have relied on stock trading by individual investors, while at the same time, forcing large securities companies to review their business models.

A new system for securities intermediary service (currently “financial instruments intermediary service”) was introduced in April 2004. Financial intermediary service is an act that involves intermediation for the sale of securities upon entrustment from securities companies. Companies other than those in the financial sector as well as individuals may engage in this service. Since December 2004, banks may also carry out securities intermediary operations (currently “financial instruments intermediation”). As of the end of June 2018, there were 864 registered financial instruments intermediary service providers (excluding banks).

![Chart 1-11: Trading Value of Online Securities Trading (Stock Trades) and Percentage of Online Securities Trading to Total Trading Value of Stock Brokerage Trading of All Members](image)

(Note) The trading value is rounded off to the 100 billion yen. The percentage is rounded off to one decimal place.

(Source) Japan Securities Dealers Association, “Survey Report on Online Securities Trading (as of the end of March 2018)”

(4) Expansion of Investment Trusts

Individuals will continue to increase their financial assets in the future in conjunction with growth in the Japanese economy. In such environment, investment trusts have come to hold a significant position as a means of asset management by individuals.

This has led to the diversification of the types of investment trusts. Under the “Financial System Reform Act,” “corporation-type investment trusts” and “private placement investment trusts” have been introduced. In May 2000, the word “securities” was removed from the “Act on Investment Trusts and Investment Corporations” for the diversification of investment targets. Real estate investment trusts (REIT) were formed in accordance with this revision, with the total net
assets at the end of June 2018 of JPY10.9863 trillion. The TSE established a market for listed real estate investment trusts in March 2005 (listed in November 2005), and the OSE established a market for listed corporation-type investment trusts focusing on venture companies in December of the same year (listing in the same month). In July 2005, exchange traded funds (ETF) were listed in TSE and OSE.

The distribution channels of investment trusts have also become diversified. Beginning in December 1997, investment trust sales by the so-called “sub-leasing” method were approved, and investment trust management companies began selling investment trusts in a corner of branches of major banks. From December 1998, the sale of investment trusts by banks themselves became allowed, and thereafter, the sale of investment trusts started at post offices since October 2005. The share of investment trust sales by banks, etc. has risen steadily, accounting to 47.8% of the total balance of publicly offered and private placement investment trusts, and 51.9% of stock investment trusts at the end of July 2018, developing into a major channel for sales of investment trusts.

The total net assets of publicly offered investment trusts amounted to JPY 51.3536 trillion at the end of 1999. Since the beginning of the 2000s, stock investment trust balances continued to increase despite the influence of the fluctuations in stock prices, reaching JPY103.0008 trillion as of the end of July 2018.

(5) Revenue Structure of Securities Companies

Chart 1-12 shows the revenue structure of securities companies. Operating revenue of securities companies, which corresponds to sales of non-securities companies, consists of commission received, net trading income, and financial revenue. Commission received includes commission for brokerage service, commission for underwriting and secondary distribution (underwriting new issues of securities), commission for handling of public offering and secondary distribution (selling beneficiary certificates of investment trusts), and other fees received (e.g., trust fees for investment trusts, income from M&A services).

Deregulation of stock trading brokerage commissions changed the revenue structure of securities companies significantly. Before deregulation, brokerage commissions had accounted for about 40% of the total operating revenue, but recently, the proportion of this revenue source has been below 20%. The percentages of commissions for trading services or for sale of investment trusts have been increasing in recent years.

However, the revenue structure greatly differs among securities companies depending on the size or nature of the companies. While large securities companies earn revenue from commissions for the sale of investment trusts in addition to brokerage commissions and trading income, the percentage of brokerage commissions in the total revenue of small and medium-sized securities companies is larger than that of larger companies.
### Chart 1-12  Operating Revenue of Securities Companies

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Commission received</td>
<td>2,830</td>
<td>1,797</td>
<td>2,128</td>
<td>1,898</td>
<td>1,634</td>
<td>1,793</td>
<td>2,461</td>
<td>2,293</td>
<td>2,295</td>
<td>2,134</td>
</tr>
<tr>
<td>(For brokerage)</td>
<td>898</td>
<td>599</td>
<td>552</td>
<td>493</td>
<td>390</td>
<td>473</td>
<td>870</td>
<td>687</td>
<td>690</td>
<td>558</td>
</tr>
<tr>
<td>(For underwriting and secondary distribution)</td>
<td>120</td>
<td>91</td>
<td>234</td>
<td>145</td>
<td>75</td>
<td>115</td>
<td>170</td>
<td>162</td>
<td>176</td>
<td>166</td>
</tr>
<tr>
<td>(For handling of public offering and secondary distribution)</td>
<td>375</td>
<td>221</td>
<td>436</td>
<td>444</td>
<td>415</td>
<td>469</td>
<td>513</td>
<td>465</td>
<td>345</td>
<td>298</td>
</tr>
<tr>
<td>(Other fees)</td>
<td>1,435</td>
<td>884</td>
<td>905</td>
<td>815</td>
<td>752</td>
<td>734</td>
<td>905</td>
<td>978</td>
<td>1,082</td>
<td>1,110</td>
</tr>
<tr>
<td>Net trading income</td>
<td>579</td>
<td>435</td>
<td>804</td>
<td>540</td>
<td>636</td>
<td>896</td>
<td>1,097</td>
<td>1,237</td>
<td>1,088</td>
<td>1,113</td>
</tr>
<tr>
<td>Financial revenue</td>
<td>1,150</td>
<td>860</td>
<td>417</td>
<td>428</td>
<td>406</td>
<td>439</td>
<td>480</td>
<td>578</td>
<td>605</td>
<td>651</td>
</tr>
<tr>
<td>Other</td>
<td>23</td>
<td>62</td>
<td>31</td>
<td>53</td>
<td>33</td>
<td>41</td>
<td>49</td>
<td>46</td>
<td>49</td>
<td>57</td>
</tr>
<tr>
<td>Operating revenue</td>
<td>4,582</td>
<td>3,156</td>
<td>3,381</td>
<td>2,920</td>
<td>2,710</td>
<td>3,171</td>
<td>4,088</td>
<td>4,156</td>
<td>4,038</td>
<td>3,956</td>
</tr>
</tbody>
</table>

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</tr>
</thead>
<tbody>
<tr>
<td>Commission received</td>
<td>61.8</td>
<td>56.9</td>
<td>62.9</td>
<td>65.0</td>
<td>60.3</td>
<td>56.5</td>
<td>60.2</td>
<td>55.2</td>
<td>56.8</td>
<td>53.9</td>
</tr>
<tr>
<td>(For brokerage)</td>
<td>19.6</td>
<td>19.0</td>
<td>16.3</td>
<td>16.9</td>
<td>14.4</td>
<td>14.9</td>
<td>21.3</td>
<td>16.5</td>
<td>17.1</td>
<td>14.1</td>
</tr>
<tr>
<td>(For underwriting and secondary distribution)</td>
<td>2.6</td>
<td>2.9</td>
<td>6.9</td>
<td>5.0</td>
<td>2.8</td>
<td>3.6</td>
<td>4.2</td>
<td>3.9</td>
<td>4.4</td>
<td>4.2</td>
</tr>
<tr>
<td>(For handling of public offering and secondary distribution)</td>
<td>8.2</td>
<td>7.0</td>
<td>12.9</td>
<td>15.2</td>
<td>15.3</td>
<td>14.8</td>
<td>12.5</td>
<td>11.2</td>
<td>8.5</td>
<td>7.5</td>
</tr>
<tr>
<td>(Other fees)</td>
<td>31.3</td>
<td>28.0</td>
<td>26.8</td>
<td>27.9</td>
<td>27.7</td>
<td>23.1</td>
<td>22.1</td>
<td>23.5</td>
<td>26.8</td>
<td>28.1</td>
</tr>
<tr>
<td>Net trading income</td>
<td>12.6</td>
<td>13.8</td>
<td>23.8</td>
<td>18.5</td>
<td>23.5</td>
<td>28.3</td>
<td>26.8</td>
<td>29.8</td>
<td>26.9</td>
<td>28.1</td>
</tr>
<tr>
<td>Financial revenue</td>
<td>25.1</td>
<td>27.2</td>
<td>12.3</td>
<td>14.7</td>
<td>15.0</td>
<td>13.8</td>
<td>11.7</td>
<td>13.9</td>
<td>15.0</td>
<td>16.5</td>
</tr>
<tr>
<td>Other</td>
<td>0.5</td>
<td>2.0</td>
<td>0.9</td>
<td>1.8</td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>1.1</td>
<td>1.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Operating revenue</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

(Notes) 1. Excluding securities companies whose business was suspended at the end of March of each term.
2. The data for FY2014 and thereafter include companies whose accounts are closed during a month other than March and those that changed their accounting terms following the revision of the rules for accounting years.
3. The amounts were rounded down to one billion yen, and the percentages were rounded off to two decimal places.

(Source) Japan Securities Dealers Association, “Financial Overview of Regular Members”
Globalization of Capital Markets and Japanese Securities Market

During the 20th century, Japan achieved what has been termed miraculous economic growth and has become one of the largest economies in the world. Along with this, the Japanese securities market has also achieved development.

Contact and communication between the markets of the various trading zones in the EU, the U.S., and the Asia-Pacific economic zone will continue to progress in the years to come. This will lead to vibrant global trading by the many different institutional investors that have developed, but will also intensify the competition between markets given that securities companies will offer 24 hour trading and the various markets will become more homogeneous and integrated.

Developments in alliance and integration between financial instruments exchanges, international harmonization of systems and customs, increasing diversification of securities, and more sophisticated and more complicated trading methods will in all likelihood continue to progress.

The economic development within Asia’s newly industrialized economies (NIEs) and within the Association of Southeast Asian Nations (ASEAN) has been remarkable since the 1980s. This region has experienced remarkable growth in the financial and securities markets, attracting the attention of the world. The Asian securities markets, however, as yet have only a brief history, and there are many areas in which they lack maturity. For these reasons, the governments are all putting their greatest efforts into creating a firm infrastructure, including creation of a more effective legal structure surrounding securities and improving the quality of securities companies, thereby taking initiative to foster and build their own securities markets.

In China, financial instruments exchanges opened in Shanghai and Shenzhen, and they are thriving, backed by the high rates of economic growth. As China is a huge economic region, developments in this country have a major impact on the global economy.

It is anticipated that a huge Asian securities market will develop within the Asia-Oceania region, including Japan, in the near future. In such a climate, Japan’s securities markets and securities companies are now being asked how they will contribute to the development of the financial and capital markets of Asia.

The Japanese government adopted the Japan Revitalization Strategy revised in June 2014, in which it sets a specific goal of securing Tokyo’s status as an international financial center. Following this, the Tokyo Metropolitan Government and securities-related organizations have launched initiatives to make Tokyo the number-one international financial center in Asia.
5 Challenges of Japanese Securities Industry

The Japanese securities markets and securities industry face the following challenges for the future.

The first challenge is the response to the globalization of securities transactions. Along with this trend, the adjustment of trading and settlement systems between the markets of major countries, the standardization of regulations regarding securities and the international harmonization of financial and securities related legislations, tax systems and accounting standards have become important issues. It is desired that the Japanese government and securities associations should make accurate responses to overseas regulatory movements and participate in the formation of an international framework in collaboration with foreign governments and related organizations. This is also necessary for the process of securing Tokyo’s status as an international financial center.

The second challenge is enhancement of the functionality of securities markets. On stock markets, enhancement of the equity financing function and diversification of financing methods are desirable. In particular, enhancing the function to supply risk money to growing companies is a task that is indispensable to the growth strategy of the Japanese economy. Other related issues include diversification of the types of companies issuing corporate bonds and improvement of the availability of price information and other infrastructure on bond markets, as well as the creation of a comprehensive exchange through the combination of spot and derivatives markets.

The third challenge is the improvement of the legislative framework for securities markets. In order to ensure that active transactions will be conducted on securities markets in a transparent, fair, reliable and efficient manner, it is necessary to clearly indicate various rules and ensure sufficient customer protection, while developing conditions to make easily available investment information such as corporate information and price information. It is also desirable that securities companies have a high level of compliance consciousness as well as a sufficient system in place to monitor and detect improper transactions.

The fourth challenge is the development of environment that facilitates the participation of individual investors in securities transactions. In addition to promoting the tax exemption programs for small amount investments, the so-called Nippon Individual Savings Account (NISA; put into operation in January 2014), Junior NISA (put into operation in April 2016), and Dollar-Cost Averaging NISA (put into operation in January 2018), it is necessary to discuss the method of taxation of securities transactions from a medium-to long-term perspective.

The fifth challenge is the improvement of the financial literacy of all levels of people. Making efforts to enhance education on finance and the economy, starting with junior high and high school students, through cooperation among the government, securities associations and those engaged in education, thereby deepening the public understanding of securities, will be imperative to the fostering of investors and the development of securities markets on a long-term basis.

By addressing the foregoing challenges, the Japanese securities markets will be able to develop to an international center of finance and capital capable of responding to global inter-market competition with full transparency, fairness, reliability and efficiency.
**Column: Securities Investment Day (October 4)**

In view of the advancement in the decline of the birth rate and the aging of population in Japan, asset building through individuals’ self-reliant efforts is a critically important issue. In order to ensure that the Dollar-Cost Averaging NISA and other NISA programs, which are designed to support individuals in building their assets over the mid- to long-term, and investment schemes using individual-type defined contribution pension plans (iDeCo), will take root, it is necessary to encourage individuals to become knowledgeable and understand the correct information concerning financial instruments and transactions and improve their abilities to make decisions on their own.

In 1996, with the aim of making more people interested in securities investment, the JSDA designated October 4 as the “Securities Investment Day.” In Japanese, the term meaning investment, “投資,” is pronounced as “tou-shi,” which consists of the same sounds as the numbers “10” (tou) and “4” (shi).

The mascot character for Securities Investment Day, “Toushi-kun,” is a cute bull that represents the initiative to get more people involved in investment and the wish for everlasting bull markets in Japan. It is the hope of JSDA that Toushi-kun will be fostered by people over time and with care (“long-term investment”). Each year, the JSDA holds events during the period around the Securities Investment Day to more effectively publicize the significance and attractiveness of securities investment.

**Column: Securities Industry and SDGs**

The SDGs, or Sustainable Development Goals, are a set of international goals designated by the United Nations, consisting of 17 goals and 169 targets, with the objective of realizing a world where “no one will be left behind.” The whole world, including Japan and other developed countries, is carrying out efforts to end poverty, fight against inequality, and take action on climate change.

In line with this movement, the securities industry is also promoting the SDGs. Given that one major challenge against the achievement of the SDGs is the serious shortage of funds in developing countries, the supply of private sector funds is critically necessary and the securities industry is expected to fulfil its role by making adjustments for the excess or deficiency in funds, actions which constitute its core area of business. At the same time, securities companies are also expected to incorporate the SDGs into their business management, thereby increasing their corporate value and achieving sustainable growth. So far, the securities industry has engaged in creating social infrastructure by way of securities markets.

For more information concerning the securities industry’s efforts in relation to the SDGs, please access the JSDA website.
Chapter 2

Financial Instruments and Exchange Act

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Introduction

The Financial Instruments and Exchange Act (hereinafter the “FIEA”) is the law coordinating the requirements to establish a capital market, and to enable such market to realize its full potential. Starting with general provisions, the FIEA contains provisions governing matters such as the disclosure system, financial instruments business operators, financial instruments firms associations, investors protection fund, financial instruments exchanges, financial instruments clearing organizations, securities finance companies, regulation on transactions, etc. of securities, and administrative monetary penalty.

The FIEA was enacted in June 2006, amending the name and content of the former Securities and Exchange Law (hereinafter the “SEL”) which was enacted as Act No. 25 of 1948. Although the FIEA is an amended law of the SEL, it is in substance extensive enough to constitute an enactment of new legislation. Taking into account the changes to the domestic and foreign capital markets, etc., the FIEA has been amended every year since its enactment.

In order to enhance the competitiveness of the financial/capital market of Japan, amendments in 2008 were made to establish the so-called professional market, review the regulations on the scope of business of financial institution groups and reform the administrative monetary penalty system, etc.

The amendments in 2009 revised the disclosure system and the like related to secondary distributions of securities, and the transfer procedures for professional investors and general investors, and introduced separate management duties for securities OTC derivatives transactions as well as official regulations for credit rating agencies, established a finance ADR system, and introduced rules concerning cross entrance of financial instruments exchanges and commodity exchanges.

In light of the international discussions in response to the global financial crisis, and in order to respond to issues seen in the Japanese financial and capital markets, amendments in 2010 were made to require the use of clearing organizations regarding OTC derivatives transactions, etc., enhance the group regulations and supervision of financial instruments business operators and take other measures.

In 2011, the FIEA underwent further amendments for the purpose of strengthening the foundation of the capital markets and the financial industry, such as improving the disclosure system for rights offering, relaxing the regulations on the investment management business operators who exclusively deal with professionals, expanding the scope of disclosure documents that may be submitted in the English language, developing regulations for trading of unlisted shares by unregistered business operators, and prescribing additional conditions for refusing registration of investment advisory and agency business operators.

The FIEA was further amended in 2012 for the purpose of reinforcing the effort to strengthen the international competitiveness of the Japanese capital market and ensuring fairness and transparency in financial instruments transactions, by facilitating the establishment of a comprehensive exchange, obligatory use of electronic information systems for over-the-counter derivatives transaction, revision of the administrative monetary penalty system and revision of
insider trading regulation.

The amendments in 2013 were intended to take measures against a financial crisis originating from market disruption and to restore the reliability and strengthen the functions of the financial and capital markets and of the financial instruments business. These amendments include: (i) strengthening the insider trading regulations in response to the recent insider trading incidents related to public offering; (ii) revising asset management regulations based on the experience of the AIJ scandal; (iii) establishing an orderly resolution regime for financial institutions; (iv) enhancing provision of capital by banks, etc.; and (v) providing diversified financing and capital policy methods for investment corporations.

The 2014 amendments include: (i) developing a system for equity-based crowdfunding; (ii) creating a new trading system for unlisted shares; (iii) reviewing the regulations relating to the business year for financial instruments business operators; (iv) reducing the burden on newly public companies; (v) reviewing the regulations on fund distributors; (vi) introducing regulations on financial indicators; and (vii) developing a procedure for confiscation of electronic share certificates, etc.

The 2015 amendments strengthened regulations on specially permitted services for qualified institutional investors, etc., for the purpose of ensuring the sound management of funds for professional investors and facilitating the supply of growth money.

The 2017 amendments introduced various measures to adapt to the development of information and communication technology and others changes in Japanese financial and capital markets. These new measures include responding to High Speed Trading in shares, etc., enhancing flexibility in terms of the division of operations within an exchange group, and ensuring fair information disclosure by listed companies.

The outline of the FIEA is explained below, with emphasis on subjects that are highly relevant and recur frequently in the activities of sales representatives.

The abbreviations for names of laws and regulations as used in this Chapter are as follows:

“FIEA” or “Act” … Financial Instruments and Exchange Act (Act No. 25 of 1948)

“SEL” …………… Securities and Exchange Law (Act No. 25 of 1948)

“ITA” …………… Act on Investment Trusts and Investment Corporations (Act No. 198 of 1951)

“FISA” ………… Financial Instruments Sales Act (Act No. 101 of 2000)

“FIEAEO” …….. Financial Instruments and Exchange Act Enforcement Order (Cabinet Order No. 321 of 1965)

“Definition Ordinance”

……….. Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Ministry of Finance Ordinance No. 14 of 1993)

“Corporate Matters Disclosure Ordinance”

……….. Cabinet Office Ordinance Concerning Disclosure of Corporate Matters, Etc. (Ministry of Finance Ordinance No. 5 of 1973)
“Ordinance on Disclosure of Specified Securities”
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“Securities Information Ordinance”
   · Cabinet Office Ordinance Concerning Provision or Publication of Securities Information, Etc. (Cabinet Office Ordinance No. 78 of 2008)
“Material Information Ordinance”
   · Cabinet Office Ordinance on Disclosure of Material Information under Chapter II-6 of the Financial Instruments and Exchange Act (Cabinet Office Ordinance No. 54 of 2017)
“FIBCOO”
   · Cabinet Office Ordinance Concerning Financial Instruments Business, Etc. (Cabinet Office Ordinance No. 52 of 2007)
“Designated Dispute Resolution Ordinance”
   · Cabinet Office Ordinance Concerning Designated Dispute Resolution Organizations Pursuant to Chapter 5-5 of the Financial Instruments and Exchange Act (Cabinet Office Ordinance No. 77 of 2009)
“OTC Derivatives Ordinance”
   · Cabinet Office Ordinance Concerning Regulations on Over-the-Counter Derivatives Transactions, Etc. (Cabinet Office Ordinance No. 48 of 2012)
“Financial Indicator Ordinance”
   · Cabinet Office Ordinance on Designated Financial Indicator Calculation Agents (Cabinet Office Ordinance No. 39 of 2015)
“Securities Transaction Ordinance”
   · Cabinet Office Ordinance Concerning Regulation of Transactions, Etc. in Securities (Cabinet Office Ordinance No. 59 of 2007)
“Administrative Monetary Penalty Ordinance”
   · Cabinet Office Ordinance Concerning Administrative Monetary Penalties under the Provisions of Chapter VI-2 of the Financial Instruments and Exchange Act (Cabinet Office Ordinance No. 17 of 2005)
“Financial Statements Ordinance”
   · Ordinance Concerning the Terms, Forms and Method of Preparation of Financial Statements, Etc. (Ministry of Finance Ordinance No. 59 of 1963)
“Audit Certificate Ordinance”
   · Cabinet Office Ordinance Concerning the Certification of Audits of Financial Statements, Etc. (Ministry of Finance Ordinance No. 12 of 1957)
“Internal Control Ordinance”
   · Cabinet Office Ordinance Concerning an Organization to Achieve Appropriateness of Documents and Other Information in Connection
History of the Establishment and Amendments to the Securities and Exchange Law

The SEL was drafted to integrate the patchwork pre-war regulations concerning securities trading as well as incorporating wholesale the legal system of the United States in line with the democratization of securities.

Following its enactment, the SEL was amended several times to reflect the actual condition of securities trading in Japan. Notably, the amendments in 1965 (implementation of a license system for the securities business, strengthening of the oversight provisions, and attempting to coordinate the securities sales representative system), and those in 1971 (which mainly covered rationalization of the disclosure system, and creation of registration system for the tender offer) were groundbreaking in reexamining the state of securities trading at that time. In 1988, a comprehensive amendment was adopted as Act No. 75 of 1988 to coordinate the securities futures market, to reform the disclosure system and to coordinate insider trading regulations.

Several more amendments followed—amendments in 1992 after the “bursting” of Japan’s economic bubble and a spate of securities industry scandals, implemented the establishment of the Securities and Exchange Surveillance Commission, strengthened the function of self-regulatory organizations, coordinated the definition of securities, reexamined the concept of a public offering, the treatment of private placements, and mutual entry by securities and banking institutions into each other’s businesses, etc.; amendments in 1994 provided for disclosure, etc. of acquisitions of treasury shares corresponding to the liberalization of restrictions on treasury shares; and amendments in 1996 introduced market value accounting for the trading accounts of securities companies.

Subsequently, the discussion concerning the system-wide reform of the securities market in order to allow it to realize its full potential reached a fever pitch just as Japan’s Financial Big Bang was announced, and legal amendments were carried out in line with this discussion. In 1998, the SEL was completely overhauled with the enactment of the “Act on Coordination, Etc. of Laws Relating to the Reform of the Financial System (the “Financial System Reform Act”)” which orchestrated amendments to the SEL, the Securities Investment
Trust Act and other relevant laws in order to expand the selection of investment products and opportunities for investors and financiers, to create a smooth running environment promoting healthy competition between securities companies, etc. and financial institutions (by once again shifting the securities business licensing system to a registration system, etc.), and to coordinate reforms to the structure of the financial and securities markets to make them more useful and reliable for domestic and foreign users.

Further, amendments were enacted in 1999 with respect to the reform of the Japanese government pursuant to the laws related to central ministries and agencies reform, etc., and again in 2000 concerning the electronic disclosure, and the conversion of the securities exchanges into stock companies. In 2002, amendments were made concerning the clearing brokerage of securities and settlement institutions, etc. In 2003, in connection with the “Program for Promoting Securities Market Reform” announced by the Financial Services Agency a year earlier, the law was amended to allow for the creation of a securities intermediary system with a view to improve and diversify the sales channel for securities, and in 2004, an administrative monetary penalty system was introduced, the provisions for civil liability were reviewed, and the provisions relating to the prospectus were overhauled.

In 2005, amendments were made to the tender offer system for shares, to illegalize the use of off-auction floor trading in order to acquire a large block of shares in a company, in order to address the criticism that had been received as a result of the incident in which the company Livedoor had acquired a major holding in Nippon Broadcasting System by using off-auction trading, which is a vehicle for large volume transactions on the Tokyo Stock Exchange. In addition, in the same year amendments were made to the disclosure of parent company information of a listed company which had become a major issue with the Seibu Railways scandal, and a further amendment was made in connection with English language disclosure of corporate matters by foreign companies, etc.

In 2006, criminal penalty became stricter and a fundamental review was made with regard to the tender offer system and the reporting system of possession of large volume.

The massive reform concerning the financial system began with the Financial System Reform Act in 1998, but with the globalization of the capital market, each country has progressed further reform of the financial system and Japan, too, was required to implement a comprehensive and cross-sectional reform of legal systems. In 2007, the FIEA was enacted in the form of an investment service law as an amendment of the former SEL, with objectives that included introducing an overarching legal and regulatory system with respect to matters such as selling and solicitation of investment products, as well as covering matters such as interests of collective investment schemes within the regulatory framework when they had previously been excluded from regulation, and permitting a certain degree of flexibility in the regulations for business operators (Act No. 65 and 66 of 2006).
Overview

1 Financial Instruments Markets and Securities

The financial instruments market is a market in the abstract sense that encompasses the process from the time securities are issued until they are acquired by investors for example, and the process by which securities circulate among investors. Financial instruments markets consist of the location where entities such as corporations and public organizations raise the funds they require through the issuance of stocks and bonds, etc. (the primary market) and a place where investors can freely convert the securities they acquired into cash (secondary market).

Only when such a secondary market exists may investors confidently participate in the primary market. The trading price and trading conditions formulated for securities in the secondary market are also a major determining factor in the scale and issue terms of new securities issues in the primary market.

In this way, the primary market and the secondary market are intimately connected, and the FIEA promotes the protection of investors by regulating the fairness and efficiency of trading activities conducted on the financial instruments markets, centered on these two markets.

There are various types of securities, and the following are the types of securities listed in the FIEA as the subjects to regulation (FIEA, art. 2, para. 1):

(i) Japanese national government bonds;
(ii) Municipal bonds;
(iii) Bonds issued by a juridical person under a special act;
(iv) Specified corporate bonds prescribed in the Securitization Act;
(v) Corporate bonds (including those issued by a mutual company);
(vi) Investment securities issued by a juridical person under a special act (Bank of Japan investment securities, etc.);
(vii) Preferred equity investment certificates prescribed in the Preferred Equity Investment Act;
(viii) Preferred equity investment certificates and securities indicating preemptive rights for new preferred equity investment prescribed in the Securitization Act;
(ix) Share certificates and share option certificates;
(x) Beneficiary securities of investment trusts or foreign investment trusts prescribed in the Act on Investment Trusts and Investment Corporations (the “ITA”);
(xi) Investment securities of an investment corporation (so-called corporate-type investment trusts), investment equity subscription right certificates,
investment corporation bonds or foreign investment securities;

(xii) Beneficiary securities of loan trusts;

(xiii) Beneficiary securities of specific purpose trust prescribed in the Securitization Act;

(xiv) Beneficiary securities of beneficiary securities issuing trusts prescribed in the Trust Act;

(xv) Promissory notes which have been issued by a juridical person in order to raise funds necessary to operate its business and are specified by Cabinet Office Ordinance (so-called CP);

(xvi) Mortgage securities prescribed in the Mortgage Securities Act;

(xvii) Securities or certificates which have been issued by a foreign state or foreign person and have the nature of securities or certificates listed in (i) through (ix) above, or (xii) through (xvi);

(xviii) Securities or certificates which have been issued by a foreign person, indicate a beneficial interest of a trust in which loan claims held by persons engaging in banking business or persons otherwise conducting money loan in the course of trade are entrusted, or indicate any other similar rights, and are specified by a Cabinet Office Ordinance (so-called Certificates for Amortizing Revolving Debts (CARDs), etc.);

(xix) Securities and certificates which indicate the rights pertaining to transactions specified in the FIEA, Article 2, Paragraph 21, Item 3 conducted in a financial instruments market in accordance with such requirements and by using such method as prescribed by the operator of the financial instruments market, rights pertaining to the transactions conducted in a foreign financial instruments market and are similar to the ones specified in the FIEA, Article 2, Paragraph 21, Item 3 (excluding transactions related to commodities), and rights pertaining to the transactions specified in the FIEA, Article 2, Paragraph 22, Items 3 or 4 conducted in neither a financial instruments market nor foreign financial instruments market (hereinafter the rights shall be collectively referred to as the “options”) (so-called covered warrants);

(xx) Securities or certificates which have been issued by a person to whom securities or certificates listed in any of (i) through (xix) above are deposited and in a state other than the state in which the deposited securities or certificates were issued and which indicate the rights pertaining to the deposited securities or certificates (so-called Depository Receipts (DRs)); and

(xxii) In addition to what is listed in the preceding items, the following are provided for in the FIEA: securities or certificates specified by a Cabinet Order as those for which it is found, when taking into consideration the liquidity thereof and other factors, necessary to secure the public interest or
protection of investors (negotiable certificates of deposit issued by foreign juridical person pursuant to the provisions of the FIEAEO, art. 1 (foreign CDs) or school bonds (Definition Ordinance, art. 4)).

The rights to be indicated in the above securities and which are prescribed by Cabinet Office Ordinance (hereinafter referred to as “rights to be indicated on securities”) shall, even when securities indicating these rights have not been issued, be deemed to be securities indicating these rights (FIEA, art. 2, para. 2, first sentence; registered bonds, book-entry transfer bonds, shares without share certificates, and share options without certificates fall within this rule), and among electronically recorded monetary claims, specified electronically recorded monetary claims prescribed by Cabinet Order as considered necessary to deem as corporate bonds or other securities in consideration of the status of distribution and other circumstances are deemed as securities (FIEA, art. 2, para. 2, second sentence; provided, however, there is no such Cabinet Order at this time).

Furthermore, the rights listed below are deemed as securities even if they are not indicated on securities or certificates (FIEA, art. 2, para. 2, third sentence):

i) Beneficial interests in a trust;

ii) Rights against a foreign person which have the nature of beneficial interests in a trust;

iii) Membership rights of a general partnership company or limited partnership company (limited to those prescribed by Cabinet Order) or membership rights of a limited liability company;

iv) Membership rights of a foreign juridical person that has the nature of the rights set forth in the preceding item;

v) Interests in a collective investment scheme (fund) (including those rights pursuant to a foreign law or regulation that are equivalent to the same);

   Interest in a collective investment scheme shall mean rights based on a partnership agreement under the Civil Code, an anonymous partnership agreement under the Commercial Code, an investment limited partnership agreement, or a limited liability partnership agreement, membership rights in an incorporated association, or other rights for which the holder thereof can receive dividends of profits arising from the business conducted by using money invested or contributed by the equity investors (the “invested business”) or distributions of assets of the invested business. Nevertheless, the following are excluded:

   (i) Rights of an equity investor in cases where all of the equity investors participate in the invested business as specified by Cabinet Order (meaning cases in which the execution of the invested business is carried out with the consent of all equity investors, and in which all equity investors are engaged on full standing basis in the invested business, or
have particular specialized skills and are indispensable to the continuation of the invested business—FIEAEO, art. 1-3-2);

(ii) Rights of an equity investor where it is provided that equity investors will not receive dividend of profits or distribution of the assets of the invested business in an amount exceeding the amount invested or contributed by them;

(iii) Rights pursuant to certain insurance agreements, mutual aid agreements or real estate specified joint enterprise agreements; and

(iv) Other rights as prescribed by Cabinet Order as those for which it is found not to hinder the public interest or protection of equity investors even if these rights are not deemed to be securities (rights in connection with insurance and mutual aid agreements, rights in connection with investment, etc. in juridical persons of various types with the exception of general incorporated associations other than public interest incorporated associations as well as general incorporated foundations other than public interest incorporated foundations, rights pursuant to an agreement to divide crops or forestry yields, rights pursuant to a partnership agreement, etc. in which the invested business is a business solely by certified public accountants, attorneys-at-law, judicial scriveners, land and house investigators, administrative scrivener, certified tax accountants, certified real estate appraisers, public consultant on social and labor insurance or certified patent specialists as parties, employee stockholding associations, expanded employee stockholding associations and business affiliate stockholding associations; FIEAEO, art. 1-3-3; Definition Ordinance, art. 6 and art. 7);

vi) Rights specified by Cabinet Order as those for which it is found, when taking into consideration the fact that they have an economic nature similar to securities provided in the FIEA, Article 2, Paragraph 1 and rights set forth in Paragraph 2 of the said Article and other circumstances, necessary and appropriate to secure the public interest or protection of investors by deeming them as securities (certain school bonds (receivables in connection with loans to an incorporated educational institutions, etc.; provided, however, that syndicated loans for incorporated educational institutions offered by banks, etc. are excluded) are designated; FIEAEO, art. 1-3-4). Such school bonds are subject to the disclosure regulations as “rights in securities investment business, etc.”) (FIEA, art. 3, item 3(c); FIEAEO, art. 2-10, para. 2).

Securities under the FIEA

The FIEA does not seek to regulate all of the securities under private law and applies only to those that are determined to be investment instruments and investment objects that
are of a nature of being suited to formation of a securities market in a broad sense (suitability for market trading), and for which it is recognized that formation of this type of market (trading) will benefit the national economy (FIEA, art. 1). This is justified since it is necessary to identify the meaning of the content of securities from the perspective that the objective of the FIEA is to achieve fair price formation for financial instruments and by fully exerting the functions of the capital markets, thereby enabling sound development of the national economy. One precondition to enable the formation of such market transactions is that these securities under private law have a nature of being transferred freely among investors.

Under the FIEA, if securities have the potential possibility of forming a market in the future, they can be recognized as securities before they actually form a market, and even in the event that a market is closed, or in connection with subsequent windup transactions of securities that have been traded on that market, they may be treated as securities under the FIEA.

The current legal concept of securities defines instruments for which rights are embodied in certificates or receipts as being securities (but excluding securities in the FIEA, Article 2, Paragraph 2); however, the original concept of a “security” under U.S. securities law or an “investment” under U.K. securities law does not require the existence of a physical certificate. In addition, the demands for prompt processing of transactions have led to an increased need for a transfer settlement system covering the circulation of these investments. As a result traditional securities are becoming “paperless.”

Derivatives Transactions and Financial Instruments as well as Financial Indicators

In addition to securities, the scope of application of the FIEA includes certain derivatives transactions that stem from securities (FIEA, art. 2, para. 20).

The underlying assets that constitute the basis for derivatives transactions are financial instruments and these products include currencies, etc. in addition to securities. Moreover, investment consulting contracts or investment advisory contracts as well as asset management agreements are also considered to involve rights in connection with the securities or derivatives transactions that are made on the basis of an investment decision pursuant to an analysis of factors such as the value of the financial instruments.

It is necessary to be aware that the concepts of a financial instruments market, the financial instruments business and a financial instruments exchange do not mean business or market in financial instruments as mentioned above.

Derivatives transactions covered by the scope of the FIEA include the following:

(i) Market transactions of derivatives
Market transactions of derivatives mean those transactions that are carried out on a financial instruments market in accordance with the requirements and by using methods prescribed by the operator of the financial instruments market. This includes futures transactions in financial instruments and financial indexes, options transactions, swaps transactions, commodity-related market transactions of derivatives (market transactions of derivatives for which commodities or commodity-related financial indicators are used as underlying assets or reference indexes), credit derivatives transactions (transactions in which the other party promises to pay cash in the event that a certain event occurs in connection with matters such as the creditworthiness of a corporation) as well as those transactions that are prescribed by Cabinet Order as being similar to the same (FIEA, art. 2, para. 21).

(ii) Over-the-Counter transactions of derivatives

Over-the-Counter transactions of derivatives mean those transactions that are equivalent to market transactions of derivatives which are carried out outside a financial instruments market or on a foreign financial instruments market (FIEA, art. 2, para. 22). Provided that transactions related to commodities, etc. shall be excluded. Nevertheless, transactions in currency options that are included in savings deposits, etc., insurance and mutual aid agreements, debt guarantee agreements and loss indemnity agreements on loans are excluded from Over-the-Counter derivatives transactions (FIEAEo, art. 1-15).

(iii) Foreign market derivatives transactions

Foreign market derivatives transactions mean those transactions that are carried out on a foreign financial instruments market, and which are similar to market transactions of derivatives (FIEA, art. 2, para. 23). Provided that transactions related to commodities, etc. shall be excluded.

Financial instruments mean the following (FIEA, art. 2, para. 24):

(i) Securities;
(ii) Claims on a deposit agreement or other rights, as well as those securities or certificates indicating these claims or rights, and which are prescribed by Cabinet Order;
(iii) Currencies;
(iv) Commodities (among the commodities prescribed in Article 2, Paragraph 1 of the Commodity Derivatives Act, meaning those specified by the Cabinet Order as a commodity for which there is no risk of harm to the appropriate price formation by the market transactions of derivatives conducted in relation to the commodity and the market transactions of derivatives conducted in
relation to the commodity in the financial instruments exchange market are conducive to the national economy, by taking into account the fact that whether or not there are any measures concerning the stabilization of the price of the relevant commodity under the provisions of laws and regulations as well as other conditions of price formation and supply and demand of the relevant commodity);
(v) Assets for which there are many of the same kind, which have substantial price volatility, and which are specified by Cabinet Order as those for which it is found necessary to secure the protection of investors with regard to derivative transactions (or other similar transactions) pertaining thereto (excluding commodities under the Commodity Derivatives Act; however, there is no such Cabinet Order at this time); and
(vi) Standardized instruments (meaning those that a financial instruments exchange has prescribed for the purpose of facilitating market transactions of derivatives, in connection with those financial instruments that are prescribed by Cabinet Office Ordinance, other than currency).

Financial indicators mean the following (FIEA, art. 2, para. 25):

(i) Price or interest rate, etc. of financial instruments;
(ii) Figures pertaining to the results of meteorological observations published by the Meteorological Agency or others;
(iii) Among indicators which it is impossible or extremely difficult for a person to exert his/her influence on the fluctuation in and which may have serious influence on business activities of business operators or statistical figures pertaining to social or economic conditions, indicators or figures specified by a Cabinet Order as those for which it is found necessary to secure the protection of investors with regard to derivative transactions pertaining thereto (excluding commodities indices under the Commodity Derivatives Act which are calculated based on the price of commodity under the Commodity Derivatives Act other than the commodity).

Among the index derivatives transactions referred to indicators determined by Cabinet Order there are, specifically, derivatives transactions of reference indexes of values of measurement results of geological conditions, geological conditions, geomagnetism, geo-electricity or hydrological conditions, such as earthquake derivatives transactions, GDP derivatives transactions, derivatives transactions using as reference indexes statistics in connection with designated statistical surveys and statistical study filings, etc. under the Statistics Act, and derivatives transactions using, as reference indexes, rents, etc. for real property published or provided by the administrative organs or by organizations engaged in the real property-
related business (FIEAEO, art. 1-18); and
(iv) Figures calculated pursuant to these financial indicators.

1 Purpose of the FIEA

Article 1 of the FIEA states “The purpose of this Act is, inter alia, by developing systems for disclosure of corporate affairs and other related matters, providing for necessary matters relating to persons who engage in Financial Instruments Business and securing appropriate operation of Financial Instruments Exchanges, to ensure fairness in, inter alia, issuance of the Securities and transactions of Financial Instruments, etc. and to facilitate the smooth distribution of Securities, as well as to aim at fair price formation of Financial Instruments, etc. through the full utilization of functions of the capital market, thereby contributing to the sound development of the national economy and protection of investors.”

Article 1 of the FIEA uses language to the effect that in addition to ensuring fair and smooth transactions in and distribution of securities through full enhancement of important systems under the FIEA, including disclosure of corporate affairs and other related matters, and regulating the financial instruments business as well as financial instruments exchanges, etc., fair formation of prices can be promoted by fully exploiting the functionalities of capital markets. Ensuring fairness of transactions and facilitating of distribution, however, are functions that are subsumed in the functions of capital markets and the broad-based objective of fair price formation. Consequently, it appears that the position has been made explicit that the objective of the FIEA is “assuring the fair price formation” through “full utilization of functions of the capital markets.”

It also seems that by use of the word “thereby,” “the sound development of the national economy” and “the protection of investors” is to be the result of achieving fair price formation. Thus, the greater of what has formerly been referred to as “protection of investors” has come to have a theoretical position of being a condition or assumption for achieving fair price formation by full utilization of functions of the capital markets.

“Fair price formation” is a concept that presumes a situation in which conditions for forming a market are in place, and means the forming of prices that is achieved through a competitive concentration of investment decisions by investors who identify the true value of the securities that are the target of investment. Information disclosure is a system for the purpose of enabling the identification of the true value of securities at the time of a transaction, while a financial instruments exchange is a forum in which these types of investment decisions are concentrated and prices are formed through competitions, and persons engaged in the financial instruments business are persons who fulfill the responsibility of being those who have the role of forming a market.
Organization of the FIEA

The provisions of the FIEA can be roughly divided into four types below:

(1) **Information Disclosure (Disclosure)**: These provisions deal with the preparation and disclosure of the filing of the securities registration statements and prospectuses at the time of a public offering or secondary distribution of securities, as well as the preparation and disclosure of the annual securities reports and semiannual securities reports, etc. in each business year, and aim to ensure the establishment of terms for the formation of a market through providing information pertaining to the true value of the securities to the broader market in connection with issuance and distribution of securities.

In addition, there are regulations concerning tender offers under which shares are acquired in one block from an unspecified number of many persons as well as the reporting system of possession of large volume to be filed upon an acquisition of large volume of shares, etc. which relate to information disclosure.

(2) **Regulation Concerning the Bearers of the Capital Markets**: Detailed provisions are included with a view towards clarifying the vital roles in the capital markets played by financial instruments business operators and registered financial institutions, etc. who play major roles in various aspects of the capital markets, the financial instruments exchanges that operate markets regarding financial instruments, financial instruments clearing organizations that handle clearing of transactions, authorized financial instruments firms associations which handle the regulation of professionals in the industry, and securities finance companies who take responsibility for facilitating margin transactions and loan transactions.

(3) **Regulation of Transactions**: Many provisions have been stipulated concerning transactions in general in the financial instruments business as well as trading on financial instruments exchanges, in order to prohibit acts that will interfere with the functioning of capital markets, including prohibitions against unfair transactions such as market manipulation and insider trading.

(4) **Financial Regulatory Authorities**: Provisions have been stipulated concerning matters such as supervision of and administrative actions against business activities by the Financial Services Agency within the regulation in connection with those who have responsible roles within the capital markets, but in addition systems exist concerning matters such as investigation of criminal cases by the Securities and Exchange Surveillance Commission as well as the system in which the Financial Services Agency orders the payment of administrative monetary penalties.
Financial Instruments Business Operators

2.1 General

Financial Instruments Business Operators and Financial Instruments Business

Financial instruments business operators are entities who have registered with the Prime Minister and engage in the financial instruments business (FIEA, art. 2, para. 9).

Financial instruments business operators play a variety of roles for the purpose of “forming fair prices in financial instruments, etc. through full utilization of functions of the capital markets,” which constitutes the objective of the FIEA. More specifically, financial instruments business operators handle a large distribution market as members or transaction participants on financial instruments exchanges which constitute organized markets. They also fulfill the roll of linking the investment decisions of a broad-based stratum of investors with the financial instruments markets, through brokering on financial instruments markets the orders of investors who cannot become transaction participants.

Furthermore, it is of utmost necessity that financial instruments business operators determine the investor base that is suited to transactions in accordance with the nature of the financial instruments that are to be transacted, to achieve investment decisions that are consistent with the financial instruments market, and to prevent the interference of improper investment decisions in price formation. In order to promote the understanding of investors concerning the quality and value of securities, financial instruments business operators have a duty to provide certain explanations and advice. In the case of negotiated markets, financial instruments business operators also have a duty to engage in transactions with investors at a fair price.

Based on such roles, a financial instruments business operator can be said to be a highly sophisticated specialist who has the most central role and responsibility of assuring the functionality of the capital markets, and of giving living substance to the various rules in order for capital markets to be formed. For this reason, the FIEA imposes a variety of regulations on financial instruments business operators.

The scope of the financial instruments business has been greatly broadened with the enactment of the FIEA when compared to the former securities business. In addition to the previous securities business, the financial instruments business includes the financial futures trading business, the commodities investment sales business, the trust beneficial interest sales business, the investment advisory business, business in connection with discretionary investment contracts, the investment trust management business, the investment corporation asset management business, and the mortgage securities business, all of which had been covered under their respective business laws.

In addition to these activities, the issuer’s acts of solicitation to acquire securities that the issuer will newly issue (i.e., a self-managed offering), agency or intermediation in an investment
advisory contract or a discretionary investment contract, forming a collective investment scheme or the like and mainly carrying out management as an investment in securities or rights in connection with derivatives transactions (i.e., self-management), acts of accepting deposits of cash or securities from a customer in connection with securities transactions, as well as opening an account for the purpose of carrying out book-entry transfer of bonds, etc. and carrying out book-entry transfer of bonds have also been newly designated as financial instruments business.

In order to make a differentiation in the regulations such as conduct regulations and financial regulations depending on the type of financial instruments business that a financial instruments business operator conducts, the FIEA classifies the financial instruments business into four classes consisting of the type I financial instruments business, type II financial instruments business, investment advisory and agency business, and investment management business (FIEA, art. 28, para. 1 through para. 4), and allows flexibility in entry regulations.

In addition, banks, cooperative structured financial institutions, and other financial institutions as prescribed by Cabinet Order are generally prohibited from engaging in securities-related business or the investment management business (FIEA, art. 33, para. 1). However, this restriction is rapidly being liberalized (for details, see Section 2.12 “Financial Institutions and Financial Instruments Business”).

### Meaning of Financial Instruments Business

#### (1) Content of Financial Instruments Business

The financial instruments business means the following enumerated functions (FIEA, art. 2, para. 8).

(i) **Sales and Purchase of Securities, Market Transactions of Derivatives**

(Excluding Commodity-Related Market Transactions of Derivatives), and **Foreign Market Derivatives Transactions**

This category covers transactions conducted on one’s own account. However, commodity-related market transactions of derivatives conducted on one’s own account are excluded from the scope of financial instruments business because the lawmakers considered it necessary to enable a broad range of parties who are engaged in the production and distribution of commodities and highly capable of procuring and supplying the actual commodities to participate in commodity-related market transactions of derivatives.

(ii) **Intermediary, Brokerage or Agency Service for Sales and Purchase of Securities, Market Transactions of Derivatives and Foreign Market Derivatives Transactions**

“Intermediary” means attempting to establish a transaction between other persons. “Brokerage” means undertaking to buy or sell, etc. securities in the securities companies’ own name, but for the account of the investor. This is also referred to as “broker functions.” “Agency service” means undertaking to perform purchases or sales, etc. of securities in the
name of the principal for the account of the principal (or representing one’s status as the agent of the principal).

(iii) **Intermediary, Brokerage or Agency Service for entrustment of: Sales and Purchase of Securities Conducted in a Financial Instruments Exchange Market or Market Derivatives Transactions; or Sales and Purchase of Securities in a Foreign Financial Instruments Exchange Market or Foreign Market Derivatives Transactions**

Intermediary, brokerage or agency service for entrustment refers to when a financial instruments business operator that does not have a qualification to conduct trades, etc. on a financial instruments exchange market consigns a customer order to another financial instruments business operator that does have this qualification.

(iv) **Over-the-Counter Transactions of Derivatives or Intermediary, Brokerage (Excluding Brokerage for Clearing of Securities, Etc.) or Agency Service Therefor**

Derivative financial products such as securities-related forward transactions, securities-related over-the-counter index, etc. forward transactions, securities-related over-the-counter option transactions, or securities-related over-the-counter index, etc. swap transactions (hereinafter “Securities-related Over-the-Counter Transactions of Derivatives”) are products of a highly speculative nature, and traditionally only standardized derivatives transactions on exchanges have been allowed. Subsequently, in response to the various financial innovations of recent years, the 1998 revisions to the SEL completely lifted this prohibition, as a result of which Securities-related Over-the-Counter Transactions of Derivatives as well as the intermediary, brokerage and agency service thereof became permitted as a securities business. The FIEA has continued in keeping this change.

(v) **Brokerage for Clearing of Securities, Etc.**

This refers to the business of receiving customer orders conditional on having a financial instruments clearing organization or a foreign financial instruments clearing organization bear the debts from the subject transactions, and executing such transactions as the agent of the customer, etc. It has the nature of being a brokerage business between securities companies, which was introduced with the amendments to the SEL that were implemented in 2002 (FIEA, art. 2, para. 27).

(vi) **Underwriting of Securities**

Underwriting means, upon the public offering, secondary distribution or private placement or exclusive offer to sell, etc. to professional investors of securities, undertaking to sell such securities on behalf of the issuer or the offering party, or concluding a contract whereby a financial instruments business operator will acquire a share option certificate pertaining to a share option yet to be exercised and will exercise the share option or have a third party exercise it.

Professional investors mean qualified institutional investors, national government, the Bank of Japan, investor protection funds, etc., specific purpose companies, listed companies,
stock companies with a stated capital amount of JPY500 million or more, financial instruments business operators, persons who have submitted the notification of qualified institutional investors operation, foreign corporations and persons who have transferred from a general investor to a professional investor after taking certain procedures (FIEA, art. 2, para. 31; Definition Ordinance, art. 23; FIEA, art. 34-3 and art. 34-4).

Legally speaking, the underwriting of securities is the execution of an agreement to acquire for resale all or part of such securities (firm commitment underwriting), or to acquire any unsold securities (standby underwriting) (direct underwriting from the issuer or the offering party falls within the definition of “wholesale underwriting” described in the FIEA, art. 21, para. 4 and art. 28, para. 1, item 3(a) and (b)).

Both are characterized by the incurring of a risk that some securities will remain unsold and require the ability to conduct a sophisticated underwriting examination. A financial instruments business operator must be registered with the Prime Minister as a type I financial instruments business operator in order to engage in this wholesale underwriting (FIEA, art. 28, para. 1, item 3(a) and (b) and art. 29).

Under the amendments in 2011, which introduced provisions for rights offerings (a means to raise capital by allotting share options to all shareholders free of charge), acquisition and exercise by financial instruments business operators of share options yet to be exercised are now regarded as a type of underwriting of securities (FIEA, art. 2, para. 6, item 3; FIEAEO, art. 15 and art. 17-3).

(vii) Public Offering and Private Placement of the Following Securities

(a) Beneficiary securities of investment trusts that involve beneficial interests in investment trust managed under instructions from the settlor;
(b) Beneficiary securities of foreign investment trusts;
(c) Mortgage securities;
(d) Securities or certificates which have been issued by a foreign state or a foreign person that have the nature of mortgage securities;
(e) Those rights that are to be indicated on securities set forth in (a) or (b), or those rights that are to be indicated on securities set forth in (c) or (d) above and particularly specified by Cabinet Office Ordinance, those which are deemed to be securities pursuant to the provisions of the FIEA, Article 2, Paragraph 2;
(f) Interests in collective investment schemes; and
(g) Securities as prescribed by Cabinet Order in addition to those set forth in (a) through (f).

The “public offering of securities” and the “private placement of securities” refer to the act causing investors to acquire newly issued securities or the act of solicitation thereof, but here, the “self-managed offering” by the issuer of the securities itself is considered to be the
subject of the business. This reflects the characteristic of collective investment schemes where the origination of the instruments and sales are carried out as a package, and is aimed to respond to problematic cases such as fraudulent transactions prior to the enactment of the FIEA.

(viii) Secondary Distribution of Securities or Exclusive Offer to Sell, Etc. to Professional Investors

A “secondary distribution of securities” is defined as a solicitation of an application to sell or purchase already-issued securities, which in the case of Paragraph (1) Securities (securities, rights to be indicated on securities or specified electronically recorded monetary claims) shall mean those that are made to large number of persons (fifty or more persons; FIEAEO, art. 1-8) and which meet certain requirements (FIEA, art. 2, para. 4, item 1 and item 2), and in the case of Paragraph (2) Securities (deemed securities prescribed by each item under the FIEA, art. 2, para. 2) shall mean those in which a considerably large number of persons (at least 500; FIEAEO, art. 1-8-5) will render the securities in connection with the secondary distribution (FIEA, art. 2, para. 4, item 3). As in the case of public offering, with respect to Paragraph (2) Securities, securities other than those are mainly invested in securities are treated as excluded securities (FIEA, art. 3, item 3).

An “exclusive offer to sell, etc. to professional investors” is defined as the offer to sell, etc. of Paragraph (1) Securities that have already been issued to a large number of persons, which meets the requirements that (i) the solicitation is made only to professional investors, (ii) the solicitation is conducted by a financial instruments business operator upon entrustment from customers or for itself (excluding where the party to which the relevant offer to sell, etc. is made is the Japanese government, the Bank of Japan, or a qualified institutional investor), and (iii) the solicitation falls under cases where the securities are less likely to be transferred from the acquirer to a person other than a professional investor, etc., excluding the solicitation involving the trading on a financial instruments exchange market, etc.

(ix) Dealing in Public Offering or Secondary Distribution of Securities or Dealing in Private Placement or Exclusive Offer to Sell, Etc. to Professional Investors

A “public offering of securities” means a solicitation, from among solicitations of an application to acquire newly issued securities (including those specified by Cabinet Office Ordinance as being similar to such solicitation (acts similar to solicitation for acquisition)), depending on the type of securities: with regard to Paragraph (1) Securities, (i) a solicitation that is made to a large number (at least 50) of persons (excluding those made only to professional investors) (FIEA, art. 2, para. 3, item 1), or (ii) a solicitation that does not fall under any of [i] through [iii] below; i.e., [i] a solicitation made only to qualified institutional investors in which the securities are less likely to be transferred from the acquirer to a person other than a qualified institutional investor (i.e., a QII private placement), [ii] a solicitation made only to professional investors in which the solicitation for acquisition (excluding solicitation to the Japanese government, the Bank of Japan or qualified institutional investors) is conducted by a financial instruments business operator, etc. upon entrustment.
from customers or for itself and the securities are less likely to be transferred to a person other than a professional investor (i.e., a professional investors private placement), or [iii] a solicitation to a small number of general investors in which the securities are less likely to be transferred from the acquirers to a large number of persons (i.e., a limited private placement) (FIEA, art. 2, para. 3, item 1 and item 2); and with regard to Paragraph (2) Securities, a solicitation that falls under cases in which a considerably large number of persons (500 or more; FIEAEO, art. 1-7-2) will come to own the securities in connection with the solicitation (FIEA, art. 2, para. 3, item 3).

“Dealing in public offering or secondary distribution” refers to undertaking solicitation activities on behalf of another party for application to acquire the securities when the said party makes public offering or secondary distribution of such securities. This differs from underwriting in that the dealer does not assume the risk that the securities will remain unsold.

“Private placement” refers to those solicitations for application to acquire newly issued securities that do not fall within a public offering of securities since they are targeted towards qualified institutional investors, professional investors or a small number of investors (FIEA, art. 2, para. 3, second sentence). Also, “dealing in private placement” means the practice of undertaking solicitations for private placements. Financial institutions such as banks and insurance companies are also permitted to conduct the dealing in private placements (FIEA, art. 33, para. 2).

(x) Proprietary Trading System (PTS) Operations

Proprietary Trading System (PTS) operations mean sales and purchase of securities or intermediary, brokerage or agency service therefor which is conducted through an electronic information system, by using any of the following price formation method or other similar method, and in which a large number of persons participate simultaneously as the one party in the transaction or the transaction is conducted between a large number of persons (FIEA, art. 2, para. 8, item 10):

- (a) An auction method (but limited to situations where the volume of securities traded does not exceed the standards set by FIEAEO, art. 1-10);
- (b) For securities that are listed on a financial instruments exchange, methods that use the trading price, on the exchange, of such securities;
- (c) For over-the-counter traded securities, a method that uses the trading price of the securities announced by the authorized financial instruments business operators association that carries out the said registration;
- (d) A method that uses the price established based on negotiations between customers; or
- (e) In addition to the methods described in (a) through (d) above, the method provided for by Cabinet Office Ordinance (Definition Ordinance, art. 17).

Of these, the provision described in A. above was added by amendment to the SEL in
2004. Although the traditional approach was to distinguish between an exchange and a proprietary trading system (PTS) based on the existence of a price formation function, this change meant that the distinction is now made on a basis that also takes into consideration trading volume.

However, issues for professional investors, etc. which are considered inappropriate for investor protection purpose to trade outside the financial instruments exchange market in light of the type, etc. of securities are excluded from the subject of proprietary trading system (PTS) operations (FIEAEO, art. 1-9-3).

Furthermore, if a financial instruments business operator will perform proprietary trading system (PTS) operations, it must obtain authorization from the Prime Minister (FIEA, art. 30, para. 1).

(xii) Conclusion of Investment Advisory Contract and Provision of Advice Under the Investment Advisory Contract

An investment advisory contract is a contract in which one of the parties promises to give advice to the other party by oral, written or other means in connection with investment decisions pursuant to an analysis of values, etc. of securities, or the value, etc. of financial instruments, and the other party promises to pay remuneration for the same. This, however, excludes newspapers, magazines, and others published for the purpose of sale to numerous and unspecified persons, and which may be purchased at any time by numerous and unspecified persons.

(xiii) Conclusion of a Discretionary Investment Contract or a Contract on Entrustment of Assets Investments with a Registered Investment Corporation, and Investment of Money or Other Properties in Securities or Rights Pertaining to Derivatives Transactions (In Cases Relating to Commodities, Limited to Those Listed on a Financial Instruments Exchange) Conducted Base on Analysis of Value, Etc. of Financial Instruments (The former is the business activities of former discretionary investment contracts, while the latter is equivalent to the former investment corporation asset management business.)

(xiv) Agency or Intermediary Service for Conclusion of an Investment Advisory Contract or a Discretionary Investment Contract

(xv) Investment of Money or Other Properties Contributed from a Person Who Holds Rights Such as Investment Trust Beneficiary Certificates, as an Investment in Securities or Rights Pertaining to Derivatives Transactions Conducted Based on Analysis of the Value, Etc. of Financial Instruments (The former investment trust management business.)

(xvi) Investment of Money or Other Properties Invested or Contributed from a Person Who Holds Rights Such as Beneficiary Securities or Interests in a Collective Investment Scheme, as an Investment Mainly in Securities or Rights Pertaining to Derivatives Transactions, Based on Analysis of the Value, Etc. of Financial Instruments (i.e., self-management)

(xvii) Acceptance of Deposits of Money or Securities from the Customers in
Relation to Securities Transactions, Etc. or Derivatives Transactions
(Equivalent to the former safekeeping.)

In the case of conducting the acts set forth in (ii), (iii), and (v) above with respect to commodity-related market transactions of derivatives, including the acceptance of deposit of commodity or securities or certificates issued in relation to the commodity deposited from the customers.

(xvii) Transfer Bonds, Etc. Conducted in Response to Opening of an Account for Transfer of Bonds, Etc. as Set Forth in the “Act on Transfer of Bonds, Shares, Etc.”

(xviii) Acts That Are Defined by Cabinet Order as Being Similar to Acts as Set Forth in (i) Through (xvii)

Nevertheless, certain acts have been excluded from the financial instruments business on the grounds that in view of circumstances such as the nature of business, those acts are found not to compromise investor protection (FIEA, art. 2, para. 8, main paragraph; FIEAEO, art. 1-8-6; Definition Ordinance, art. 15 and art. 16).

(2) Classification of Financial Instruments Business

In principle, if a financial instruments business operator has registered with the Prime Minister, the financial instruments business operator is allowed to engage in any of the activities covered under the financial instruments business. Nevertheless, the extent of necessity to secure the soundness of a financial instruments business operator differs depending on the business that the financial instruments business operator will carry out.

The FIEA, therefore, in principle, requires registration as a regulation on participating in the financial instruments business, while at the same time classifying the financial instruments business into four categories consisting of the type I financial instruments business, type II financial instruments business, investment advisory and agency business, and investment management business. It further specifies differing conditions depending on the nature of the business activities with respect to matters such as attaining financial soundness, the effectiveness of compliance and the quality of management.

(i) Type I Financial Instruments Business

The type I financial instruments business means, among the financial instruments business, conducting any of the following acts in the course of trade (FIEA, art. 28, para. 1). Covered under this category are the securities businesses, including the former safekeeping service, as well as the financial futures transactions business, etc.: 

i. With respect to securities (limited to the securities and certificates set forth in each Item of the FIEA, Article 2, Paragraph 1, and the rights which are deemed as such securities in accordance with FIEA, Article 2, Paragraph 2, main clause but not including the rights set forth in each Item of the said Paragraph), (i) sales and purchase, market transactions of derivatives or foreign market derivatives transactions; (ii) intermediary,
brokerage or agency service for the transactions of (i); (iii) intermediary, brokerage or agency service for entrustment of the transactions of (i); (iv) brokerage for clearing of securities, etc.; (v) secondary distribution; and (vi) dealing in public offering, secondary distribution and private placement;

ii. Intermediary, brokerage and agency service for the commodity-related market transactions of derivatives, or intermediary, brokerage and agency service for the entrustment of the same, and brokerage for clearing of securities, etc. therefor;

iii. Over-the-counter transactions of derivatives, and the intermediary, brokerage and agency service therefor or brokerage of clearing therefor;

iv. Underwriting of securities;

v. Activities of operating a Proprietary Trading System (PTS); and

vi. Securities, etc. management business.

(ii) Type II Financial Instruments Trading Business

The type II financial instruments business means, among the financial instruments business, conducting any of the following acts in the course of trade (FIEA, art. 28, para. 2).

The former commodities investment sales business and the trust beneficial interest sales business, etc. are covered under this category:

i. Public offering or private placement of securities listed in (1) (vii) above (i.e., a self-managed offering);

ii. With respect to securities (limited to the rights set forth in each Item of the FIEA, Article 2, Paragraph 2), (i) sales and purchase, market transactions of derivatives or foreign market derivatives transactions, (ii) intermediary, brokerage or agency service for the transactions of (i), (iii) intermediary, brokerage or agency service for entrustment of the transactions of (i), (iv) brokerage for clearing of securities, etc., (v) secondary distribution, and (vi) dealing in public offering, secondary distribution and private placement;

iii. (i) Market transactions of derivatives and foreign market transactions of derivatives that do not involve securities, (ii) intermediary, brokerage or agency service for the transactions of (i), (iii) intermediary, brokerage or agency service for entrustment of the transactions of (i), as well as (iv) brokerage for clearing of securities, etc. that does not involve securities, over-the-counter transactions of derivatives and deemed securities enumerated under the FIEA, Article 2, Paragraph 2; and

iv. Acts designated by Cabinet Order as those to be included in the financial instruments business.
(iii) Investment Advisory and Agency Business

The investment advisory and agency business shall mean, among the financial instruments business, conducting any of the following acts in the course of trade (FIEA, art. 28, para. 3).

The former investment advisory business, etc. is covered under this category:

i. Entering into an investment advisory contract and carrying activities of advising in connection with values, etc. of securities or investment decisions based on analysis of values, etc. of financial instruments, pursuant to the investment advisory contract (investment advice business); or

ii. Agency or intermediary service for conclusion of an investment advisory contracts or discretionary investment contracts.

(iv) Investment Management Business

The investment management business shall mean, among the financial instruments business, conducting any of the following acts in the course of trade (FIEA, art. 28, para. 4). This also includes the former business in connection with discretionary investment contracts, the investment corporation asset management business and the investment trust management business, and in addition business activities of forming a collective investment scheme or the like and mainly carrying out management as an investment in securities or rights in connection with derivatives transactions.

The definition of the investment management business includes the case where financial institutions such as banks conducts such acts in the course of trade but they are prohibited from conducting such acts (FIEA, art. 33, para. 1, main clause):

i. Entering into a discretionary investment contract and engaging in investment of money or other properties in securities or rights pertaining to derivatives transactions conducted based on analysis of value, etc. of financial instruments (the former business in connection with discretionary investment contracts);

ii. Entering into a contract on entrustment of assets investments with a registered investment corporation and engaging in investment of money or other properties in securities or rights pertaining to derivatives transactions conducted based on analysis of value, etc. of financial instruments (the former investment corporation asset management business);

iii. Investment of money or other properties contributed from a person who holds rights such as investment trust beneficiary certificates, as an investment in securities or rights pertaining to derivatives transactions conducted based on analysis of value, etc. of financial instruments (the
former investment trust settlor business, etc.); and
iv. Investment of money or other properties invested or contributed from a person who holds rights such as beneficiary securities or interests in a collective investment scheme, as an investment mainly in securities or rights pertaining to derivatives transactions conducted based on analysis of value, etc. of financial instruments (i.e., self-management).

○ Electronic Offering Handling Business

The electronic offering handling business shall mean dealing in a public offering or secondary distribution or dealing in a private placement of securities or exclusive offer to sell, etc. to professional investors, by means of an electronic information system or by any other means of information and communications technology specified by Cabinet Office Ordinance in the course of trade (FIEA, art. 29-2, para. 1, item 6, parenthetical statement; FIBCOO, art. 6-2).

The 2014 FIEA amendment introduced a new scheme designed to facilitate the risk money supply for emerging and growing companies, whereby such companies in need of funds are connected to prospective fund providers via the Internet and financial instruments business operators, etc. go between them to help these companies raise a small amount of funds each from a number of fund providers by way of issuing shares and interests in funds. This scheme is generally referred to as equity-based crowdfunding.

The following obligations are imposed on financial instruments business operators, etc. engaged in the electronic offering handling business with regard to certain types of securities to ensure that they provide investors with the information necessary for making investment decisions and perform the minimum required checks on the issuers of securities:

(i) Submit a written application for registration stating the intention to carry out the electronic offering handling business and become registered or to have any change in relation to the business registered (FIEA, art. 29-2, para. 1, item 6, art. 31, para. 4, and art. 33-3, para. 1, item 5);

(ii) Take measures to check the issuers of securities and examine their business plans (FIEA, art. 29-4, para. 1, item 1, (f), art. 33-5, para. 1, item 5, and art. 35-3; FIBCOO, art. 70-2, para. 2); and

(iii) Make the information concerning the issuers of securities available for inspection by investors on the website (FIEA, art. 43-5; FIBCOO, art. 146-2).

With a view to promoting the entry in the electronic offering handling business, regulations on type I financial instruments business or type II financial instruments business, such as those relating to the capital adequacy ratio and concurrency in business, are partly relaxed in the case of financial instruments business operators engaged only in the electronic offering handling business with regard to unlisted securities, etc., which falls within the scope of type I financial instruments business or type II financial instruments business and which satisfies certain requirements (e.g. the issue value of securities is small) (FIEA, art. 29-4-2 and art. 29-4-3; FIEAEIO, art. 15-10-3).
These requirements as specified by Cabinet Order are as follows: (i) the amount calculated as the total issue value is less than JPY100 million; and (ii) the amount calculated as the amount to be paid by the person who is to acquire securities is not more than JPY500,000.

(3) Business Other Than Financial Instruments Business

Financial instruments business operators cannot function in their full capabilities by conducting only their main business that is the financial instruments business. Accordingly, it is understood to be desirable to allow financial instruments business operators to engage in those businesses which would be impossible to separate from their main business, or for which separation would be unreasonable, so long as such businesses will not harm the interest of the general public or be detrimental to investor protection.

Under the old licensing system, the businesses of securities firms used to be limited to the securities business and approved side businesses; however, the 1998 revisions to the SEL vastly expanded the scope of businesses outside of the traditional securities business, and this scope has been further expanded with the enactment of the FIEA.

These businesses other than the financial instruments business are separated into incidental businesses, businesses that require notification and businesses that require approval.

(i) Incidental Businesses

A financial instruments business operator that engages in the type I financial instruments business or an investment management business may engage in the following activities as incidental businesses to the financial instruments business (FIEA, art. 35, para. 1).

It is unnecessary for the financial instruments business operator to file a separate notification or obtain the approval of the Prime Minister with respect to these businesses:

i. Lending and borrowing of securities, or intermediary or agency service thereof;
ii. Money loan incidental to a margin transaction;
iii. Money loan secured by securities that are deposited for safe custody from customers (limited to those prescribed by Cabinet Office Ordinance);
iv. Agency service for a customer concerning securities;
v. Agency service of the business pertaining to the payment of earnings, redemptions, or cancellation fees in connection with investment trusts;
vi. Agency service of the business pertaining to distribution of money, distribution of refunds or residual assets or payment of interest or redemption money with regard to investment securities, investment equity subscription right certificates, or investment corporation bond certificates or foreign investment securities;

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A contract for cumulative investment is an agreement under which a financial instruments business operator which carries out securities, etc. management business receives a deposit of money from a customer, and in consideration of the said money, periodically sells securities to the said customer on a date specified in advance.

viii. Providing information or advice relating to securities (other than the information or advice falling within the definition of investment advisory business);

ix. Agency service of the business of another financial instruments business operator or a registered financial institution (limited to the activities that the agent financial instruments business operator could itself conduct, and excluding those set forth in (v) above);

x. Retention of the assets of a registered investment corporation;

xi. Consultation to any other business operator with regard to a business assignment, merger, company split, share exchange or share transfer, or intermediation for these matters;

xii. Consultation to any other business operator concerning management;

xiii. Sales and purchase of currencies or other assets prescribed by Cabinet Order as being related to derivatives transactions (excluding transactions of securities-related derivatives), or intermediary, brokerage or agency service thereof;

xiv. Sales and purchase of negotiable deposits and other monetary claims (excluding those that fall under the category of securities), or intermediary, brokerage or agency service thereof; and

xv. Investment of investment property as an investment in the following assets;
   (a) Specified assets as set forth in ITA, Article 2, Paragraph 1 (excluding real estate and other assets as prescribed by Cabinet Order); and
   (b) Other assets as prescribed by Cabinet Order in addition to (a) above.

(ii) Businesses That Require Notification

A financial instruments business operator that engages in the type I financial instruments business or an investment management business may file a notification to the Prime Minister and engage in the following activities (FIEA, art. 35, para. 2 and para. 3):

i. Business pertaining to transactions on the commodity markets, etc.;

ii. Business pertaining to transactions conducted by using fluctuations in commodity prices and other indicators, market gaps, etc. as specified by a Cabinet Office Ordinance (excluding the business set forth in i. above);

iii. Business pertaining to money lending business or other money loans, or intermediary service of lending and borrowing of money;
iv. Business pertaining to building lots and buildings transaction business defined in Article 2, Item 2 of the Building Lots and Buildings Transaction Business Act or lease of building lots or buildings prescribed in Item 1 of the said Article;

v. Real estate specified joint enterprise defined in Article 2, Paragraph 4 of the Real Estate Specified Joint Enterprise Act;

vi. Business of conducting investment of money and other properties for others through commodities investment, etc. provided for in the Act Concerning Control for Business Pertaining to Commodity Investment, Article 2, Paragraph 1 (excluding the businesses set forth in i. and ii. above);

vii. Business of conducting investment of investment property (excluding those that fall under the category of the business of conducting the act specified in (i) xv above and those set forth in i, ii, and vi above) as an investment in assets other than securities or rights arising from derivative transactions; and

viii. Such other businesses as are prescribed by Cabinet Office Ordinance.

(iii) Businesses That Require Approval

A financial instruments business operator that engages in the type I financial instruments business or an investment management business may obtain approval from the Prime Minister and engage in business other than those set forth in (i) and (ii) above (FIEA, art. 35, para. 4).

In this event, the Prime Minister cannot deny this approval unless the Prime Minister finds that the proposed business is detrimental to the public interest or harmful to the protection of investors due to the difficulty of managing the risk of loss (FIEA, art. 35, para. 5).

(iv) Special Provisions for Type I Small Amount Electronic Offering Handling Business Operators

Type I small amount electronic offering handling business operators may carry out the types of business set forth in (ii) and (iii) above without making notification or obtaining approval (FIEA, art. 29-4-2, para. 3 and para. 4).

Since type I small amount electronic offering handling business operators are specialized in handling public offering or private placement of unlisted securities, etc. and are permitted to accept money deposited from customers only in the course of the electronic offering handling business, even if they fail in any other business they concurrently carry out and their management base is endangered, this could only have a relatively limited risk of harming the investors’ interests.

(v) Extent of Concurrent Business That May Be Conducted by Persons Who Only Engage in Type II Financial Instruments Business or the Investment Advisory or Agency Business
The FIEA does not stipulate any regulation, such as that set forth above, on the scope of business activities of those financial instruments business operators that only engage in the type II financial instruments business or the investment advisory or agency business (FIEA, art. 35-2).

2 Regulations on Major Shareholders

A major shareholder of a financial instruments business operator that engages in the type I financial instruments business or the investment management business must submit to the Prime Minister, without delay, a notification of holdings in subject voting rights stating particulars such as the percentage of voting rights held and the purposes of holding of stock (FIEA, art. 32, para. 1; para. 3) (in principle, a major shareholder is a person that holds at least 20 percent of the voting rights of all shareholders, etc., although this also includes a person who holds at least 15 percent if certain facts exist as prescribed by Cabinet Office Ordinance as being those from which it may be presumed that the said person will have a significant influence on decisions of finance or business policy of the company).

If a major shareholder of a financial instruments business operator falls under any of the reasons for disqualification, the Prime Minister may order the major shareholder to take action, etc. so that it will no longer be a major shareholder (FIEA, art. 32-2, para. 1).

A major shareholder of a financial instruments business operator must notify the Prime Minister without delay if it ceases to be a major shareholder of the financial instruments business operator (FIEA, art. 32-3, para. 1).

In addition, if a major shareholder of a financial instruments business operator becomes a specified major shareholder (meaning a person holding voting rights in excess of 50% of the voting rights of all shareholders, etc. of the company) of the financial instruments business operator, a notification must be made to the Prime Minister without delay in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 32, para. 3 and para. 4).

This is for the authorities to timely recognize what kind of person the specified major shareholder of a financial instruments business operator is.

If the Prime Minister considers it necessary for public interest or investor protection in light of the status of business or financial standing (if the specified major shareholder is a corporation, including the financial standing of the subsidiary corporation, etc. of the specified major shareholder) of the specified major shareholder of the financial instruments business operator, it may order the specified major shareholder to take measures necessary for the improvement of the operation of business of the financial instruments business operator or the financial standing to the extent necessary (FIEA, art. 32-2, para. 2). If this order is violated, the Prime Minister may order the specified major shareholder measures to make it a non-major shareholder (id., para. 3).
This provision was established in consideration of the possibility that the funding of a financial instruments business operators may become difficult due to the financial deterioration of a shareholder having a big effect on the management of the financial instruments business operators, etc. under the control of such shareholder, or the possibility that the noncompliance or conflict of interest of such shareholder may have an adverse effect on the management of the financial instruments business operator under the control of such shareholder.

In addition, if a specified major shareholder becomes a major shareholder other than a specified major shareholder of the financial instruments business operator, a notification must be made to the Prime Minister to that effect without delay (FIEA, art. 32-3, para. 2).

These regulations address the entry from other industries into the financial instruments business, and place ultimate priority on achieving the objectives of the FIEA by eliminating unsuitable persons from shareholders who have the ability to exercise an influence over management of a financial instruments business operator.

Similar regulations also exist over banks and insurance companies.

### Registration and Authorization of Financial Instruments Business Operators

#### (1) Registration System for Financial Instruments Business

##### (i) Significance

The financial instruments business cannot be conducted by any person other than a person who has registered with the Prime Minister (FIEA, art. 29).

A “registration system” was implemented to control entrance into the securities business under the SEL as enacted in 1948; however, a downturn in the markets shortly thereafter led to questionable practices in the securities industry, and in light of several scandals that erupted, this registration system was replaced with a “license system” in accordance with the 1965 SEL revisions.

Subsequently, however, in response to calls for the promotion of free competition accompanied by the requisite deregulation in the face of changes in economic circumstances due to the globalization of finance and other factors, the 1998 SEL revisions reverted once again from a “license system” to a “registration system.” Nevertheless, this registration system differed from its previous analog, and clarifies the registration application procedures and the criteria for refusing registration, as well as implementing measures to insure that the abuses inherent in a registration system do not occur such as by making the securities companies register available for public inspection.
The enactment of the FIEA has also changed into a registration system the securities-related over-the-counter transactions of derivatives, etc., wholesale underwriting, investment trust management business, investment corporation asset management business, and business in connection with discretionary investment contracts, which were heretofore subject to an authorization system, as well as the investment products sales business which was subject to a permit system. These changes have unified the regulations on entry in connection with the financial instruments business into a registration system (FIEA, art. 29), with the exception of conduct of a proprietary trading system (PTS) (FIEA, art. 30, para. 1).

### The Former “License System”

Under the former “license system,” there was a general ban on engaging in the securities business, which the Minister of Finance could lift for those persons found to satisfy certain criteria, thereby allowing them to lawfully conduct a securities business. Procedurally, a separate license was granted for the four types of functions constituting the securities business ((1) the trading of securities (dealing); (2) brokering of trades, etc. of securities (brokerage); (3) the underwriting of securities (underwriting); and (4) the dealing in public offerings and secondary distributions or private placements of securities (selling)). A single securities company would have more than one license depending on the scope of its functions (the term “general securities companies” was used to refer to securities companies that had obtained all of the available licenses).

The following minimum capitalization or deposit for operation is required as a condition for registration or authorization depending on the type of business (FIEAEO, art. 15-7, para. 1; art. 15-11, para. 1; and art. 15-12):

- **Type I financial instruments business**: JPY50 million (in the event of carrying out wholesale underwriting and when carried out as the lead manager, this is JPY3 billion, and in other cases is JPY500 million (or JPY300 million in the case of conducting specified over-the-counter transactions of derivatives, etc. using the electronic information system provided for the business related to over-the-counter transactions of derivatives, etc.))

- **Investment management business**: JPY50 million (however, in the case of conducting investment management business for qualified investors, JPY10 million)

- **Type II financial instruments business**: JPY10 million

  Type II financial instruments business in the case of an individual: JPY10
If the Prime Minister authorizes the activities of operating a proprietary trading system (PTS) the Prime Minister shall enter a note stating the same in the registration of the financial instruments business operator (FIEA, art. 30, para. 2). The Prime Minister may also state conditions for authorization (FIEA, art. 30-2, para. 1); however, these conditions must be the necessary minimum for the protection of investors or the public interest (id., para. 2).

Specific provisions have been enacted regarding the application procedures for a registration or an authorization, as well as the criteria, etc. for authorization (FIEA, art. 29-2; art. 29-3; art. 29-4; art. 30-3; and art. 30-4).

Penalties apply to companies who engage in operations without registering or authorization (FIEA, art. 197-2, item 10-4 and item 10-5; and art. 201).

(ii) Procedures for Applying for Registration

In order to register a financial instruments business, an applicant must submit an application to the Prime Minister stating the matters prescribed in the FIEA (FIEA, art. 29-2, para. 1).

In this event, a foreign corporation that intends to engage in the type I financial instruments business must determine a representative in Japan (limited to a person who is responsible for the activities of all business offices or offices that the said foreign corporation will establish in Japan for the purpose of carrying out the type I financial instruments business, and submit a registration application.

If an application for registration has been made, the Prime Minister must register the matters set forth in the FIEA into the registry of financial instruments business operators, unless the registration rejection criteria (FIEA, art. 29-4, para. 1) are met (FIEA, art. 29-3, para. 1). The Prime Minister must make the registry of financial instruments business operators available for public inspection (FIEA, art. 29-3, para. 2).

(iii) Registration Rejection Criteria

The Prime Minister must refuse a registration if any of the registration rejection criteria as prescribed by the FIEA have been met, or if a false entry or record is made in the registration application, the attached documentation or electromagnetic record, or if a material matter is not stated or entered (FIEA, art. 29-4, para. 1).

(2) Deposit for Operation

In addition to the above registration rejection criteria, a deposit for operation is required from a person who intends to engage in the type II financial instruments business (limited to an individual), or solely in the acts of investment advising or agency (FIEA, art. 31-2, para. 1).

The amount of the deposit for operation that must be deposited is to be determined by
Cabinet Order in consideration of the circumstances of the business of the financial instruments business operator as well as the necessity of protecting investors (\textit{id.}, para. 2) (see (1)(i) above for details).

(3) **Restrictions on Use of Trade Name, Etc.**

A person who is not a financial instruments business operator must not use a trade name or firm name of a financial instruments business operator or a trade name or firm name that would be confused with a financial instruments business operator (FIEA, art. 31-3).

(4) **Prohibition of Advertising and Solicitation by Unregistered Business Operators**

An unregistered business operator must not (i) make an indication that the business operator conducts financial instruments business or (ii) solicit others to conclude a contract for financial instruments transactions for the purpose of conducting financial instruments business (FIEA, art. 31-3-2).

This rule was introduced under the amendments in 2011 in order to enforce early crackdown on unregistered business operators, in view of the frequent incidents in which unregistered business operators pressure elderly persons into purchasing unlisted shares.

(5) **Lifting of Restrictions on Concurrent Business of Officer and Employee**

Previously under the FIEA the officers of financial instruments business operators engaged in the securities-related business such as securities companies, etc. were prohibited from concurrently serving as an officer or employee of its parent bank, etc., and officers and employees of such financial instruments business operators were prohibited from concurrently serving as an officer of its subsidiary bank, etc. This is because it was believed that officers and employees of financial instruments business operators must dedicate themselves to the ensuring of capital market functions, the inherent mission of financial instruments business operators, and shall not concurrently serve as officers, etc. of banks whose inherent mission is to maintain orderly credit conditions.

However, the barriers between the banking business and the securities business are being lowered as a result of developments such as the growth in financial grouping and the progress in financial technology, which has led to the idea that the existence of the restrictions on concurrent business may constrain the positioning of officers and employees controlling the overall operations of the financial group, and that such restrictions pose an impediment from the point of view of the comprehensive risk management and compliance of the group as a whole.

Accordingly, with the amendments in 2008, the restrictions on the concurrent business by officers and employees were abolished on the precondition having a system in place to manage conflicts of interest within a financial enterprise as well as the financial group.

The following notifications are required if officers and/or employees will hold concurrent positions.

If a director or an executive officer of a financial instruments business operator that engages in the type I financial instruments business or the investment management business is appointed as
a director, accounting advisor, auditor or executive officer of another company (including cases where a director, accounting advisor, auditor or executive officer of the other company shall concurrently serve as a director or executive officer of a financial instruments business operator) or has retired from such office, he/she shall without delay notify the Prime Minister to that effect (FIEA, art. 31-4, para. 1).

Furthermore, the same applies if a director or executive officer is appointed or has retired as director, accounting advisor, auditor or executive officer of a parent bank, etc. or subsidiary bank, etc. of the said financial instruments business operator (including cases where a director, accounting advisor, auditor or executive officer of such parent bank, etc. or subsidiary bank, etc. shall concurrently serve as a director or executive officer of such financial instruments business operator) (id., para. 2).

(6) Organization of Conflict of Interest Management System

In accordance with the diversification of the operations within financial groups and the abolition of restrictions on concurrent business by officers and employees, the construction of a conflict of interest management system within financial groups has become even more important.

Therefore, specified financial instruments business operators (meaning persons engaged in the financial instruments business who are engaged in the securities-related business and are registered under the FIEA, art. 29 to engage in the type I financial instruments business (FIEAEO, art. 15-27)) are required in connection with the transactions conducted by the specified financial instruments business operator, etc. or its parent financial institution, etc. or subsidiary financial institution, etc. to adequately manage information concerning the financial instruments related operations (meaning operations concerning financial instruments trading acts and other operations prescribed by Cabinet Office Ordinance) by the specified financial instruments business operator, etc. or its subsidiary financial institutions, etc., prepare a system to adequately monitor the status of implementation of the financial instruments related operations and take other necessary measures to prevent unfair harm to the interest of customers concerning the financial instruments related operations conducted by the said specified financial instruments business operators, etc. or the subsidiary financial institutions, etc. (FIEA, art. 36, para. 2).

Specifically, the following measures must be implemented (FIBCOO, art. 70-4):

1. Putting in place a system for identifying subject transactions by an appropriate method;
2. Putting in place a system to properly ensure the protection of relevant customers by the following listed methods or other methods:
   (a) A method of segregating the department that conducts the subject transaction and the department that conducts transactions with the relevant customer;
   (b) A method of changing the subject transaction or transaction terms and conditions with the relevant customer or the transaction method;
   (c) A method of suspending the subject transaction or transactions with the
subject customer; and
(d) A method of appropriately disclosing to the relevant customer the risk that the relevant customer's interests will be unduly harmed upon conducting the subject transaction;

3. Formulation of the policy to carry out the measures listed in 1 and 2 above, and publication by an appropriate method of a summary of that policy;

4. Preservation of the following listed records (these records must be preserved for a period of five years from the day that they are created):
   (a) Records relating to the identification of the subject transactions carried out under the structure set forth in 1 above; and
   (b) Records of the measures for properly ensuring the protection of customers carried out under the structure set forth in 2 above.

“Subject transaction” here means relevant transactions where, with a transaction conducted by a specified financial instruments business operator, etc. or its parent financial institution, etc. or subsidiary financial institution, etc., there is a risk of unduly harming the interests of a customer related to the financial instruments related operations that are conducted by the relevant specified financial instruments business operator, etc. or its subsidiary financial institution, etc. (FIBCOO, art. 70-4, para. 3).

A “parent financial institution, etc.” means an entity holding a majority of the voting rights of the total shareholders, etc. of a specified financial instruments business operator, etc. or other persons prescribed by Cabinet Order as having a close relationship with the specified financial instruments business operator, etc. that are financial instruments business operators, banks, cooperative financial institutions or other persons engaged in the financial business as prescribed by Cabinet Order (FIEA, art. 36, para. 4).

A “subsidiary financial institution, etc.” means an entity whose majority voting rights of its total shareholders, etc. are held by the specified financial instruments business operator, etc. or other persons prescribed by Cabinet Order as having a close relationship with the specified financial instruments business operator, etc. that are financial instruments business operators, banks, cooperative financial institutions or other persons engaged in the financial business as prescribed by Cabinet Order (id., para. 5).

(7) Registration of Change, Etc.

If a change has occurred in the matters stated in a registration application or attached documentation thereto, the financial instruments business operator must notify the Prime Minister to that effect within two weeks from the date thereof in the event of a change in the registration application, and promptly in the event of a change in the attached documentation (FIEA, art. 31, para. 1 and para. 3).

Nevertheless, authorization from the Prime Minister must be obtained in the event that financial instruments business operator which has obtained authorization from the Prime Minister in order to operate proprietary trading system (PTS) intends to make a change in the method of
managing risks of loss, methods of determining sales prices, delivery and other methods of settlement or other changes in the content or methods of business as prescribed by Cabinet Office Ordinance in connection with activities for which authorization has been obtained (FIEA, art. 31, para. 6).

2 Financial Regulation and Risk Management

Financial instruments business operators must have a sound financial basis so their operations will not easily collapse, in order that they may fully fulfill their duties as the bearers of the capital markets, which are a public asset.

For this reason, the FIEA stipulates numerous regulations on the financial situation of financial instruments business operators that have obtained registration.

(1) Accounting (Ensuring Soundness)

It is necessary for financial instruments business operators, which lie at the core of the capital markets, to strengthen their risk management divisions and quantify their risk in order to maintain sound management at all times.

Accordingly, the following regulations have been implemented:

(i) Each business year, financial instruments business operators must prepare explanatory documents stating the matters prescribed by Cabinet Office Ordinance in connection with the status of their business and assets, and must keep such documents at each business office for a period of one year following the passage of the period fixed by Cabinet Order (four months) after the close of each business year, and maintain such documents available for public inspection at all business offices or administrative offices, or disclose them via the Internet or by other means, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 46-4; FIEAEO, art. 16-17);

(ii) Financial instruments business operators must compute their capital-to-risk ratios (the ratio of the sum of capitalization, reserves, and other amounts provided for by Cabinet Office Ordinance after deducting the sum of fixed assets and other amounts provided for by Cabinet Office Ordinance to the sum of the amount provided for by Cabinet Office Ordinance as the amount corresponding to the risks which may arise due to fluctuations in the price of securities or other reasons) and notify the Prime Minister thereof at the end of each month and in the cases prescribed by Cabinet Office Ordinance (cases where the ratio falls below 140% or recovers to 140% or more) (FIEA, art. 46-6, para. 1; FIBCOO, art. 179);

(iii) Financial instruments business operators must prepare documents stating
their capital-to-risk ratios on the last day of each quarter (meaning each three-month period of the business year; four times per year), and keep such documents at each business office or office and make them available for public inspection for a period of three months from the date on which one month expires from respectively the last day of March, June, September and December (FIEA, art. 46-6, para. 3); and

(iv) Financial instruments business operators must ensure that their capital-to-risk ratios do not fall below 120% (FIEA, art. 46-6, para. 2).

(2) Accumulating a Financial Instruments Transaction Liability Reserve

A financial instruments business operator is required to accumulate a financial instruments transaction liability reserve, to accommodate incidents in connection with a financial instruments transaction (FIEA, art. 46-5, para. 1; FIBCOO, art. 175).

Type I small amount electronic offering handling business operators are exempted from the obligation to accumulate a financial instruments transaction liability reserve, because they are specialized in handling public offering or private placement of securities and are not permitted to engage in sales and purchase, etc. of securities in the course of trade (FIEA, art. 29-4-2, para. 6),

(3) Business Year

According to 2014 amendment, the business year of financial instruments business operators that engage in type I financial instruments business has been changed to begin on the first day of a month selected by the respective financial instruments business operators and end on the day on which one year has elapsed since the said day (FIEA, art. 46), thus allowing type I financial instruments business operators to set their business year as beginning on the first day of any month they select, instead of using the conventionally required uniform business year extending from April 1 of each year to March 31 of the following year.

Specific regulations have not been enacted concerning persons other than a type I financial instruments business operator.

(4) Duty to Submit Reports/Materials, Etc.

A financial instruments business operator must prepare a business report for each business year in the manner prescribed by Cabinet Office Ordinance, and within three months after the close of each business year must submit the same to the Prime Minister (FIEA, art. 46-3, para. 1 and art. 47-2). If a financial instruments business operator is a foreign corporation, a business report is required to be prepared within the period specified by Cabinet Order after the close of each business year (FIEA, art. 49, para. 1 and para. 3).

A type I financial instruments business operator must, in addition to submitting the business report, also file with the Prime Minister a report on the status of its business or assets, in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 46-3, para. 2).

A financial instruments business operator is further required to prepare and keep books of
Supervision of Business Activities

The FIEA stipulates detailed provisions concerning the nature of various acts, such as “those for which a financial instruments business operator should take initiative in performing, and behavior in which they should not engage, as bearers of the capital markets.”

Regulatory authority is granted preventive and subsequent supervisory authorities over financial instruments business operators in order that financial instruments business operators will achieve the functions that are anticipated under the FIEA, including conduct regulations.

These supervisory regulations do not mean intrusive regulations on businesses, but are rather for the purpose of providing and putting into place conditions for achieving capital markets, as well as monitoring the activities and behaviors of the markets, and pursuing responsibility in connection with results.

(1) Restrictions on Withdrawal

(i) Restrictions on Withdrawal of Financial Instruments Business Operators

There may be cases in which a financial instruments business operator will halt or close its business, or will consolidate its business activities. It is, however, necessary to avoid situations in which this would be conducted in a way that would cause an impediment to the functioning of capital markets.

For this reason the FIEA prescribes regulations on the withdrawal from business by a financial instruments business operator.

(a) Notification of suspension, etc. of business

A financial instruments business operator, etc. must notify the Prime Minister without delay if the financial instruments business operator, etc., inter alia, suspends or resumes its business (FIEA, art. 50).

(b) Notification of discontinuance, etc. of business

If a financial instruments business operator is to, inter alia, discontinue its business, the financial instruments business operator must notify the Prime Minister of that fact, in accordance with the provisions of the FIEA, within 30 days from the date of discontinuance, etc. of business (FIEA, art. 50-2, para. 1).

(ii) Restrictions on Withdrawal of Registered Financial Institutions

A registered financial institution must notify the Prime Minister without delay if it, inter alia, suspends or resumes its business (FIEA, art. 50).

If a registered financial institution is to, inter alia, discontinue its business, it must notify the Prime Minister of that fact, in accordance with the provisions of the FIEA, within 30 days from the date of discontinuance, etc. of business (FIEA, art. 50-2, para. 1)
(2) **Order to Improve Conduct of Business**

(i) **Order to a Financial Instruments Business Operator to Improve Its Business Conduct**

If in connection with the operations of business or the financial standing of a financial instruments business operator the Prime Minister finds that it is necessary and appropriate for the protection of investors or the public interest, the Prime Minister may, to the extent necessary, order a financial instruments business operator to change its method of business or take other action that is necessary to improve its business operations or the financial standing (FIEA, art. 51).

(ii) **Order to a Registered Financial Institution to Improve Its Business Conduct**

If in connection with the operations of business of a registered financial institution the Prime Minister finds that it is necessary and appropriate for the protection of investors or the public interest, the Prime Minister may, to the extent necessary, order a registered financial institution to change its method of business or take other action that is necessary to improve the operations of business (FIEA, art. 51-2).

(3) **Supervisory Actions**

(i) **Supervisory Actions over Financial Instruments Business Operators**

Since with the exception of the PTS business the financial instruments business is subject to a registration system and the regulations on participation in the financial instruments business have been liberalized, it is necessary to thoroughly and properly carry out the supervision and dispositions after registration in order to assure the proper conduct of business on the part of financial instruments business operators. For this reason, steps are to be taken to achieve appropriate conduct of business after registration, including a revocation of registration, the deposit of assets or an order to suspend business as well as the taking of various actions in association therewith if the amount of capital or the amount of net assets falls below the legally prescribed amounts, or if a registration has been obtained through improper means, or if a violation of a disposition by a government agency has occurred, or if another legal or regulatory event has occurred in connection with the financial instruments business.

(a) **Revocation of registration or authorization or suspension of business**

If a financial instruments business operator falls under the requirements set forth in the FIEA, the Prime Minister may cancel the registration or authorization of the financial instruments business operator or designate a period of not more than six (6) months and order the financial instruments business operator to suspend its business in their entirety or in part (FIEA, art. 52, para. 1).

(b) **Management preservation order (prompt corrective action)**

If the capital-to-risk ratio of a financial instruments business operator that engages in the type I financial instruments business becomes less than 120%, and if found to be necessary and appropriate to protect investors or the public interest, the Prime Minister may to the extent necessary order a change in the method of business, the deposit of assets
or other matters that are necessary for supervision (FIEA, art. 53, para. 1).

Moreover, if the capital-to-risk ratio falls below 100%, the Prime Minister may designate a period of not more than three (3) months and order the financial instruments business operator to suspend its business activities in their entirety or in part (id., para. 2). If the capital-to-risk ratio is less than 100% even after three months, and it is found that the prospect of recovery of the position does not exist, the Prime Minister may cancel the registration of the financial instruments business operator (id., para. 3).

(c) Dismissal of officers

If an officer of a financial instruments business operator (which in the event of a foreign corporation shall be limited to an officer who is stationed at a business office or office in Japan, or the representative of Japan) falls under the requirements set forth in the FIEA, the Prime Minister can order the financial instruments business operator to dismiss the officer (FIEA, art. 52, para. 2).

(ii) Supervisory Actions over Registered Financial Institutions

If a registered financial institution falls under any of the requirements set forth in the FIEA, the Prime Minister may revoke the registration of the financial institution as a registered financial institution, or designate a period of not more than six (6) months and order the registered financial institution to suspend its business activities in their entirety or in part (FIEA, art. 52-2).

2 Regulations Against Special Financial Instruments Business Operators

(1) Significance

Formerly, securities companies were basically regulated and supervised on a stand-alone basis as a market intermediary necessary for ensuring the appropriateness of business operations and the due management, etc. of customer assets. However, the organization of securities companies have become grouped, and in some cases the authorities have difficulty in understanding the management and risk situations of the group as a whole.

Because of this, if a securities company is conducting large-scale and complex activities as a group, and that securities company suddenly fails due to financial and operational issues, etc. caused by its parent company, subsidiary or sister company within the group, its market intermediation functions may become dysfunctional, have material effect on a wide range of investors, and eventually may have a material effect on the financial system.

Accordingly, because it is necessary to conduct strong and comprehensive risk management under due business administration with respect to a securities company conducting large-scale and complex activities which acts with its group companies as a unit, the amendments in 2010 introduced consolidated-based regulations and supervision on securities companies above a certain scale.
(2) Downstream Consolidation

Because the financial conditions of a securities company will be directly affected negatively if there is a concern regarding the financial conditions of a subsidiary, etc. of the securities company, large-scale securities companies (special financial instruments business operators) that have total assets above a certain scale shall be regulated and supervised on a consolidated-basis, covering such securities company and its subsidiaries, etc.

(3) Upstream Consolidation

If the securities company (a special financial instruments business operator) subject to downstream consolidation is conducting financial activities as a group, and that securities company suddenly fails due to financial and operational issues, etc. caused by its parent company, subsidiary or sister company within the group, its market intermediation functions may become dysfunctional, have material effect on a wide range of investors, and eventually may have a material effect on the financial system.

Accordingly, a scheme has been prepared for the authorities to designate, among the parent companies of securities companies (special financial instruments business operators) subject to downstream consolidation, (i) those which administer the management of a securities company as business or (ii) those providing financial assistance to a securities company as a group, and to regulate and supervise the entire group including the parent company on a consolidated-basis.

Sales Representative System

(1) Significance of Sales Representative System

Fair price formation of financial instruments, etc. on capital markets can be achieved through concentrating investment decisions that investors have formed based on sufficient information concerning the true value of the investment targets. However, there is no guarantee that information covered by the timely disclosure rules of the financial instruments exchanges and the periodic and occasional information disclosure systems prescribed under the FIEA will be distributed evenly among all investors.

In addition, the material that investors require to make investment decisions is not limited solely to the criteria demanded by law. Investors seek a variety of information including judgments regarding economic conditions, as well as knowledge concerning the fundamentals of the stock system. As financial instruments business operators, etc. are the persons who have the mission of linking the investment decisions of investors to the market, in this sense, financial instruments business operators, etc. have a high degree of responsibility towards capital markets in their responses within their aspect of interacting with investors.

The enacting of special provisions concerning the status and authority of a sales representative under the FIEA is not simply to prevent injury to investors, but is also for the purpose of clarifying the duties of financial instruments business operators who are responsible
for building fair markets through achieving sound investment decisions.

(2) Sales Representative

A sales representative is a person who, among officers and/or employees of a financial instruments business operator, etc., engages in the following acts on behalf of the financial instruments business operator, etc., regardless of whether the person is referred to as a promoter, sales staff, canvasser, or by any other title (FIEA, art. 64, para. 1, main paragraph):

i. Any act set forth below in connection with securities (excluding those rights under Article 2, Paragraph 2 of the FIEA that are deemed as securities pursuant to the provisions of the said Paragraph):

   (a) 1. Sales and purchase of securities, market transactions of derivatives, or foreign market transactions of derivatives;
   2. Intermediary, brokerage or agency service for sales and purchase of securities, market transactions of derivatives, or foreign market transactions of derivatives;
   3. Intermediary, brokerage or agency service for entrustment of sales and purchase of securities conducted in a financial instruments exchange market or market transactions of derivatives; and
   4. Intermediary, brokerage or agency service for entrustment of sales and purchase of securities conducted in a foreign financial instruments market or foreign market derivatives transactions;
   5. Brokerage for clearing of securities, etc.;
   6. Secondary distribution of securities or exclusive offer to sell, etc. to professional investors;
   7. Dealing in public offering or secondary distribution of securities or dealing in private placement or exclusive offer to sell, etc. to professional investors of securities;

   (b) The following acts:
   1. Solicitation for application for sales or purchase, or intermediary, brokerage (excluding brokerage for clearing of securities, etc.) or agency service thereof;
   2. Solicitation for application for market transactions of derivatives or foreign market derivatives transactions, or intermediary, brokerage (excluding brokerage for clearing of securities, etc.) or agency service thereof; and
   3. Solicitation for the entrustment of market transactions of derivatives or foreign Market derivatives transactions;

ii. The following acts:

   (a) 1. Over-the-counter transactions of derivatives or intermediary, brokerage or agency service therefor;
2. Underwriting of securities; or
3. Proprietary trading system (PTS) operation activities;

(b) Solicitation for application for over-the-counter transactions of derivatives, etc.;

iii. An act as set forth by Cabinet Order other than those prescribed in i. or ii. above. The acts to be prescribed by Cabinet Order shall be the following (excluding those related to the securities prescribed in the FIEA, Article 64, Paragraph 1, Item 1) (FIEAEO, art. 17-14):

1. Market transactions of derivatives or foreign market derivatives transactions, or the intermediary, brokerage or agency service thereof;
2. The intermediary, brokerage or agency service for entrustment of market transactions of derivatives or foreign market derivatives transactions;
3. The solicitation for application for market transactions of derivatives or foreign market derivatives transactions, or the intermediary, brokerage or agency service therefor; or
4. The solicitation for entrustment of market transactions of derivatives or foreign market derivatives transactions.

A financial instruments business operator shall not have any person other than a registered sales representative carry out the duties of a sales representative (FIEA, art. 64, para. 2).

(3) Registration of Sales Representatives

A financial instruments business operator, etc. must register the personal name, date of birth, and other requisite information of its sales representatives in the Registry of Sales Representatives kept in the location (an authorized financial instruments business operators association, or a certified financial instruments business operators association as set forth in the FIEA, art. 78, para. 2) as prescribed by Cabinet Office Ordinance (FIEA, art. 64, para. 1 and art. 64-7; FIBCOO, art. 247 through art. 256).

No person other than a registered sales representative is allowed to perform sales representative activities, and since strict conditions, as described below, are imposed on registration, not only does registration make clear the scope of authority vested in sales representatives in terms of their relationship with the financial instruments business operator, etc. to which they belong, it also in effect functions as an equivalent to a “permit” in that it lifts the general prohibition of the conduct of sales representative activities only with regard to a limited scope of such registered persons.

Fitness for registered sales representatives is enforced through the establishment of disqualification criteria and through an administrative action such as revocation of registration due to violations of the laws and regulations, etc.
Persons disqualified for registration as sales representatives are those who have been sentenced to imprisonment or heavier punishment for violating the FIEA or other laws and regulations, and for whom five years have not yet passed since the day on which the execution of the sentence was completed or these persons ceased to be subject to the execution.

The following persons are also disqualified: (i) an adult ward or person under curatorship, or any person treated in the same manner under the laws and regulations of a foreign state; (ii) a person who has received a ruling of commencement of bankruptcy proceedings and whose rights have not been restored, or a person who is treated in the same manner under the laws and regulations of a foreign state; and (iii) a person who has been sentenced to a fine for violating the provisions of the Act on Prevention of Unjust Acts by Organized Crime Group Members or other laws, and for whom five years have not yet passed since the day on which the execution of the sentence was completed or the person ceased to be subject to the execution of the fine.

The Prime Minister must refuse a registration if the sales representative in connection with a registration application falls under any of the following or if a false statement is made or there is an omission of a material matter in the registration application or the documentation attached thereto (FIEA, art. 64-2, para. 1):

i. A person who falls under any of the disqualification criteria (FIEA, art. 29-4, para. 1, item 2(a) through (i));
ii. A person whose registration as a sales representative has been revoked as a supervisory disposition (FIEA, art. 64-5, para. 1) and for whom five years have yet to expire from the date of the said revocation;
iii. A person who is registered as a sales representative at a financial instruments business operator, etc. or a financial instruments intermediary service provider other than the registration applicant; or
iv. A person who is registered as financial instruments intermediary service provider (FIEA, art. 66).

If a registered sales representative falls under any of the following, the Prime Minister may revoke its registration or suspend it for a period of up to two years (FIEA, art. 64-5):

i. If the sales representative falls under any of the disqualification criteria (FIEA, art. 29-4, para. 1, item 2(a) through (i)), or is discovered to have already been fallen under any item of the FIEA, Article 64-2, Paragraph 1, at the time of registration;
ii. If the sales representative has committed a legal or regulatory violation in connection with the activities set forth in any item of the FIEA, Article 64, Paragraph 1 or related business in connection thereto, out of the financial instruments business (or in the event of a registered financial institution, the registered financial institution business), or is found to have committed an act that is otherwise significantly inappropriate in connection with the duties of a
iii. If a sales representative whose registration has been deleted within the past five years for a reason such as resignation from employment is discovered to have committed an act that falls under item ii. above, during the period of time in which the sales representative was representative (limited to an act during the previous five years).

In cases where a registration is revoked, etc., the registration of the sales representative will be deleted (FIEA, art. 64-6).

In addition, a financial instruments business operator must file a notification with the Prime Minister without delay if any of the following occurs with respect to one of its registered sales representatives (FIEA, art. 64-4):

i. If there has been a change in the full name or date of birth of the sales representative, or his or her classification as an officer or employee;
ii. If a registered sales representative falls under any of the disqualification criteria (FIEA, art. 29-4, para. 1, item 2(a) through (i)); and
iii. If a representative no longer conducts the duties of a sales representative due to retirement or other reasons.

From the perspective of enhancing the function of an authorized financial instruments business operators association as a self-regulatory body, the registration tasks in connection with sales representatives of a financial instruments business operator that is a member of an authorized financial instruments business operators association, or a certified financial instruments business operators association are to be carried out by the financial instruments business operators association (FIEA, art. 64-7, para. 1).

The association that carries out the registration tasks must notify the Prime Minister without delay to that effect if the association has made a registration, changed a registration, made a disciplinary action (excluding canceling a registration) or has deleted a registration of a sales representative (id., para. 5).

If, in connection with a registration application, a financial instruments business operator, etc. has an objection to an inaction, refusal to register or disposition made by the financial instruments business operators association that carries out the registration work, the financial instruments business operator may make a request to the Prime Minister for a review under the Administrative Appeals Tribunal Act (FIEA, art. 64-9).

(4) Legal Status of Sales Representatives

(i) Authority of Representation (FIEA, art. 64-3, para. 1)

A sales representative is deemed to possess the authority to perform any and all extrajudicial acts in connection with the acts set forth in each item of Article 64, Paragraph 1, on behalf of the financial instruments business operator to which he/she belongs (FIEA, art.
64-3, para. 1). As a result, the actions of a sales representative are directly attributed to the financial instruments business operator, etc., and the financial instruments business operator, etc. is directly liable to satisfy the obligations borne by its sales representatives.

Through this grant of authority of representation to its sales representatives, a financial instruments business operator, etc. can broaden its business activities and allow customers to feel secure in their interaction with sales representatives, thereby promoting investor protection, and enabling greater mobility of financial instruments trading. Financial instruments business operators, etc. have responsibilities as the bearers of the capital markets, and the acts of sales representatives are an extension of these responsibilities of financial instruments business operators, etc.

Consequently, if a sales representative commits a malicious act in violation of the FIEA, the financial instruments business operator, etc. cannot avoid supervisory responsibility regarding that sales representative on the grounds that the act was outside of the scope of the authority of representation.

(ii) Recognition of the Customer (FIEA, art. 64-3, para. 2)

As mentioned above, financial instruments business operators, etc. are liable for the business activities of their sales representatives. If it can be shown, however, that the customer in the transaction had known of such scope of authority (where the customer has caused the sales representative to take actions outside the scope of authority even when the customer knows there are restrictions placed on the scope of authority of the sales representative, or where the sales representative is clearly the agent of the customer, etc.), this shall not apply (FIEA, art. 64-3, para. 2).

Therefore, unless the facts indicate that the customer had known such scope of authority, a financial instruments business operator, etc. cannot avoid liability for the acts of its sales representatives. Any finding of recognition by a customer must be premised by the fact that the sales representative fulfilled his/her responsibilities.

Conduct Regulations by Financial Instruments Business Operators

(1) General

In the past, vertically organized business laws governed the conduct regulations on business operators engaged in transactions of financial instruments, and the regulations differed for each type of financial instrument handled. However, new financial products that are not covered by existing laws for protection of users have been developed and put on sale one after another backed by developments such as growth in financial technology and information technology. The blending of financial services has progressed, with financial institutions as well exhibiting a tendency towards handling products for which demand on the part of users could be found to exist as well as products based on business laws of another industry across sector boundaries. Moreover, products under differing laws have become similar in their content, and products that
span several laws are being provided.

Given these changes in the financial environment, as well as the difference in information that exists between business operators and users, it has been necessary to put in place a comprehensive and overarching framework of user protection in connection with a wide range of financial products and pursuant to the premise of seeking the individual responsibility of users, to expand the protection of users. The FIEA, consequently, is a law that is of a general nature in connection with the sales of financial products and investment of assets, and imposes uniform restrictions on behavior acts in financial products that have the same economic function, regardless of the industry in which they are involved.

The FIEA stipulates overarching conduct regulations of financial instruments business operators, etc. in view of their status as financial instruments business operators, etc. as bearers of the capital markets. In order to assure the functioning of the capital markets, matters are stipulated for which financial instruments business operators, etc. should take initiative in performing, and matters from which they are affirmatively prohibited. Both of these are prescribed as matters that contribute to the fair formation of prices through achieving quality and value of the object of a transaction as well as a competitive concentration of investment decisions in connection with value.

In addition to the prohibitions specifically applicable to financial instruments business operators, the general prohibitions against acts of market disruption also apply to financial instruments business operators. These are discussed subsequently (for details, see Section 12. Regulations Imposed on Acts of Market Abuse (Regulations Against Unfair Trading)).

(2) General Obligations

(i) Duty of Good Faith and Fairness

Financial instruments business operators, etc. as well as their officers and employees are required to perform their duties in good faith and fairly towards their customers (FIEA, art. 36).

Under the FIEA, the regulations on financial instruments business operators, etc. are not only for the purpose of adjusting interests in the form of protecting each investor, but also for the purpose of achieving fair price formation in capital markets which is a value that extends beyond this.

It can be said that the principle is that each investor enjoys the benefit to the national economy from having fair capital markets, as a citizen of the country. Capital markets that are prone to creating a bubble even if they work out to the benefit of individual investors will ultimately only be a disaster for these individual investors as well.

The duty of good faith and fairness historically is derived from the “fiduciary duty” under Anglo-American common law, and there is a tendency to view this as a duty under private law. Nevertheless, it should be viewed as an expression of a duty to promote the objectives of the FIEA from the perspective of a duty to investors.
(ii) Advertising Regulations

In view of the status of financial instruments business operators, etc. as bearers of the capital markets, the FIEA requires certain representations to be made when a financial instruments business operator, etc. makes an advertisement of the contents of the financial instruments business that the financial instruments business operator, etc. carries out, and also prohibits representations that are significantly at variance with the facts, or representations that would significantly mislead people in connection with, *inter alia*, expectations of gains.

When a financial instruments business operator, etc. carries out advertising of the contents of the financial instruments business in which it engages and other acts that are prescribed by Cabinet Office Ordinance as being similar to the same, the financial instruments business operator, etc. must, in the manner prescribed by Cabinet Office Ordinance, state the following (FIEA, art. 37, para. 1):

1. The trade name, firm name or personal name of the financial instruments business operator, etc.;
2. The fact that the said financial instruments business operator, etc. is a financial instruments business operator, etc., and the registration number of the said financial instruments business operator, etc.; and
3. Those matters which involve the content of the financial instruments business that is carried out by the financial instruments business operator, etc. and which are determined by Cabinet Order as being material matters that will influence the decisions of customers.

The specific scope of acts covered as being similar to advertising are prescribed as “providing information of the same content to large number of persons” through distribution by postal mail, courier, facsimile, email, handouts or pamphlets, etc. (FIBCOO, art. 72). By way of example, sales materials would also be covered by these advertising regulations to the extent that the above requirements are met.

The matters to be stated in advertisements are prescribed as including commissions or the like, the possibility of a loss on principal or a loss in excess of principal, as well as the indexes that would constitute the cause and the reason for the same, the matters that are disadvantageous to customers in connection with material matters, and if the financial instruments business operator, etc. is a member of a financial instruments business operators association, the name, etc. thereof (FIEAEo, art. 16; FIBCOO, art. 76). In particular, with respect to risk information, the statement must be made in letters and numbering that do not differ significantly from the largest letters and numbering that are used in the advertisement (FIBCOO, art. 73).

If a financial instruments business operator, etc. carries out an advertisement in connection with the financial instruments business in which it engages, or an act that is prescribed by Cabinet Office Ordinance as being similar to the same, the financial
instruments business operator, etc. shall not make a representation that is significantly at variance with the facts or that will significantly mislead people in connection with expectations of gains from carrying out an act of financial instrument trading, or other matters as prescribed by Cabinet Office Ordinance (FIEA, art. 37, para. 2). These matters are prescribed as particulars concerning cancellation of contract, responsibility for loss, guarantee of gains, penalty for breach, etc., financial ability, creditworthiness and performance of the business operator, and commissions, etc. (FIBCOO, art. 78).

(iii) Duty to Deliver a Document, Duty to Explain and Duty to Provide Information

The duty to explain on the part of a financial instruments business operator, etc. is an important measure for the purpose of ameliorating the difference in information between the business operator and the user, and is indispensable in order to achieve fair price formation of financial instruments, etc. on capital markets.

The FIEA, consequently, treats the duty to explain of the same contents for which there is a duty to explain under the Act on Sales, Etc. of Financial Instruments (hereinafter “Financial Instruments Sales Act”) as one of conduct regulations of financial instruments business operators in the form of an obligation under the FIEA, and supervisory dispositions may be executed directly against business operators in the event that they violate this obligation.

(a) Duty to Deliver a Document Prior to Conclusion of Contract

If a financial instruments business operator, etc. intends to enter into a contract for financial instruments transactions, the financial instruments business operator, etc. must, in a manner as prescribed by Cabinet Office Ordinance, deliver in advance to the customer a document setting forth the following (FIEA, art. 37-3, para. 1, main clause).

However, the preceding shall not apply to cases prescribed by Cabinet Office Ordinance as cases that do not present an impediment to the protection of investors (id., proviso):

i. The trade name, firm name or personal name and address of the financial instruments business operator, etc.;

ii. The fact that the financial instruments business operator, etc. is a financial instruments business operator, etc., and the registration number of the financial instruments business operator, etc.;

iii. The outline of the relevant contract for financial instruments transactions;

iv. Matters that are prescribed by Cabinet Office Ordinance concerning the fee, commission or other consideration that the customer is to pay in connection with the contract for financial instruments transaction;

v. If there is a risk of loss as a result of fluctuation in interest, price of currency, prices on financial instruments markets or other indicators in connection with acts of financial instruments transactions that will be conducted by the customer, a statement to that effect;
vi. If there is a risk that a loss under the preceding item will exceed the amount of a customer margin or other security deposit as prescribed by Cabinet Office Ordinance that is placed on deposit by the customer, a statement to that effect; and

vii. Such other matters in connection with the content of the financial instruments business that are prescribed by Cabinet Office Ordinance as having a material impact on a customer’s decisions, in addition to those set forth in each of i. through vi. above.

First, a document to be delivered prior to the conclusion of contract is required to state, at the start of the document, that the document should be read thoroughly, and also state particularly important matters that will have an impact on the investment decisions of the customer, in a simplified manner using lettering and numbering of at least 12 points in size (FIBCOO, art. 79, para. 3). Next, a clear and accurate statement must be made with regard to a summary of the commissions, etc., the possibility of a loss on principal or a loss in excess of principal, the trade name, etc. of the counterparty to cover transactions in over-the-counter financial futures transactions (amended to “over-the-counter transactions of derivatives” in the 2010 amendments) as well as the method of separate management and the entity with which the deposit is to be placed, matters concerning transactions covered by the electronic application-based electronic offering handling business, and the applicability of a cooling-off period. These matters must be stated within the frame borders in the document, using lettering and numbering of at least 12 points in size (id., para. 2). The other matters must be stated clearly and accurately using lettering and numbering of at least eight points in size (id., para. 1).

In addition to the statutorily required statements, common matters to be stated in the document to be delivered prior to the conclusion of contract include: a statement to the effect that the contents of the document to be delivered prior to conclusion of contract must be read thoroughly; the amount and method of calculation of customer margins, etc. payable by the customer; the causes, indicators, etc., and reasons if the possibility exists that losses on principal or in excess of principal will occur; the outline of the taxes to be levied; the details of grounds for termination of the contract if any such grounds are stipulated; whether a cooling-off period applies; an outline, etc. of the financial instruments business operator, etc.; the method by which the customer will communicate with the financial instruments business operator, etc.; whether the financial instruments business operator has membership in any financial instruments firms association, and the name of the association in which the business operator is a member; whether the financial instruments business operator is covered by operations of any certified investors protection organization, and the name of the organization by which it is covered; and the trade name or firm name of the designated dispute resolution organization (FIBCOO, art. 82). Other matters that should be stated depending on the financial instrument or the transaction are also prescribed (FIBCOO, art. 83 through art. 96).
The following exceptions exist to the obligation to deliver the document to be delivered prior to conclusion of contract.

The first case is where, in connection with sale and purchase, etc. (excluding derivatives transactions and margin transactions, etc.) of securities that are listed on a financial instruments exchange (excluding covered warrants, etc.), a comprehensive document (hereinafter referred to as “Explanatory Document on Listed Securities, etc.”) has been delivered to the customer within one year prior to the conclusion of a contract for financial instruments transaction (FIBCOO, art. 80, para. 1, item 1).

The second exception is if, within one year prior to the conclusion of a contract for financial instruments transaction, a document to be delivered prior to conclusion of contract has been delivered to the customer in relation to another contract for financial instruments transaction that is of the same type (id., item 2).

The third is if a prospectus has been delivered to the customer which states all of the matters to be set forth in the document to be delivered prior to conclusion of contract (id., item 3).

The fourth is if a contract for financial instruments transaction is to be concluded for the purpose of partly changing another contract for financial instruments transaction already in effect, but such partial change does not result in changing the matters stated in the document to be delivered prior to conclusion of contract regrading such contract already in effect, or an explanatory document on change of contract information has been delivered to the customer (id., item 4).

The foregoing duty to deliver a document to be delivered prior to conclusion of contract may not be interpreted that simply delivering a written statement to the customer would be enough. Namely, with respect to the delivery of a document to be delivered prior to conclusion of contract, an explanation on matters iii. to vii. above must be given to the customer in the manner and degree necessary for the customer’s understanding in light of the customer’s knowledge, experience, financial standing and purpose of entering into a contract for financial instruments transaction and enter into a contract for financial instruments transaction (FIBCOO, art. 117, para. 1, item 1), and the obligation to give explanation based on the customer’s suitability must be performed.

(b) **Duty to Deliver a Document to Be Delivered upon Conclusion of Contract, Etc.**

A financial instruments business operator, etc. must prepare a document and deliver the same to the customer pursuant to the provisions of Cabinet Office Ordinance without delay upon the conclusion of a contract for financial instruments transaction or when otherwise specified by Cabinet Office Ordinance (FIEA, art. 37-4, para. 1, main clause).

However, this shall not apply to a case that is prescribed by Cabinet Office Ordinance as being a case in which it can be found that not delivering this document to a customer would not present an impediment to the protection of investors or the public interest, in view of the nature of the contract for financial instruments transaction or other circumstances (id., proviso).

Moreover, if a financial instruments business operator, etc. has received a security
deposit (limited to those as prescribed by Cabinet Office Ordinance) to be placed by a customer in connection with the financial instruments business that the financial instruments business operator, etc. carries out, the financial instruments business operator, etc. shall immediately deliver to the customer a written statement to that effect, in the manner as prescribed by Cabinet Office Ordinance (FIEA, art. 37-5, para. 1).

Violations of the duty to deliver documents may be punished by an administrative action, and in addition, the violator or the corporation may be punished by penal sanction (FIEA, art. 205 and art. 207).

(c) Duty to Provide Information in the Electronic Offering Handling Business

When a financial instruments business operator, etc. provides an electronic offering handling business with regard to a certain scope of securities, the financial instruments business operator, etc. must, pursuant to the provisions of Cabinet Office Ordinance, make the particulars to be stated in the document to be delivered upon conclusion of a contract which are specified by Cabinet Office Ordinance as having a material influence on decisions by the other party to the electronic offering handling business available for inspection by the said other party, by means of an electronic information system or by any other means of information and communications technology specified by Cabinet Office Ordinance, throughout the period in which it provides an electronic offering handling business with regard to such securities (FIEA, art. 43-5; FIBCOO, art. 146-2).

This duty is intended to ensure that investors are provided with sufficient information for making investment decisions.

(d) Written Cancellation (Cooling-Off)

In order to encourage sound investment decisions by general investors, a general clause concerning written cancellation (cooling-off) has been stipulated in the FIEA.

Except in the cases as prescribed by Cabinet Office Ordinance, a customer who has entered into a contract for financial instruments transaction (limited to those as prescribed by Cabinet Order in consideration of the substance of the said contract for financial instruments transaction and other circumstances) with a financial instruments business operator, etc. may cancel the contract for financial instruments transaction by a written statement during the period from and including the date on which the customer has received the written statement through the expiration of the number of days as prescribed by Cabinet Order (FIEA, art. 37-6, para. 1). Cancellation of a contract for financial instruments transaction as set forth in the preceding paragraph shall have effect from the date of issue of the written statement to the effect that the said contract for financial instruments transaction would be cancelled (id., para. 2). Investment advisory contracts are covered by those prescribed by Cabinet Order (FIEAEO, art. 16-3, para. 1), and the number of days to be prescribed by Cabinet Office Ordinance is stipulated as 10 days (id., para. 2).

If a contract for financial instruments transaction has been cancelled pursuant to the FIEA, Article 37-6, Paragraph 1, the financial instruments business operator, etc. cannot demand the payment of any damages or penalty, in association with the cancellation of the
contract for financial instruments transaction, that exceeds the amount that is prescribed by
Cabinet Office Ordinance as the amount of consideration that the customer is to pay as
fees, commission or other consideration in connection with the contract of financial
instruments transaction relevant to the period until cancellation of the contract for financial
instruments transaction (FIEA, art. 37-6, para. 3).

Furthermore, if a contract for financial instruments transaction has been cancelled
pursuant to the provisions of the FIEA, Article 37-6, Paragraph (1), and the financial
instruments business operator, etc. has received prepayments of consideration in
connection with the contract for financial instruments transaction, the financial instruments
business operator, etc. must return the same to the customer (FIEA, art. 37-6, para. 4);
provided, however, that the preceding shall not apply in connection with an amount as set
forth by Cabinet Office Ordinance (FIEA, art. 37-6, para. 4, proviso).

Any rider which violates the provisions of each of the preceding clauses, to the
detriment of the customer, shall be null and void (FIEA, art. 37-6, para. 5).

(e) Prohibition Against Uninvited Solicitation

A financial instruments business operator, etc. or an officer or employee thereof may
not visit or telephone customers who have not requested soliciting and solicit entering into
a contract for financial instruments transaction that has been prescribed by Cabinet Order
as particularly requiring care to protect investors, in view of the contents of the contract
for financial instruments transaction or other circumstances (FIEA, art. 38, item 4).

Over-the-counter financial futures transactions have been stipulated as being covered
by the prohibition against uninvited solicitation (FIEAO, art. 16-4, para. 1, item 1). From
the perspective of preventing the evasion of this prohibition, a business operator is
prohibited from soliciting a customer to enter into a contract without informing the
customer in advance that the business operator intends to solicit the customer to enter into
a contract for over-the-counter financial futures transaction (FIBCOO, art. 117, para. 1,
item 8).

Over-the-counter transactions of derivatives for individual investors shall be subject
to provisions concerning the prohibition against uninvited solicitation in accordance with
the 2010 amendments (FIEAO, art. 16-4, para. 1, item 2).

(f) Obligation to Confirm Customer’s Intention to Accept Solicitation and
Prohibition Against Repeated Solicitation

A financial instruments business operator, etc. or an officer or employee thereof may
not solicit a customer to enter into a contract for financial instruments transaction that has
been prescribed by Cabinet Order as particularly requiring care to protect investors, in
view of the contents of the contract for financial instruments transaction or other
circumstances (which is prescribed as being market transactions of derivatives (including
commodity-related market transactions of derivatives) (FIEAO, art. 16-4, para. 2),
without confirming with the customer prior to the solicitation whether the customer has a
desire to receive such solicitation (FIEA, art. 38, item 5).

Moreover, a financial instruments business operator, etc. or an officer or employee
thereof must not continue to solicit even though a customer who has received solicitation has indicated its intention not to enter into the contract for financial instruments transaction (including an intention to the effect that the customer does not desire to continue to be solicited) (FIEA, art. 38, item 6).

The prohibition against repeated solicitation does not permit soliciting in violation of the intention of the customer in view of the nature and substance of the product, even in connection with those for which the necessity to impose a prohibition against uninvited solicitation cannot be found to exist. The obligation to confirm the customer’s intention to accept solicitation is recognized as the premise for a prohibition against repeated solicitation. Both of these prohibitions are positioned squarely of the principle of suitability and the prohibition against uninvited solicitation, and are understood as being appropriate for those instruments that present problems in view of compliance with suitability.

In order to prevent evasion of this prohibition, prohibitions exist against the act of gathering customers together and soliciting them to enter into a contract without informing them in advance that the objective (of the gathering) is to solicit customers to enter into a contract for over-the-counter transactions of derivatives (FIBCOO, art. 117, para. 1, item 8), as well as the act of soliciting the entering into of a contract even though the customer has stated in advance that the customer does not intend to enter into a contract in connection with derivatives transactions (FIBCOO, art. 117, item 9).

When conducting commodity-related market transactions of derivatives, financial instruments business operators, etc. are prohibited from visiting or making telephone calls to customers who are individuals before soliciting them to conclude contracts or from gathering customers who are individuals without explicitly stating that they are being gathered for the purpose of solicitation (FIBCOO, art. 117, para. 1, item 8-2). This provision substantially imposes the prohibition of uninvited solicitation on financial instruments business operators, etc. in relation to customers who are individuals.

In addition, in order to give further substance to the duty to explain, a stipulation has been made which prohibits the act of entering into a contract for financial instruments transaction without providing an explanation according to the method and to the extent that is necessary for the customer to understand in view of the customer’s knowledge, experience, financial conditions, and purpose for entering into a contract for financial instruments transaction, in connection with the document to be delivered prior to conclusion of contract, the written statement on listed securities, etc., or the prospectus, etc. (FIBCOO, art. 117, para. 1, item 1).

Over-the-counter transactions of derivatives for individual investors are now subject to provisions concerning the obligation to confirm customer’s intention to accept solicitation and prohibition against repeated solicitation in accordance with the 2010 amendments.

(g) Duty to Explain Under the Financial Instruments Sales Act

At one time, there was no special provision concerning cases in which sufficient
explanation was not given to a customer in connection with financial instruments, and this was only treated as an issue of tort liability under the Civil Code.

On April 1, 2001, however, the Financial Instruments Sales Act came into force, explicitly stipulating that at the time of solicitation of investment in financial instruments such as equities which present a risk of loss on principal, an explanation must be made to that effect as well as of the material matters that would cause the same, and that failure to do so would trigger a liability for damages (Financial Instruments Sales Act, art. 3 through art. 5).

This duty to explain has substantive significance in the providing of correct information to investors concerning the quality and value of the object of a transaction, and thereby providing the investor with a correct basis to form an investment decision, with the accumulation of these investment decisions thereby generating fair price formation.

To the extent of securities under the FIEA, this should not simply be interpreted as a duty pursuant to the principle of good faith under the Civil Code (Civil Code, art. 1, para. 2) but also as being a duty as a bearer of the capital markets.

The duty to explain under the Financial Instruments Sales Act is consists mainly of an explanation of risks, but it is obvious that depending on the circumstances there will be some cases in which an explanation must also be made of the structural nature of the product and the nature of the market.

The Financial Instruments Sales Act was also amended with the enactment of the FIEA, mainly to clarify this perspective.

First, it expanded the matters covered by the duty to explain under this law, in specifically adding “the material portions out of the structure of the transaction” to the matters covered (Financial Instruments Sales Act, art. 3, para. 1, item 1 through 6(c)). In addition, the case in which “a risk exists of a loss in excess of the initial principal” was added as being covered as a separate case from a case “in which a risk exists of loss on principal” (Financial Instruments Sales Act, art. 3, para. 1, item 2, item 4, and item 6). It, then, enacted a standard for determining whether the duty to explain had been satisfied, which included the concept of the principle of suitability, so that the explanation was then required to be according to the method and extent level for the customer to understand, in view of the attributes of the customer (i.e., the knowledge, experience, financial standing on the part of the customer, and the customer’s objective in entering into the agreement in connection with the sale of financial products) (Financial Instruments Sales Act, art. 3, para. 2).

Second, a new clause was enacted to prohibit, *inter alia*, the providing of a conclusive evaluation (Financial Instruments Sales Act, art. 4), and stipulating a liability for damages that would be a direct and strict liability in the event of a violation (Financial Instruments Sales Act, art. 5), and a clause presuming the amount of damages (Financial Instruments Sales Act, art. 5).
Sales Act, art. 6, para. 1).

The clauses concerning the duty to explain and the liability for damages under the Financial Instruments Sales Act do not apply to professional investors and to cases where the customer has manifested his/her intention that the explanation on important matters is unnecessary. However, even if the customer has manifested his/her intention not to require an explanation on important matters, the financial instruments provider, etc. shall not be exempted from performing their duties to explain to the customers in the case of dealing in commodity-related market transactions of derivatives (Financial Instruments Sales Act, art. 3, para. 7).

(h) **Duty to Give Advance Disclosure of Transaction Modes**

When a financial instruments business operator, etc. receives an order from a customer for the sale and purchase of securities or an over-the-counter transactions of derivatives, the business operator must clarify in advance to the customer whether the business operator itself will consummate the sale and purchase or the transaction as a counterparty (a transaction on dealer’s basis) or whether it will undertake the intermediation, brokering or agency with respect thereto (a transaction on broker’s basis) (FIEA, art. 37-2).

This is because if a financial instruments business operator, etc. that performs both broker and dealer functions does not clearly classify transactions into transactions on dealer’s basis and broker’s basis, there is a risk that it will injure the interests of the customer, including by selling securities that the dealer itself holds to the customer without searching for other sellers, and moreover, it goes without saying that financial instruments business operators are naturally responsible to faithfully execute the investment decisions of their customers.

(iv) **Duty to Comply with the Principle of Suitability**

A financial instruments business operator, etc. must engage in activities so that it does not solicit in a manner that is inappropriate in view of the knowledge, experience or financial position on the part of the customer, and objectives of entering into the contract for financial instruments transaction in connection with acts of financial instruments transactions, and so that insufficient protection of investors does not occur (FIEA, art. 40, item 1). This is generally known as the principle of suitability.

Since ensuring investment judgments that match the investor’s knowledge, experience, amount of funds, and investment objectives constitutes a suitable step for the purpose of participating in price formulation in the market, this responsibility is imposed on financial instruments business operators, etc. as the bearers of the market. This principle is characterized by the fact that even if the investor wants to engage in an investment, there are cases where the financial instruments business operator, etc. must say no.

Customers who engage in high risk transactions using funds that are saved for covering living expenses after retirement or borrow money from financial institutions at high interest rates despite the lack of assets available for repayment in order to continue margin transactions, cannot be expected to be able to make a true and reasonable investment
judgment. Consequently, even if the customer wishes to do so, the financial instruments business operator, etc., as a bearer of the responsibility for securing the market functions, shall not accept a transaction of this nature. This is positioned as the legal basis for business improvement orders, but it should be understood as a duty owed to investors.

(v) Duty of Best Execution

A financial instruments business operator, etc. is required to determine a policy and methodology for executing orders that it receives from a customer in connection with trading in securities and the like under the best transaction terms (best execution policy), in the manner prescribed by Cabinet Order (FIEA, art. 40-2, para. 1).

The financial instruments business operator, etc. must publicly disclose its best execution policy (id., para. 2), and orders involving securities transactions must be executed in accordance with the best execution policy (id., para. 3).

If a financial instruments business operator, etc. intends to accept an order from a customer in connection with trade in securities listed on a financial instruments exchange or OTC traded securities, or other transaction as prescribed by Cabinet Order, the financial instruments business operator, etc. must, in advance, deliver to the customer, in a manner as shall be prescribed by Cabinet Office Ordinance, a document stating the financial instruments business operator’s best execution policy, etc., in connection with the said transaction (id., para. 4). If a financial instruments business operator, etc. is requested by a customer within a period of time after the execution of the order as prescribed by Cabinet Office Ordinance, additional documents must be furnished to the customer containing a statement that the order was handled in accordance with the best execution policy as required by Cabinet Office Ordinance (id., para. 5).

The aforementioned documents may be delivered by electronic means (id., para. 6).

(vi) Prohibition of Bucketing

When a financial instruments business operator, etc. accepts entrustment of a commodity-related market transaction of derivatives, etc. (meaning a commodity-related transaction of derivatives, or intermediary, brokerage, or agency service for the entrustment thereof), the financial instruments business operator, etc. shall not close a transaction by becoming the counterparty itself instead of carrying out such commodity-related transaction of derivatives, etc. pertaining to such entrustment (FIEA, art. 40-6).

This provision, which has been introduced to ensure consistency with the prohibition of bucketing provided in Article 212 of the Commodity Futures Act, can be understood as a regulation specific to commodity-related market transactions of derivatives.

(vii) Duty to Establish Operational Control System

A financial instruments business operator, etc. must establish an operational control system for the fair and appropriate performance of its financial instruments business or services of a registered financial institution, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 35-3).

Cabinet Office Ordinance to be enacted will make it obligatory for financial instruments business operators, etc. in general to establish internal rules, etc. as necessary for performing
their business appropriately and take measures to ensure their employees’ compliance with such internal rules by providing training (FIBCOO, art. 70-2, para. 1).

Along with the 2014 amendment of the FIEA, obligations will also be introduced on financial instruments business operators, etc. engaged in the electronic offering handling business, such as taking measures to check the issuers of securities and examine their business plans (FIBCOO, art. 70-2, para. 2).

(viii) Duty to Use Electronic Date Processing System in Over-the-Counter Transactions of Derivatives

In cases where a financial instruments business operator, etc. conducts, in the course of trade, over-the-counter transactions of derivatives which are specified by Cabinet Office Ordinance as those for which the information on the outline of the transaction should be swiftly disclosed to secure fair transactions in light of the transaction volume and other conditions of transactions (referred to as “specified over-the-counter transactions of derivatives”), the financial instruments business operator, etc. must use the electronic information system used by financial instruments business operators, etc. or authorized operators for electronic over-the-counter transactions of derivatives, etc. for business related to over-the-counter transactions of derivatives (FIEA, art. 40-7, para. 1).

In light of the defects found in the market infrastructure for the settlement or clearing of over-the-counter transactions of derivatives such as credit default swaps (CDS) upon the financial crisis in fall 2008, each country is improving its system for the settlement and clearing of over-the-counter transactions of derivatives. In Japan, in order to improve the transparency of the actual conditions of over-the-counter transactions of derivatives, financial instruments business operators, etc. have been required to use an electronic information system for over-the-counter transactions of derivatives pursuant to the amendments in 2012.

Persons who have offered for use an electronic information system must publish the price, volume and other matters necessary to clarify the outline of the transactions pursuant to the provisions of Cabinet Office Ordinance with respect to the specified over-the-counter transactions of derivatives conducted by using the relevant electronic information system (FIEA art. 40-7, para. 2).

(ix) Duty to Comply with Brokerage Contract Rules

If a customer order for a trade, etc. is to be executed on a financial instruments exchange market, the brokerage contract rules prescribed by the financial instruments exchange of which the financial instruments business operator is a member must be followed in connection with accepting the order for the trade, etc. of securities on a financial instruments exchange market (FIEA, art. 133, para. 1).

Agreements in violation of these rules are not permitted, and financial instruments business operators are bound by the brokerage contract rules even if they did not know about them. The brokerage contract rules are not simply self-regulatory rules, they are public rules founded on the FIEA at the very core of the markets and are interpreted as having the same legal effect as quasi-ministerial ordinances. The effect under private law of contracts in violation of the Brokerage Rules should be judged depending on the status each provision
has in the market.

The brokerage contract rules contain detailed provisions concerning the following matters: (i) conditions for accepting entrustment of sales and purchase, etc. of securities; (ii) delivery and the manner of settlement, etc.; (iii) matters concerning the extension of credit in relation to the acceptance of entrustment of sales and purchase of securities; and (iv) in addition to (i) through (iii) above, other necessary matters concerning acceptance of entrustment of sales and purchase, etc. in securities. It is necessary to fully understand the content of the rules when soliciting investments.

Duty of Due Care of Prudent Manager and Duty of Separate Management

Financial instruments business operators, etc. constantly receive securities, deposits of money and other assets from customers accompanying their myriad securities transactions. In this event, a financial instruments business operator, etc. must carry out the administrative work of the securities with the care of a prudent manager on behalf of customers (FIEA, art. 43).

Financial instruments business operators, etc. are supposed to manage securities deposited from customers separately from their own property by a method specified by laws and regulations as a method for managing property in a reliable and orderly manner. However, oftentimes financial instruments business operators, etc. commingled customer margin relating to margin transactions or lending transactions, deposit for lending transactions, customer margins, etc. pertaining to a futures or options transaction, clearing margins or other customer assets with the assets of the financial instruments business operators, etc., giving rise to problems with respect to the securing of the rights of the customer in cases where the financial instruments business operators, etc. became insolvent.

Separate management of customer assets is the duty to keep cash and securities that support the investment decisions of customers in a form that corresponds to the investment decision. It is a duty of financial instruments business operators who are to promote the substance of investment decisions that are sufficient to participate in the formation of fair prices. It should not simply be identified as a duty for the purpose of actions to be taken at the time of a failure of a financial instruments business operator, etc. If separate management is thoroughly carried out, then the problems of a failure on the part of a financial instruments business operator, etc. should not have any impact on the functioning of the capital markets.

Consequently, in order to ensure that customer assets are properly returned without incident, a financial instruments business operator, etc. must manage the securities and cash deposited from customers separately from its own assets (FIEA, art. 43-2, para. 1 and para. 2), and must also place the money to be returned to customers in trust with a trust company in cases where it discontinues the financial instruments business, etc. or other similar circumstances (id., para. 2). Furthermore, a financial instruments business operator must undergo periodic audits by certified public accountants or audit firms regarding the status of separate management (id., para. 3).

Pursuant to the amendments in 2012, financial instruments business operators, etc. have the duty to separately manage the properties deposited from customers and properties that
belong to the customer’s account in relation to the brokerage for commodity-related market transactions of derivatives and incidental transactions thereof (FIEA, art. 43-2-2).

(xii) Collection of Hypothecation (Loan) Consent

Written consent from the customer must be obtained in a manner as prescribed by Cabinet Office Ordinance if a financial instruments business operator, etc. will hypothecate or lend to another person securities that the financial instruments business operator, etc. holds on behalf of a customer, or has received on deposit from a customer (FIEA, art. 43-4, para. 1; FIBCOO, art. 146).

If a financial instruments business operator, etc. will hypothecate or lend to others commodities that the financial instruments business operator, etc. possesses based on the account of a customer, or has accepted deposit from a customer, in relation to the business pertaining to the commodity market transactions of derivatives, written consent from the customer must be obtained (FIEA, art. 43-4, para. 2).

This written consent may be transmitted through electronic means (FIEA, art. 43-4, para. 3 and art. 34-2, para. 12).

(xii) Prohibition Against Loss Compensation

A financial instruments business operator, etc. may not itself or through a third party engage in the following acts regarding trades or other transactions in securities accepted from customers:

i. Loss Guarantee/Yield Guarantee (FIEA, art. 39, para. 1, item 1)
   An act of making an offer or promise to a customer, with regard to sale and purchase or other transactions of securities, etc., to the effect that if the customer incurs any loss or shortfall in the predetermined amount of profit, property benefit will be provided to the customer in order to compensate or make up for the whole or part of such loss or shortfall.

ii. Offering/Promising Loss Compensation (FIEA, art. 39, para. 1, item 2)
   An act of making an offer or promise to a customer, with regard to the sale and purchase or other transaction of securities, etc., to the effect that property benefit will be provided to the customer in order to compensate for the whole or part of a loss incurred by the customer or make an addition to the profit accrued to the customer.

iii. Implementation of Loss Compensation (FIEA, art. 39, para. 1, item 3)
   An act of providing property benefit to a customer, with regard to the sale and purchase or other transaction of securities, etc., in order to compensate for the whole or part of a loss incurred by the customer or make an addition to the profit accrued to the customer.

Guarantees against loss and guarantees of a yield are prohibited since an
investment that can be easily made because a guarantee has been made in advance will impair fair price formation, which is supposed to be attained by accumulating the true and independent investment decisions of investors with respect to the true value of a security.

Although post facto promises for loss compensation or ex post loss compensation do not necessarily hinder the formulation of the price itself since they are performed after the fact, these acts are also prohibited because if financial instruments business operators, etc. that are the bearers of the capital markets do not make the investor live with the results of the market, it would run contrary to their duties as bearers of the market and could cause investors to lose confidence in fair price formulation.

Also, investors being customers who demand and cause a financial instruments business operator, etc. to agree to loss compensation or provision of financial benefits to supplement profit are subject to criminal penalties (FIEA, art. 39, para. 2). It would normally be unthinkable to be adding to profits while compensating for losses after the fact, and most cases of this nature would probably be found to be the execution of a prior guarantee.

The provisions set forth in Article 39, Paragraph 1, will not apply and the acts under (i) and (iii) above will be treated as simply processing an incident, and not loss compensation, in cases where the financial instruments business operator, etc. receives advance confirmation from the Prime Minister that such loss is due to an incident, and other cases prescribed by Cabinet Office Ordinance (FIEA, art. 39, para. 3). Where the confirmation of the Prime Minister is sought, an application stating certain matters and documents necessary to prove the said facts must be submitted to the Prime Minister (FIEA, art. 39, para. 7).

In this regard, an “incident” is defined as (i) “those in which a representative, agent, employee or other worker of the financial instruments business operator, etc. causes a loss to the customer through the performance of the following enumerated acts concerning the operations of the said financial instruments business operator, etc., in connection with a sales and purchase or other transaction of securities, etc.,” or (ii) “those in which a loss is caused to a customer or a holder of rights as a result of the conduct of an act as set forth below, in connection with the investment advisory business or the investment management business” (FIBCOO, art. 118). However, for unfair trading that exceeds the boundaries of a simple incident, the illegality of the act will not be removed by the confirmation. In this manner, the incident confirmation of the Prime Minister is not binding on the decision of a court.

The following acts would be covered in connection with (i) above:

(a) Without confirming the content of the customer’s order, making sales and purchase or other transaction of securities, etc. for the customer’s account;
(b) Making solicitation in a manner that causes the customer to make an erroneous assumption concerning the items enumerated in a. through c. below:
a. Characteristics of the securities, etc.;

b. Conditions of transactions; and

c. Rises or drops, etc. in the price of financial instruments or the amount of consideration for options;

(c) Making a negligent error in the clerical processing when executing the customer’s order;

d) Making an error in executing a customer order because of abnormal functioning of an electronic information system; or

e) Other action in violation of the laws or regulations.

Moreover, the following acts would be covered in connection with (ii) above:

(a) Error in administrative processing as a result of negligence or failure in electronic information system;

(b) Negligence in duty; or

(c) Other legal or regulatory violation or violation of investment advisory contract or contract concerning the delegation of management authority, or other legal act.

In addition, stipulation has been made which lists cases in which confirmation of a securities incident is not required, e.g., those cases where a final judgment by a court has been obtained, or if a settlement has been reached in a court, or if a settlement has been obtained through mediation by the JSDA or a certified investors protection organization, or if a settlement has been obtained through the dispute resolution proceedings of the designated dispute resolution organization (FIBCOO, art. 119 and art. 277).

As a result of the amendments in 2017, the provisions of the FIEA do not apply if the economic benefit has been provided by a Financial Instruments Business Operator, etc. to cover the whole or part of a loss caused to the principal of investment trusts specified by Cabinet Office Ordinance as those of which beneficial interest is acquired or held for the purpose of providing it for paying or receiving money in the sales and purchase of securities or any other transactions between a customer and a Financial Instruments Business Operator, etc. (FIEA, art. 39, para. 4 and para. 6). This new provision has been introduced with the idea of money reserve funds (MRF) which are used for the management of individual investors’ trading funds for the settlement of securities.

(xiii) Duty to Enter into a Contract, Etc. with a Designated Dispute Resolution Organization

A financial instruments business operator, etc. must devise measures for dispute resolution such as entering into a contract, etc. with a designated dispute resolution organization (FIEA, art. 37-7). Financial instruments and services have become diverse and complicated, and in light of the gap between financial institutions and users in terms of matters such as information and knowledge and the capability to resolve problems, it is
necessary to strive for effectiveness in the disposition of complaints and the resolution of disputes. Consequently, financial instruments business operators, etc. must devise the following types of measures.

First, if a designated dispute resolution organization has been established, the financial instruments business operator, etc. is obligated to use the designated dispute resolution organization. If there are multiple designated dispute resolution organizations within the business category, a financial instruments business operator, etc. must enter into a basic agreement for the execution of procedures with at least one of the designated dispute resolution organizations, and the financial instruments business operator, etc. must publicly announce the trade name and firm name of the designated dispute resolution organization that is the other party to the basic agreement for the execution of procedures (FIEA, art. 37-7, para. 2).

Second, if a designated dispute resolution organization is not established/designated, individual financial institutions are called upon to have a standardized approach for the processing of complaints and dispute resolution in order to strive to protect users against financial problems (FIEA, art. 37-7; FIBCOO, art. 115-2).

(xiv) Professional Investor System

(a) Basic Concept

The conduct regulations over dealers under the former SEL were to apply in a uniform manner under their stipulations, regardless of the attributes of the investor. Nevertheless, there are some investors for whom application of the conduct regulations is not necessary in view of, inter alia, their knowledge, experience and financial position, and who moreover do not wish to be covered under these conduct regulations.

The FIEA, therefore, classifies investors into professional investors and general investors, enacts differences in treatment under the conduct regulations of financial instruments business operators, etc. based on this classification, and thereby promotes regulatory flexibility.

Making this categorization enables the achievement of the necessary level of regulation without unneeded restriction of persons who are able to make their own investment decisions, from which it can, consequently, be expected that regulatory efficiency can also be achieved.

Nevertheless, the liberalization of regulations concerning professional investors should not be interpreted as meaning as “there is no need for legal intervention because professional investors do not require protection.” There is a particular emphasis on the responsibility in connection with the fair formation of prices when a market is formed solely from professional investors, and this must not be understood as being a situation in which regulation is not needed.

Persons who are considered to be able to manage risks in an appropriate fashion in connection with financial instruments transactions on the basis of their knowledge, experience and financial position are designated as “professional investors,” and when a business operator engages in transactions with a professional investor, they are excluded
from the conduct regulations that are designed to ameliorate the imbalance in information, including the duty to deliver a document prior to conclusion of contract. The exclusion, however, does not apply to the conduct regulations that are designed to achieve fairness in markets, including the prohibition against compensation for losses.

Even in cases that are excluded from application of the conduct regulations which are prescribed to ameliorate the imbalance in information, this exclusion is to be interpreted as at most a release from the duty to provide the explanation that is to be provided to numerous unspecified investors. It does not constitute a release from the duty to explain, which is imposed at all times on a person who brings financial instruments to the market as a financial instruments business operator. Even if the counterparty is a professional, a failure to make the necessary explanations would at least constitute an unfair transaction, or fraud. It is necessary to be careful in this regard, as it does not mean that the duty to provide direct explanations is rendered unnecessary at all times.

The FIEA lists as professional investors (i) qualified institutional investors, (ii) the government of Japan, (iii) the Bank of Japan, (iv) investors protection funds and other juridical persons as prescribed by Cabinet Office Ordinance (FIEA, art. 2, para. 31).

(b) Classification Between Professional Investors and General Investors

The FIEA has four classifications of professional investors and general investors: (i) professional investors that cannot transfer their status to that of a general investor, (ii) professional investors that can choose to transfer their status to that of a general investor, (iii) general investors that can choose to transfer their status to that of a professional investor, and (iv) general investors that cannot transfer their status to that of a professional investor:

i) Professional investors that cannot transfer their status to that of a general investor

Qualified institutional investors, the government of Japan and the Bank of Japan are professional investors that cannot change their status to general investors. Qualified institutional investors include, *inter alia*, banks, financial instruments business operators, insurance companies, and Shinkin banks, etc. (Definition Ordinance, art. 10).

The scope of qualified institutional investors was expanded with the enactment of the FIEA, and among the requirements for a qualified institutional investor, the requirement for a company to submit an annual securities report was eliminated, and the securities balance criteria was reduced from JPY10 billion to JPY1 billion. Moreover, new categories of qualified institutional investors were created consisting of corporations in the event of a securities balance of at least JPY1 billion, an individual that has a securities balance of at least JPY1 billion and who has had an account with a financial instruments business operator, etc. for at least one year, and a corporation or individual, etc. that is an executive partner, etc. which has obtained consent from all partners, etc., and for which the securities balance in connection with the contract is at least JPY1 billion. All of these are covered by the system of notification to the Prime Minister. The effective period of a notification in connection with a qualified institutional investor is two years.
ii) Professional investors that can choose to transfer their status to that of a general investor

Investors protection funds and other juridical persons as prescribed by Cabinet Office Ordinance among professional investors may have their status deemed as being that of a general investor if they apply to the financial instruments business operator, etc. to be treated as a customer other than a professional investor (i.e., a general investor) and taking the necessary procedures (FIEA, art. 34-2). Government affiliated institutions, investors protection funds, the Deposit Insurance Corporation of Japan, foreign corporations, listed companies, and stock companies expected to have at least JPY500 million in capitalization, etc. are prescribed as professional investors that can choose to transfer their status to that of a general investor (Definition Ordinance, art. 23).

Under the amendments in 2010, local governments have been re-categorized from “investors that can choose to transfer their status to that of a general investor” to “investors that can choose to transfer their status to that of a professional investor” (to be enforced as of April 1, 2011). Furthermore, the amendments in 2013 limited the cases where an employees’ pension fund may change its status to a professional investor, and only employees’ pension funds that have set up the necessary management systems are now able to be professional investors.

iii) General investors that can transfer their status to that of a professional investor

A juridical person other than a professional investor (FIEA, art. 34-3, para. 1), as well as an individual, etc. that meets certain requirements as being a person who is equivalent to a professional investor in view of the knowledge, experience, and financial position of that individual, etc. (FIEA, art. 34-4, para. 1) may have their status treated as that of a professional investor by applying to the financial instruments business operator, etc. to be treated as a professional investor, and taking the necessary procedures.

The following requirements exist in order for an individual to transfer his or her status to that of a professional investor. If the individual is the operator of an anonymous partnership, or is an executive partner of a civil code partnership, or is a partner in a limited liability partnership (limited to a partner that contributes to decisions on material execution of business, and who himself or herself executes the said business), (i) that the partner has obtained the consent of all partners in connection with the transfer of status to that of a professional investor, and (ii) that the total amount invested in the partnership agreement is at least JPY300 million (FIBCOO, art. 61, para. 2).

Other individuals must satisfy the following three requirements (FIBCOO, art. 62):

i. That the total amount of net assets of the applicant as of the date of acceptance can be reasonably judged from the conditions of transactions or other circumstances to be expected to be JPY300 million or more;

ii. That the total amount of the financial assets that the applicant can invest as of the date of acceptance can be reasonably judged from the conditions of
transactions or other circumstances to be expected to be JPY300 million or more; and

iii. That at least one year has passed from the day on which the applicant concluded with the business operator the first contract for financial instruments transaction that is of the type of a contract pertaining to the application.

iv) General investors that cannot transfer their status to that of a professional investor

Individuals who do not fall under any of i) through iii) above are classified as general investors that cannot change their status to that of a professional investor.

(c) Application of Conduct Regulations When the Counterparty Is a Professional Investor

A professional investor is a person who is believed on the basis of that person’s knowledge, experience and financial position to be able to carry out proper management of risks in association with financial instruments transactions, and consequently, the conduct regulations which are for the purpose of ameliorating the imbalance of information between a dealer and a customer are excluded from application, with the exception of regulations that are for the purpose of achieving fairness in markets, such as the prohibition against compensation for losses, thereby liberalizing the regulatory system (FIEA, art. 45).

In particular, the following conduct regulations are excluded from application:

i) When a financial instruments business operator, etc. carries out solicitation to enter into a contract for financial instruments transaction, and the counterparty to the solicitation is a professional investor— the regulations on advertising (FIEA, art. 37), the prohibition against uninvited solicitation (FIEA, art. 38, item 4), duty to confirm intention to receive solicitation (FIEA, art. 38, item 5), prohibition against repeated solicitation (FIEA, art. 38, item 6), and the principle of suitability (FIEA, art. 40, item 1);

ii) When a financial instruments business operator, etc. has received a request to enter into a contract or has concluded a contract for financial instruments transactions, and the counterparty to the contract is a professional investor—the duty of prior explanation of the transaction structure (FIEA, art. 37-2), the duty to deliver a document prior to conclusion of contract (FIEA, art. 37-3), the duty to deliver a document upon conclusion of contract (FIEA, art. 37-4), the duty to deliver a written statement upon receipt of deposits (FIEA, art. 37-5), written cancellation (FIEA, art. 37-6), the duty of prior delivery of a written statement on the best execution policy, etc. (FIEA, art. 40-2, para. 4), and the restrictions on acts of hypothecation, etc. of the securities of customers (FIEA, art. 43-4);

iii) When a financial instruments business operator, etc. has entered into

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an investment advisory contract, and the counterparty is a professional investor—the prohibition against accepting deposits of cash and securities, etc. (FIEA, art. 41-4), and the prohibition against lending cash and securities, etc. (FIEA, art. 41-5); and

iv) When a financial instruments business operator, etc. has entered into a discretionary investment contract, and the counterparty is a professional investor—the prohibition against accepting deposits of cash and securities, etc. (FIEA, art. 42-5), the prohibition against lending of cash or securities (FIEA, art. 42-6), and the duty to deliver investment reports (FIEA, art. 42-7).

As stated below, the exclusion from application does not apply to cases prescribed by Cabinet Office Ordinance as presenting the risk of compromise of the protection of investors or the public interest (FIEA, art. 45, proviso).

For example, the exemption from application of the duty to deliver a document upon conclusion of contract (FIEA, art. 37-4), and the duty to deliver investment reports (FIEA, art. 42-7) will not apply if a system is not in place so that a prompt response can be made to an inquiry from a customer concerning an individual transaction (FIEA, art. 45, proviso; FIBCOO, art. 156).

Moreover, although the principle of suitability (FIEA, art. 40, item 1) does not apply when soliciting professional investors for a transaction, it will apply in the event of a general customer that intends to elect to transfer its status to that of a professional investor. By way of example, a financial instruments business operator, etc. would be in violation of this principle if it encourages a customer to elect to transfer its status to that of a professional investor when the customer is not suited to be a professional investor in terms of its knowledge, experience, financial position or objectives.

In addition, the conduct regulations for the purpose of assuring the fairness of market, and the fundamental duty of a consignee, apply without change regardless of whether the counterparty to the transaction with a financial instruments business operator, etc. is a general investor or a professional investor. By way of elaboration, the following conduct regulations apply:

i) With respect to all business activities—the duty of good faith and fairness to customers (FIEA, art. 36), the posting of signs (FIEA, art. 36-2), the prohibition against lending of name (FIEA, art. 36-3), and the prohibition against management of bonds, etc. (FIEA, art. 36-4);

ii) With respect to sales and solicitation, etc.—the prohibition against giving false information (FIEA, art. 38, item 1), the prohibition against providing a conclusive evaluation, etc. (FIEA, art. 38, item 2), the prohibition against compensation for loss, etc. (FIEA, art. 39), the proper handling of customer information (FIEA, art. 40, item 2), the
prohibition against trading, etc., without ensuring separate management (FIEA, art. 40-3), and prohibition of public offering, etc. where money has been diverted (FIEA, art. 40-3-2);

iii) With respect to investment advisory business—the duty of loyalty to customers (FIEA, art. 41, para. 1), the duty of care as a prudent manager (FIEA, art. 41, para. 2), the prohibited acts (FIEA, art. 41-2), and the prohibition against trading of securities, etc. (FIEA, art. 41-3); and

iv) With respect to the investment management business—the duty of loyalty to customers (FIEA, art. 42, para. 1), the duty of care as a prudent manager (FIEA, art. 42, para. 2), the prohibited acts (FIEA, art. 42-2), the delegation of management authority (FIEA, art. 42-3), and separate management (FIEA, art. 42-4).

(d) Procedures for a Professional Investor to Receive Treatment as a General Investor

If a professional investor wishes to elect to transfer its status to that of a general investor, the professional investor must first notify the financial instruments business operator, etc. that is the counterparty to the transaction, for each type of contract that the professional investor desires to be treated as a general investor (FIEA, art. 34-2, para. 1). If a financial instruments business operator, etc. has not entered into a contract with that professional investor in the past that is of the same type as the relevant contract for financial instruments transaction, the financial instruments business operator, etc. must inform the professional investor in advance that a request of this nature can be made (FIEA, art. 34).

The types of agreements consist of four classifications (i) agreements to engage in transactions, etc. in securities, (ii) agreements to engage in derivatives transactions, etc., (iii) investment advisory contracts and agreements to engage in agency and intermediation in the execution thereof, and (iv) discretionary investment contracts and agreements to engage in agency and intermediation in the execution thereof (FIBCOO, art. 53).

A financial instruments business operator, etc. that has received a notification of this nature must, in principle, accept this notification before the time of either conducting solicitation for conclusion of or concluding a contract for financial instruments transaction that is of the type of the contract for which the notification has been made (FIEA, art. 34-2, para. 2). If the financial instruments business operator, etc. has accepted a notification of this nature, it must deliver to the notifying party a document stating the date of acceptance, the type of contracts, and other necessary matters (id., para. 3 and para. 4; FIBCOO, art. 55).

If a professional investor has transferred its status to that of a general investor, the effect of the transfer is valid until the customer gives notice of return to professional investor status. Also, if the customer returns to professional investor status, the financial instruments business operator, etc. must obtain written consent from the customer so that
this can be clearly confirmed (FIEA, art. 34-2, para. 11; FIBCOO, art. 57-2). It is possible
to obtain this consent by electromagnetic method (FIEA, art. 34-2, para. 12; FIBCOO, art.
57-3).

(e) Procedures for a General Investor to Receive Treatment as a Professional
Investor

If a general investor wishes to elect to transfer its status to that of a professional
investor, the general investor must first notify the financial instruments business operator,
etc. that is the counterparty to the transaction, for each type of contract, that the general
investor desires to be treated as a professional investor (FIEA, art. 34-3, para. 1; FIEA, art.
34-4, para. 1).

If an individual investor has given notice that he or she wishes to elect to transfer his
or her status to that of a professional investor, the financial instruments business operator,
etc. that has received this notice must deliver a written statement stating the content of the
special exceptions in connection with applying the conduct regulations to professional
investors, as well as the risks associated with the transfer (i.e., that there is a risk of
insufficient protection if a person who is not appropriate in view of his or her knowledge,
experience or financial position becomes a professional investor), and must further confirm
that the notifying party satisfies the requirements for voluntary transfer of status to that of
a professional investor (FIEA, art. 34-4, para. 2 and para. 3).

If a financial instruments business operator, etc. will accept a notice from a general
investor, the financial instruments business operator, etc. must in advance obtain consent
from the notifying party, by means of a written statement which in addition to the date of
acceptance, the expiration date and the type of contracts, also confirms that the notifying
party understands the content of the special exceptions in connection with applying the
conduct regulations to professional investors, as well as the risks associated with the
transfer (i.e., that there is a risk of insufficient protection if a person who is not appropriate
in view of his or her knowledge, experience or financial experience becomes a
professional investor) (FIEA, art. 34-3, para. 2 and para. 34-4, para. 4; FIBCOO, art. 59).

Under the amendments in 2009, “the effect that the notifying party may give notification
pursuant to the provisions of the FIEA, Article 34-3, Paragraph 9 at any time on or after
the date of acceptance” has been added to the matters to be stated in such document
(FIBCOO, art. 59, para. 2, item 5).

Although a transfer from general investor to professional investor status is valid for
one year, by making a request it is possible to return to general investor status even before
one year has elapsed (FIEA, art. 34-3, para. 9 and art. 34-4, para. 4). Further, while it is
possible to renew professional investor status even before the validity of the transfer to
professional investor expires, from the standpoint of investor protection, the request for
renewal cannot be made unless it is within a certain fixed period of time before the
expiration date (no more than 1 month before the expiration date) (FIEA, art. 34-3, para. 7
and art. 34-4, para. 6; FIBCOO, art. 60 and art. 64-2).
Conduct Regulations Concerning Type of Business and Condition of Business Activities

(i) Prohibition Against Lending of Name

A financial instruments business operator, etc. must not allow another person to conduct the financial instruments business under the name of the financial instruments business operator, etc. (FIEA, art. 36-3).

The reason for prohibiting the lending of name is to prevent a person who has not obtained registration from borrowing the name of a person who has obtained registration, and conducting the financial instruments business.

(ii) Prohibition Against Becoming a Bond Manager

A financial instruments business operator that engages in the securities-related business is not permitted to become a bond manager or trustee under a secured bond trust indenture (FIEA, art. 36-4, para. 1).

The reason for this is that these acts are for the purpose of protecting the interests of bond-holders, and are acts that are not compatible with the neutral position of a financial instruments business operator that engages in the securities business, as a bearer of the capital markets.

These financial instruments business operators, however, are allowed to serve as an underwriter (FIEA, art. 36-4, para. 2).

(iii) Prohibition Against Churning, Etc.

A financial instruments business operator, etc. must not frequently conduct the purchase and sale or any other transaction of securities or derivative transactions, etc. (excluding brokerage for clearing of securities, etc.) on the customer’s account, without confirming the contents of the customer’s order in advance (FIEA, art. 40, item 2; FIBCOO, art. 123, para. 1, item 1).

Financial instruments business operators, etc. accept orders for securities trading, etc. from customers and carry them out; however, for orders placed orally or over the phone, there are instances where problems later arise between the financial instruments business operator, etc. and the customer as to whether the order was based on the intent of the customer. This is especially true in the case of churning, where several revolving trades, etc. are conducted without taking into account the intentions of the customer. This type of activity is particularly contrary to investor protection and can harm the fairness of the market. Thus, there is a prohibition on conducting frequent trades, etc., without confirming the order from the customer in advance.

(iv) Prohibition Against Excessive Underwriting Competition

A financial instruments business operator, etc. is prohibited from underwriting securities at a volume, price or other terms and conditions deemed grossly inappropriate in order to maintain its own business status or give it an advantage with respect to underwriting (FIEA,
Acts of this nature are likely to distort underwriting conditions, and as a consequence distort primary markets, making it necessary to prohibit this type of behavior.

Conduct of this type of behavior presents the possibility that investors will buy equities at an inflated price, and then incur damage when stock prices fall drastically because of this distorted relationship between supply and demand.

(v) Preventing of Confusion with Financial Institution

If the principal office or other business office or office of a financial instruments business operator conducts activities in the same building as the principal office or other business office or office of a financial institution, the financial instruments business operator must take appropriate steps so that customers do not confuse the financial instruments business operator with the financial institution (FIEA, art. 40, item 2; FIBCOO, art. 123, para. 1, item 22).

(vi) Prohibition Against Extending Credit by Underwriter

In cases where a financial instruments business operator sells securities that it underwrote (in the case of a financial instruments business operator who is to acquire and exercise a share option upon a commitment-based rights offering, the securities that it is to acquire by exercising the share option), it must not make a loan of the purchase price to the purchaser of such securities until six months have passed since the underwriting date (FIEA, art. 44-4).

The intent behind this prohibition is to prevent the financial instruments business operator from shifting the risks traditionally borne by it to the customer by extending credit to potential purchasers of shares acquired by the financial instruments business operator as an underwriter, thereby facilitating the acquisition of the securities.

The risk of unsold securities underwritten must be a risk that is based on the competitive principles of the capital market. If the underwriter grants credit, this can easily lead to avoiding of the underwriting risk, thereby distorting the primary market.

Consequently, this regulation has been enacted in order to assure the integrity of the primary market.

(4) Conduct Regulations on Investment Solicitation and Acceptance of Entrustment

(i) Restrictions on Bunched Orders

A financial instruments business operator, etc. must not make an acceptance of entrustment, etc. of the purchase and sale of securities or derivative transactions from a person having been entrusted with the purchase and sale of the securities or derivative transactions through the solicitation of unspecified and many investors (excluding a person
conducting acts of financial instruments transaction in compliance with the laws and regulations), knowing that such transactions are to be conducted on such investors’ accounts, and without confirming such investors’ intentions in advance (FIEA, art. 40, item 2; FIBCOO, art. 123, para. 1, item 2).

There have been cases of orders received from investment advisors or an investment group which receives a delegation from numerous and unspecified investors and issues bunched orders for trading or other transactions, in which determining whether the orders actually reflected the intentions of each of the investors has become a problem at a later date. Therefore, upon accepting an order from such investment groups, financial instruments business operators, etc. are required to confirm in advance the intent of each of the investors.

(ii) Prohibition Against Solicitations by Offering a Conclusive Evaluation

Since the price of stock fluctuates in response to a variety of factors, it is impossible to accurately predict future price movements. Consequently, financial instruments business operators, etc. are prohibited from undertaking solicitations by offering a conclusive evaluation such as “buy this stock because its price is going to rise to X” or “sell this stock since it is absolutely going to fall in price” which would cause a customer to harbor strong expectations (FIEA, art. 38, item 2).

Providing conclusive evaluations concerning dividends or new share issues that have not been confirmed similarly fall within this prohibition on solicitations.

The rationale behind the rule prohibiting these types of actions is that they cause distortions in price formulation in the markets, and customers who give credence to such statements may incur unexpected losses. Note that such solicitations do not become legal because they turn out to be correct. The issue is whether they distort the formation of the investment decision.

In addition, it must be remembered that a conclusive evaluation does not have to specify a price or price range to which the security will rise or fall or pinpoint an exact date, and even opinions that do not use words like “definitely” or “for sure” can still be found to constitute a conclusive evaluation.

A business operator who gives conclusive evaluation is held to be liable under the Financial Instruments Sales Act to compensate the customer for damages that the customer incurs thereby (Financial Instruments Sales Act, art. 4 and art. 5). In this case as well, the amount of loss on principal is presumed to be the damage incurred by the customer, and the liability of the business operator is held to be strict liability.

(iii) Prohibition Against Acts of False Notification, Etc.

(a) Prohibition Against False Notification

It is prohibited for financial instruments business operators, etc. or an officer or employee thereof to make false notification in connection with entering into a contract for financial instruments transaction or soliciting of the same (FIEA, art. 38, item 1).
(b) **Prohibition Against False Representation**

Financial instruments business operators, etc. or an officer or employee thereof, in connection with the conclusion of a contract for financial instruments transactions or solicitation thereof, must not make false statements or statements that cause a misunderstanding regarding the material matters that could exert a significant influence on the investment decision of the investor (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 2).

This applies even if no “solicitation” takes place. Statements can be made by any medium, including orally, in writing, through graphics, broadcast, or film. “Misleading statements” means not only expressions that are affirmatively misleading, but also includes omissions of necessary representation.

Since this provision prohibits the statement itself, it does not distinguish between intentional or negligent statements.

(iv) **Duty to Explain When Using an Unregistered Credit Rating Agency**

If a credit rating was given by a person who conducts credit rating services other than a credit rating agency, a financial instruments business operator, etc. or an officer or employee thereof must not provide the credit rating to a customer and solicit the execution of a contract for financial instruments transaction without informing the customer that the person who gave the relevant credit rating is not a person who has been registered under Article 66-27 of the FIEA and the significance of the relevant registration, as well as other matters provided by Cabinet Ordinance (FIEA, art. 38, item 3; FIBCOO, art. 116-3).

Since credit ratings by unregistered businesses have not gone through a ratings process under a regulatory framework, and since no information disclosure obligation is imposed concerning the method and premises for the credit rating, there is a risk that it could distort the investor’s investment decisions if this kind of credit rating is provided to an investor without making its characteristics clear.

The Cabinet Office Ordinance provides as matters to be notified (i) significance of the registration under Article 66-27 of the FIEA, (ii) (a) the trade name, firm name or individual name of the party giving the credit rating, (b) if a juridical person (including an unincorporated group with a provision on the representative or administrator), the individual name or firm name of officers (in the case of an unincorporated group with a provision on the representative or administrator, the representative or administrator), and (c) the name of the principal office, other main business office or office and location thereof, (iii) the outline of the credit rating policies and manners used by the person giving the credit rating, and (iv) the premises, significance and limitations of credit ratings (FIBCOO, art. 116-3, para. 1).

Furthermore, notwithstanding the above, starting January 1, 2011, the following matters must be explained with respect to a credit rating given by an affiliate of a credit rating agency.
that is designated by the Commissioner of the Financial Services Agency for a fixed duration in consideration of the contents and manner of the credit rating services by such affiliate of the credit rating agency, status of disclosure of information regarding credit rating and other circumstances (hereinafter referred to as the “specified affiliate”) (id., para. 2):

(i) The effect that the person giving the credit rating is not registered under Article 66-27 of the FIEA;
(ii) Significance of the registration under Article 66-27 of the FIEA;
(iii) Trade name or firm name and registration number of the credit rating agency;
(iv) Name used by the special affiliate to indicate the credit rating services;
(v) Outline of the credit rating policies and manners used by the special affiliate giving the credit rating or the method of obtaining information regarding such outline from the credit rating agency; and
(vi) Premises, significance and limitations of credit ratings.

In addition, credit ratings, etc. targeting the evaluation of the credit conditions of the underlying assets of asset securitization products, etc. is provided as credit ratings which are unlikely to undermine investor protection (FIBCOO, art. 116-2).

(v) Prohibition Against Solicitation by Offering Special Profits

A financial instruments business operator, etc. or an officer or employee thereof must not solicit for contract for financial instruments transactions that promise to provide special profits to a customer or to a person designated by a customer, or to provide special profits to a customer or a third party (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 3).

Since the profits provided are limited to those that are special or extraordinary, this does not include services that are generally accepted as a matter of social custom. Thus, special contracts for the preferential allotment of publicly offered shares or the sale of securities at an unreasonably low price might fall under special profits.

Such acts are prohibited because as investment decisions that are unrelated to the quality and value of the investment target, and which are motivated by the provision of these profits, impair fair price formulation on capital markets.

(vi) Prohibition Against Blanket Recommendations

A financial instruments business operator, etc. or an officer or employee thereof must not commit any act of soliciting unspecified many customers in relation to purchase or sale of a specified and small number of issues of securities or the entrustment thereof, simultaneously and in an excessively aggressive manner, continuously over a certain period, as this is likely to prejudice formation of a fair price (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 17).
This is because encouraging customers to make concentrated purchases of a certain issue presents the risk that the price of a stock could be influenced by the sales policies of the financial instruments business operator, etc., and moreover there is a strong risk that such activities could be used to manipulate stock prices, or that customers will be subjected to high-pressure solicitations that ignore the customer’s financial resources.

There is a particularly strict prohibition against blanket recommendations where the solicitations are for securities presently held by such financial instruments business operator, etc.

It is possible that these acts themselves could be classified as market manipulation.

(vii) Prohibition Against Accepting Orders for Insider Trading

A financial instruments business operator, etc. or an officer or employee thereof must not become the counterparty to a trade or accept the entrustment, etc. of a transaction with a customer, with knowledge that the said transaction is or may be an insider transaction (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 13).

This provision is for the purpose of clarifying that as a bearer of the markets a financial instruments business operator, etc. may not, inter alia, accept entrustment of acts that are disruptive to the markets.

A financial instruments business operator, etc. has a fundamental duty to contribute to the formation of investment decisions that create fair market prices on capital markets, and to prevent investment decisions that disrupt fair price formation from participating in the formation of prices.

Acts such as knowingly accepting entrustment that is for the purpose of price manipulation are prohibited in this same spirit.

Administrative actions may be taken against a violation of this provision, and it is also possible that criminal liability will be sought as abetting insider trading.

(viii) Prohibition Against Soliciting by Providing Confidential Corporate Information

A financial instruments business operator, etc. or an officer or employee thereof must not carry out investment solicitation to a customer by providing confidential corporate information of an issuer of securities in connection with the trading or other transaction, etc. in the securities (FIEA, art. 38, item 9; FIBCOO, art. 1, para. 4, item 14 and art. 117, para. 1, item 14).

Acts of this nature constitute acts of solicitation by offering special profits, and moreover, have the significance of increasing the probability of insider trading or of abetting insider trading as an act of diffusing material confidential corporate information. Consequently, this provision has been enacted in order to call for particular...
(ix) Prohibition Against Excessive Solicitation in Order to Gain Profits on the Part of the Business Operator Itself or Other Customers

A financial instruments business operator, etc. or an officer or employee thereof must not commit any act of soliciting many and unspecified customers to purchase or to sell securities, or to engage in market transactions of derivatives, or to consign, etc. the same, over a certain period of time and in a concentrated or excessive manner, for the purpose of profits for its own account or that of a third party other than the relevant customer by fluctuations in the prices, indexes, values or consideration based on a transaction with the relevant customer (FIEA, art. 38, item 9; and FIBCOO, art. 117, para. 1, item 18).

This includes having acts of solicitation carried out by a registered financial institution that carries out the entrustment of the financial instruments intermediary service, or a financial instruments intermediary service provider.

(x) Prohibition Against Provision of Unjustifiable Calculation Basis Data

A financial instruments business operator, etc. or an officer or employee thereof must not provide a specified financial indicator calculation agent (for details, see “11. Regulations on Specified Financial Indicator Calculation Agents”) with calculation basis data (meaning the price, indicator, figure, or any other information provided to the specified financial indicator calculation agent as the basis for calculation of specified financial indicators) that is not supported by any justifiable grounds, with a view to benefiting itself or a third party (FIEA, art. 38, item 7).

Financial indicators play an important role in financial and capital markets as they are used for the calculation of the interest rate for loans and the amount payable in derivatives transactions. Financial instruments business operators, etc. that are engaged in derivatives transactions involving such financial indicators are considered to be rather easily motivated to provide calculation basis data that is not supported by any justifiable grounds, in an attempt to manipulate figures of financial indicators and thereby earn unjust profit. To prevent such conduct, the present regulation was introduced by way of the amendment to the FIEA in 2014.

(xi) Regulations on Fund Distributers

A financial instruments business operator, etc. must not solicit customers to invest in a fund for which separate management of assets is not ensured under its rules (FIEA, art. 40-3). If separate management is not ensured, the fund management companies might misappropriate the money invested by customers, thus posing the risk of harming investors’ interests.

The 2014 amendment to the FIEA further tightened regulations, providing that financial instruments business operators, etc. must not handle public offering of interests in a fund, knowing that the money invested in the fund is not appropriated for the intended purpose (FIEA, art. 40-3-2).

This provision assumes the case where a type II financial instruments business operator,
etc. handles public offering of interests in a collective investment scheme.

(xii) Conduct Regulations Concerning Commodity-Related Market Transactions of Derivatives

A financial instrument business operator, etc. must not conduct the following acts in connection with commodity-related market transactions of derivatives.

(a) With regard to accepting entrustment, etc. from a customer to conduct a commodity-related market transaction of derivatives, recommending the customer (excluding professional investors) to make the volume and maturity of the sale or purchase in the commodity-related market transaction of derivatives or any similar transaction conducted by the customer exactly match the volume and maturity of a transaction that would offset such transaction (which means a transaction that would reduce the losses arising from such transaction) (prohibition of recommendation for cross order) (FIBCOO, art. 117, para. 1, item 35).

(b) Accepting entrustment, etc. of a transaction that would offset (that is, a transaction that would reduce the losses arising from) the sale or purchase in the commodity-related market transaction of derivatives or any similar transaction and that has a volume or maturity different from such transaction from a customer who does not understand the details of such transaction (prohibition of being entrusted, etc. with a transaction similar to cross order) (FIBCOO, art. 117, para. 1, item 36).

(c) Accepting entrustment, etc. from a customer to conduct a commodity-related market transaction of derivatives and intentionally having the transaction under its own account offset with the transaction pertaining to such entrustment, etc., thereby carrying out a transaction harmful to the interest of the customer (prohibition of mukaigyoku) (FIBCOO, art. 117, para. 1, item 37).

(d) When seeking to accept entrustment, etc. of a commodity-related market transaction of derivatives from a customer, accepting the said entrustment, etc., without explaining the following matters to the customer in advance, despite the fact that the financial instruments business operator, etc. engages intentionally in a transaction with regard to the same commodity or commodity-related financial indicator and for the same maturity as the transaction entrusted, etc. by the customer, with a view to having a transaction on its own account offset with the customer’s transaction (referred to as a “specified transaction” in a. and b. below) (duty to explain for sagyoku-mukai) (FIBCOO, art. 117, para. 1, item 38).

a. the fact that the financial instruments business operator, etc. engages in the specified transaction; and
b. when the transaction entrusted etc., by the customer and the transaction on the account of the financial instruments business operator, etc. are offset with each other via the specified transaction, the possibility that a conflict in interests could arise between the customer who has entrusted, etc. the transaction and the financial instruments business operator, etc.

These acts have a risk of causing a conflict in interests between financial instruments
business operators, etc. and customers and thereby causing a huge loss to customers, and therefore they are prohibited under the FIEA in the same manner as under the Financial Futures Act.

(xiii) **Prohibition Against Accepting Orders for High Speed Trading from Unregistered Persons, Etc.**

It is prohibited for a financial instruments business operator, etc. or an officer or employee thereof to engage in accepting consignment of a purchase and sale of securities or a market derivatives transaction pertaining to High Speed Trading conducted by a person other than a High Speed Trader, and engage in other acts specified by Cabinet Office Ordinance as being equivalent to them (FIEA, art. 38, item 8, and art. 60-13; FIEAEO, art. 16-4-2).

The 2017 amendments of the FIEA introduced regulations on High Speed Traders in view of the need to ensure effective regulatory control over persons engaging in High Speed Trading, who may be foreign corporations or individuals domiciling in foreign countries as well.

Under the Cabinet Office Ordinance, a High Speed Trader which has received an order for suspension of business pertaining to High Speed Trading and a High Speed Trader which cannot be confirmed to have implemented the measures for securing sufficient management of an electronic data processing system and other facilities for High Speed Trading are prohibited from accepting the entrustment of the High Speed Trading (FIBCOO, art. 116-4 and art. 230-3)

(5) **Acts of Market Abuse Relating to Distortion of Market Prices**

(i) **Prohibition Against Front Running**

When a buy (or sell) order for securities is received from a customer, the financial instruments business operator is prohibited from making, before consummating the trade, etc. related to the relevant order, etc., purchases (or sales), etc., for its own account of the same issue as the security ordered by the customer in order to consummate a trade at the same price or a more advantageous price than the price related to the relevant customer’s order, etc. (a price lower than the customer’s price in the case of a purchase [a price higher than the customer’s price in the case of a sale]). Such conduct constitutes the improper use of trading information and is prohibited as violating the duty of good faith and fairness towards the customer since it increases the cost of executing the trades of the customer (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 10).

Front running does constitute a violation of the duty of good faith and fairness to customers, since the customer orders will be executed at an inflated price. Nevertheless, it is difficult for a customer to prove each case of violation of the duty of good faith and fairness. For this reason the objective facts themselves of front running have been made illegal.

It is also possible to evaluate this act as constituting a violation of the duty of a
financial instruments business operator, etc. to execute customer trading orders without fail on a competitive market. A financial instruments business operator, etc. is not permitted to execute customer orders on a market that it has distorted itself.

Moreover, it is also possible to view acts of this nature as being an act similar to insider trading, which uses large orders of customers and undermines the formation of prices on the market.

(ii) Prohibition Against Trading Without Customer’s Consent

A financial instruments business operator, etc. or an officer or employee thereof may not make trades of securities on a customer account without obtaining the consent of the customer in advance (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 11).

If a financial instruments business operator, etc. makes a trade on a customer’s account without an order from the customer, then even without reference to the FIEA this would be invalid as an unauthorized trade under private law, and would also be a core violation under the FIEA, as a violation in the form of providing the market with a fictitious investment judgment.

In addition, from the perspective of an ongoing transaction relationship with a customer, the conduct of trades without confirming the intention of customers presents the possibility of a subsequent dispute as to whether in fact an entrustment was made.

An act of making a purchase and subsequently obtaining the approval of the customer would constitute an act that obstructs the market unless it complies with the true intention of the investors, and there is a major risk of this encouraging mere generation of commissions.

(iii) Restrictions on Principal (or Proprietary) Transactions and Excessive Volume Transactions

By effectuating trades or other transactions as a principal, or by engaging in transactions of an excessive volume, a financial instruments business operator, etc. who performs both dealer and broker functions can magnify price fluctuations on financial instruments exchange markets or over-the-counter securities markets, presenting the risk of disrupting the order of the markets, and also encouraging financial instruments business operators to give priority to their own proprietary transactions by mixing customer transactions with their proprietary transactions.

Consequently, if a financial instruments business operator will engage in trading of securities or securities transactions pursuant to a discretionary trading agreement, etc., the financial instruments business operator must not conduct acts which are of a quantity that are found to be excessive in view of the intent of the delegation or the amount of the contract and can be found to be disruptive to the discipline of, inter alia, the financial instruments exchange markets (FIEA, art. 161; Securities Transaction Ordinance, art. 9, Definition Ordinance, art. 16, para. 1, item 8(a) and (b); FIBCOO, art. 123, item 13(b) through (e)).
(iv) Insufficient Management of Confidential Corporate Information

A financial instruments business operator, etc. must conduct its business so that the management of confidential corporate information that it handles (FIBCOO, art. 1, para. 4, item 14) or the management of trades or other transactions, etc. in securities by a customer does not fall into a state in which it can be found that it has not devised measures that are necessary and appropriate in order to strive to prevent unfair transactions in connection with confidential corporate information (FIEA, art. 40, item 2; FIBCOO, art. 123, para. 1, item 5).

Confidential corporate information may incite insider trading by the financial instruments business operator, etc. itself, or incite customer trading using confidential corporate information, or may at times mean the providing of insider trading information by the customer.

Solicitation by providing confidential corporate information is separately prohibited, and this regulation covers insufficient management of confidential corporate information in and of itself.

(v) Prohibition Against Creating an Artificial Market, Etc.

Market manipulation and other harmful practices are prohibited since fair price formation is the ultimate goal of market regulation (FIEA, art. 159). In many cases, however, manipulation is difficult to prove, and consequently, the FIEA also prohibits a financial instruments business operator, etc. or its officers or employees from acts of accepting entrustment of sales and purchase or other transactions in a specific issue of stock or securities with knowledge that the completion thereof will cause the creation of an artificial market not reflective of actual market conditions irrespective of subjective purpose (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 20).

Furthermore, “with knowledge that…will cause the creation of an artificial market not reflective of actual market conditions” is determined using an objective standard taking into account the surrounding circumstances, such as the timing of the acceptance, volume, status and identification of the person placing the order, etc.

Since the acceptance of entrustment of market manipulation itself is prohibited (FIEA, art. 159), the market manipulation provisions may also apply to such acts; however, the current provision allows an administrative action without having to wait for the court decision.

It must not be understood that “the creation of an artificial market constitutes the regulation that is the basis for administrative action and is not an act that does not constitute market manipulation.”

(vi) Prohibition Against Dual Trading in Margin Transaction

Under the current margin transaction system, financial instruments business operators executing a customer margin transaction on the market are responsible for procuring the cash
or shares necessary to settle the trade. However, if the financial instruments business operator could offset the buy order of one customer with the sell order of another customer for the same issue, it could simply make up the remaining difference. It is also theoretically possible that the financial instruments business operator could become counterparty to the transaction and accomplish the same result by filing the order with its own inventory.

For example, suppose a financial instruments business operator agrees to handle a margin buy for a customer in a certain stock, and establishes the trade by offsetting it with its own margin sell. Later, when the customer directs the financial instruments business operator to sell in order to close out its position, if the financial instruments business operator offsets the sell order with its own margin buy, the financial instruments business operator will be able to settle the transaction without any cash or shares. However, in such cases, if the customer profits from a rise in prices the financial instruments business operator will suffer a loss, and if the customer suffers a loss due to a fall in prices, the financial instruments business operator will profit. Either way, the interests of the customer and the financial instruments business operator are in direct conflict.

This sort of “competing with the customer” constitutes an act that violates the duty of good faith to the customer, the order by the financial instruments business operator cannot be said to constitute a legitimate investment decision, and is prohibited as obstructing fair price formation (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 24).

When a financial instruments business operator, etc. is entrusted with commodity-related market transactions of derivatives, etc. (meaning the commodity-related market transactions of derivatives or the intermediary, brokerage or agency service thereof), the financial instruments business operator, etc. must not effect the transaction by serving as a counter-party without carrying out the commodity-related market transaction of derivatives so entrusted (FIEA, art. 40-6).

(vii) Abuse of Position as Officer or Employee

Financial instruments business operators who are individuals or the officers or employees of financial instruments business operators, etc. are prohibited from engaging in the purchase and sale, etc. on the basis of trends in orders in connection with the purchase and sale, etc. in securities by customers, or other special information of which they have obtained knowledge in the course of their duties, or carry out the purchase and sale, etc., solely for the purpose of pursuing speculative gains, by taking advantage of their business position (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 12).

Although securities trading using order information, etc. of customers does not constitute the company’s insider information, it is a transaction taking advantage of a gap in access to certain market information, and should be prohibited for the same reason as that for prohibiting insider trading.
(viii) Prohibition Against Proprietary Trading During a Stabilization Period by an Underwriting Financial Instruments Business Operator

A financial instruments business operator that may engage in stabilization activities must not during a stabilization period make purchases or request order for purchases, etc. to another financial instruments business operator for its own account in connection with equities that are issued by an issuer of securities in connection with a public offering or secondary distribution and which are listed on a financial instruments exchange, or that constitute over-the-counter securities (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 22).

Stabilization means an artificial price maintenance that has the nature of market stabilization. These are permitted within a certain range for the purposes of procuring funds. In these circumstances if a financial instruments business operator that is engaged in stabilization activities makes a purchase for its own account, it is quite likely that this would constitute an act that would distort supply and demand in the primary market. For this reason these provisions have been enacted in order to specifically prohibit an act of this nature.

This regulation constitutes an important provision which has the nature of regulating market stabilization activities on primary markets, and also covers officers and employees of financial instruments business operators.

A financial instruments business operator that may engage in stabilization activities is also prohibited from engaging in the act of accepting entrustment of transactions in equities issued by the issuer of the relevant securities without disclosing the stabilization (FIEA, art. 38, para. 9; FIBCOO, art. 117, para. 1, item 23).

In addition to share certificates in connection with public offering or secondary distribution, the regulation also applies to share option, bonds with share option, preferred equity investment, investment securities or market-value investment equity subscription right certificates, and securities related derivatives transactions in connection with trades in the said securities. These types of transactions which have different markets are also prohibited as they may have an impact on the formation of prices on the market in connection with the stabilization.

Acts of this nature would further constitute acts that present the possibility of being considered illegal in the form of being inter-markets price manipulation, but proving this is difficult, and for this reason the acceptance of entrustment of these transactions is in itself prohibited.

(ix) Transactions Using Confidential Corporate Information

Financial instruments business operators or their officers or employees must not engage in proprietary trades or other transactions, etc. of securities based on confidential corporate information.
Confidential corporate information is obtained through the receipt of such information within the corporation. As a financial instruments business operator is usually recognized to obtain such confidential corporate information in the quality of contractor with the corporation, it falls under the recipient of information within the corporation that is subject to the insider trading regulations as a primary conductor.

Basically, a financial instruments business operator should be subject to a strict internal administration system for preventing its own insider trading. Moreover, there are cases where obtaining proof of insider trading by the business operator is not so easy. Therefore, the financial instruments business operator is prohibited from conducting securities trading by itself by using confidential corporate information.

(6) Restrictions on Transactions Between a Financial Instruments Business Operator and a Parent/Subsidiary Corporation

Financial institutions may establish subsidiaries to enter into the financial instruments markets, and financial instruments business operators may establish bank (trust bank) subsidiaries. However, in cases where transactions are conducted based on the special relationship between parent/subsidiary corporations, there is a risk of distortions in the markets that financial institutions respectively bear.

In order to prevent these harmful effects, anti-abuse provisions are included such as restrictions on transactions between the financial instruments business operator and other corporations/associations that stand in a parent/subsidiary relationship vis-à-vis the financial instruments business operator, for the purpose of ensuring the independence of each financial institution (FIEA, art. 44-3).

These provisions apply not only to newly established financial instruments business operators, but also to existing financial instruments business operators which are recognized as a “parent corporation, etc. or subsidiary corporation, etc.” in a certain capital or personnel relationship.

(7) Introduction of Margin Regulations on Securities-Related Over-the-Counter Transactions of Derivatives

In securities CFD (Contract for Difference) transactions (transactions on underlying assets such as securities or securities index conducted upon receiving the deposit of a small amount of margin and settled by net settlement), etc. in the recent years, the counterparty is sometimes an individual. In such transactions with individuals, there are issues such as (i) the possibility that the customer will incur unexpected damages, (ii) the possibility that the financial soundness of a financial instruments business operator is affected if the customer’s loss exceeds the margin and
Accordingly, in order to prevent such negative effects, the amendments in 2009 introduced margin regulations to securities-related over-the-counter transactions of derivatives with individuals.

Financial instruments business operators are prohibited from conducting securities-related over-the-counter transactions of derivatives with individuals without receiving the deposit of the margin below (against the notional amount) for each underlying asset (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, items 29 and 30, para. 13 through para. 22):

- Independent share: 20% or more (=Leverage of 5× or less)
- Share index: 10% or more (=Leverage of 10× or less)
- Bonds: 2% or more (=Leverage of 50× or less)

(8) Points of Attention Regarding Solicitation of Transactions That Use Tax Exemption for Small-Amount Investments

In January 2014, a tax exemption program for small-amount investments (hereinafter, “NISA” (Nippon Individual Savings Account)) was introduced as a scheme for supporting households in stable asset building. Starting to this, a similar tax exemption program targeting minors (“Junior NISA”) was introduced in April 2016, and a new tax exemption program targeting adults who make installment investment (“Dollar-Cost Averaging NISA”) was also introduced in January 2018 (hereinafter the first NISA program (“general-type NISA”), the Junior NISA, and the Dollar-Cost Averaging NISA are collectively referred to as the “NISA program”).

Under the NISA program, any proceeds that investors gained from financial instruments purchased up to the annual investment limit are exempt from income tax during the prescribed tax exemption period, with a view to encouraging people to start building their assets by investing in financial instruments (for details, see Volume 3, Chapter 4, “1-5 Tax Exemption of Dividend Income and Capital Gains, Etc. from Small-Amount Listed Shares, Etc. in Tax Exempt Accounts (NISA)” and “1-6 Tax Exemption of Dividend Income and Capital Gains, Etc. from Small-Amount Listed Shares, Etc. in Minors’ Accounts (so-called Junior NISA)”)

When soliciting customers to engage in transactions using the NISA program, financial instruments business operators must endeavor to properly provide them with basic information on investment, such as the effects of mid to long-term investment and diversified investment, and also provide them with an accurate and simple explanation of this program if necessary in light of the principle of suitability so that customers will not have an incorrect understanding.

(Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., IV-3-1-2 (8))

2. 10 Investment Management Business

The former business of an asset management company of an investment corporation,
business of an investment trust management company, as well as the business activities in connection with discretionary investment contracts under the Investment Advisory Business Act(Note) constitute the investment management business under the FIEA.

All of these investment management business activities are involved in building customer assets based on an assumption of a relationship of a high degree of trust with the customer, and share the characteristic of a strong obligation of a fiduciary duty that should be incurred, including preventing conflicts of interest.

The FIEA, therefore, implements across the board regulation of these businesses.

Under the amendments in 2011, the regulations have been relaxed with regard to investment management business exclusively dealing with professionals.

(Note) The Securities Investment Advisory Business Act has been abolished with the enactment of the FIEA. In addition, although stipulations concerning the “structure” of investment trusts and investment corporations remain extant in the ITA, they have been substantially amended, including deletion of a considerable portion of the business regulations and the conduct regulations in connection with investment trust management firms.

(1) Conduct Regulations Concerning Investment Management Business

The FIEA applies rules on sales and solicitation, including the duty to deliver a written statement before entering into a contract, in the event that a financial instruments business operator that engages in the investment management business intends to enter into a discretionary investment contract, or at the stage of carrying out sales or solicitation of interests in a collective investment scheme for which self-management is carried out. Moreover, the special provisions in relation to the investment management business apply at the stage that a financial instruments business operator, etc. carries out investment management activities.

The following are the major stipulations:

(i) Duty of Good Faith and Duty of Care as a Prudent Manager

A financial instruments business operator, etc. must carry out the investment management business faithfully on behalf of the following persons holding rights. Moreover, a financial instruments business operator, etc. must carry out the investment management business with the care of a prudent manager towards the holders of rights (FIEA, art. 42):

i. An investment corporation by which management of the assets is entrusted (FIEA, art. 42, para. 1, item 1);
ii. The counterparty to the discretionary investment contract (FIEA, art. 42, para. 1, item 1);
iii. The beneficiaries to an investment trust (FIEA, art. 42, para. 1, item 2); and
iv. A person who has an interest, etc. in a collective investment scheme that
engages in self-management (FIEA, art. 42, para. 1, item 3).

(ii) Prohibited Acts

A financial instruments business operator, etc. must not commit any of the following in connection with the investment management business (FIEA, art. 42-2).

Nevertheless, those cases that are prescribed by Cabinet Office Ordinance as being those in which investor protection is achieved or in which fairness of transactions is not hindered, or the faith in the financial instruments business is not undermined are excluded from the prohibition in connection with i. and ii. below (FIEA, art. 42-2, proviso):

i. Making an investment intended to conduct a transactions with the financial instruments business operator, etc. itself, or a director or executive officer thereof (i.e., principal transactions);

ii. Making an investment intended to conduct a transactions between investment properties (i.e., trading between investment properties);

iii. Making an investment intended to conduct an unjustifiable transaction regarding a particular financial instrument, financial indicator or option, for the purpose of securing the interest of the financial instruments business operator, etc. or a third party other than the right holder by using fluctuations in the price, indicator, figure or amount receivable based on the transaction (i.e., scalping);

iv. Making an investment intended to conduct a transaction under terms and conditions that are different from ordinary terms and conditions and detrimental to the right holder’s interest;

v. Conducting sales and purchase or other transactions of securities, etc. based on the account of the financial instruments business operator, etc. by using the information concerning the transaction conducted as an investment;

vi. Providing property benefit to a right holder or a third party or having a third party provide it to the right holder in order to compensate in whole or in part of a loss incurred by the right holder from the transaction conducted as investment of investment property or make an addition to the profit accrued to the right holder from the transaction conducted as investment of investment property (prohibition against compensation for losses), provided, however, that this shall exclude the cases of compensating in whole or in part of a loss incurred from a problematic conduct or a loss caused to the principal of an investment trust specified by Cabinet Office Ordinance as those of which beneficial interest is acquired or held for the purpose of providing it for paying or receiving money for the sales and purchase of securities or any other transactions between the right holder and the financial instruments business operator,
etc.; or
vii. In addition to the matters set forth in items i. through vi., commit an act that is prescribed by Cabinet Office Ordinance as being insufficient in respect of the protection of investors, or as damaging the fairness of transactions or undermining the reputation of the financial instruments business.

(iii) Delegation of Management Authority (Duty of Self-Execution)

A financial instruments business operator, etc. may entrust all or a portion of the authority to carry out the management on behalf of the right holder to another financial instruments business operator, etc. (limited to one who engages in the investment management business) or other person as prescribed by Cabinet Order, only if a stipulation is made, in the contract prescribed below or other legal act, of the matters prescribed by Cabinet Office Ordinance (FIEA, art. 42-3, para. 1):

i. A contract on entrustment of assets investment of an investment corporation;
ii. A discretionary investment contract;
iii. An investment trust contract; or
iv. A contract, etc. in connection with a collective investment scheme that carries out self-management.

If management authority has been entrusted, the party that has received the entrustment of management authority will have a duty of good faith and duty of care of a prudent manager to the right holders, and various prohibitions shall apply (FIEA, art. 42-3, para. 3).

Finally, a financial instruments business operator, etc. which engages in the investment management business must not delegate all of the authority to manage all of its investment assets (id., para. 2).

(iv) Duty of Separate Management

If a financial instruments business operator, etc. engages in self-management in connection with the investment management business that it carries out, the financial instruments business operator, etc. must in accordance with Cabinet Office Ordinance segregate and manage the investment assets separately from its own proprietary assets and other investment assets (FIEA, art. 42-4).

(v) Prohibition Against Accepting Deposits of Cash or Securities, Etc.

A financial instruments business operator, etc. must not accept deposits of cash or securities from a customer, in any name whatsoever, in connection with an asset management agreement or a discretionary investment contract with an investment trust or an investment corporation, unless it does so as securities, etc. management business, or unless it does so in a case that is specified by Cabinet Order (FIEA, art. 42-5).

However, this shall not apply if this is necessary to settle a transaction due to certain
actions for a customer with respect to the investment management business *(id., proviso)*.

**(vi)** Prohibition Against Lending of Money or Securities, Etc.

A financial instruments business operator, etc. must not lend cash or securities to a customer, or act as an intermediary or agent in the lending of money or securities by a third party to a customer in connection with the investment management business that the financial instruments business operator, etc. carries out (FIEA, art. 42-6).

However, this shall not apply in the event of lending related to margin transactions or other cases as prescribed by Cabinet Order *(id., proviso)*.

**(vii)** Duty to Deliver Investment Report

A financial instruments business operator, etc. must periodically prepare investment reports in connection with investment property, in the manner prescribed by Cabinet Office Ordinance, and deliver them to the known right holders in connection with the investment property (FIEA, art. 42-7, para. 1).

This shall not apply to cases specified by Cabinet Office Ordinance where non-delivery of investment reports to the right holders will not hinder protection of the right holders *(id., proviso)*.


Under the existing law, a person who intends to conduct the investment management business needs to obtain registration from the Prime Minister (FIEA, art. 28, para. 4 and art. 29), by satisfying the strict requirements for registration established from the perspective of protecting general investors. Registration for Type I financial instruments business is also required in order to deal in public offering or private placement of Paragraph 1 Securities, such as beneficiary certificates in investment trusts. However, these business regulations have been criticized as imposing restrictions on such activities as the management of small funds operating on behalf of professionals with a certain level of ability to make proper investment decisions.

Accordingly, with a view to promoting the creation of investment funds to meet diverse needs for asset management among the public, the FIEA was amended in 2011 to (i) partially relax the requirements for registration of investment management business operators who exclusively deal with qualified investors and whose total operating assets do not exceed the prescribed amount (investment management business for qualified investors), and (ii) relax regulations relating to the solicitation for acquisition of securities.

**(i) Requirements**

Where a person intends to conduct investment management business for qualified investors, the following requirements must be satisfied (FIEA, art. 29-5, para. 1).

i. The right holders of all the investment property (including creditors of an investment corporation, etc.) consist solely of qualified investors;

ii. The total amount of all the investment property does not exceed the amount specified by Cabinet Order by taking into account the actual conditions of the investment management business and the influence of the investment management
business on the Japanese capital market as well as other circumstances.

“Qualified investors” means (i) professional investors or other persons specified by Cabinet Office Ordinance as those equivalent to professional investors in light of knowledge, experience and status of property, or (ii) persons specified by Cabinet Order as those having a close relationship with a financial instruments business operator (FIEA, art. 29-5, para. 3). As for the former, the Cabinet Office Ordinance prescribes individuals who are expected to hold one billion yen or more of financial assets such as securities or corporations, etc. with stated capital of 50 million yen or more (FIBCOO, art. 16-6; FIEAO, art. 17-12, para. 1). However, special purpose companies whose issued share certificates, etc. are held by persons other than qualified investors are excluded (FIBCOO, art. 16-7). As for the latter, the Cabinet Order prescribes officers, employees and parent company, etc. of the relevant financial instruments business operator and persons specified by Cabinet Office Ordinance as being equivalent to these (FIEAO, art. 15-10-7). Furthermore, collective investment schemes invested by persons other than qualified investors fall under the category of qualified investors if the relevant collective investment scheme is managed by a financial instruments business operator, etc., engaged in the investment management business (id., art. 15-10-8).

The upper limit for the total amount of investment assets of a financial instruments business operator engaged in investment management business for qualified investors is prescribed to be 20 billion yen (FIEAO, art. 15-10-5).

(ii) Relaxation of the Requirements for Registration of Investment Management Business for Qualified Investors

The requirement for registration in terms of the applicant’s corporate status has been relaxed to allow registration of companies with company auditors (FIEA, art. 29-5, para. 1). The minimum capital requirement has also been relaxed to 10 million yen (FIEAO, art. 15-7, para. 1, item 7).

(iii) Relaxation of Regulations Relating to the Solicitation for Acquisition of Securities

Under the special regulations relating to the solicitation to qualified investors for acquisition of securities, if investment management business operators conduct private placement of beneficiary certificates in investment trusts managed by themselves, with professional investors being their counterparty, such private placement is deemed to be Type II financial instruments business (FIEA, art. 29-5, para. 2). In this case, solicitation for acquisition must be made on condition that a contract on transfer specifying certain matters based on which the relevant securities are deemed as being less likely to be transferred to persons other than a qualified investor will be concluded (FIEAO, art. 15-10-6; FIBCOO, art. 16-5). Moreover, a financial instruments business operator, etc. must confirm the attribute of investors of the relevant customers as measures necessary and appropriate for preventing any person other than a qualified investor from becoming its customer (FIBCOO, art. 123, para. 1, item 13-2).
The FIEA has introduced a new overarching definition of interests in collective investment schemes, and regulates various types of funds that had heretofore been outside the scope of regulation.

A “fund” here means a structure in which funds contributed by investors are pooled and managed by specialists (a collective investment scheme) but for which strict regulations envisioning participation by general investors, such as the regulations applicable to investment trusts or investment corporations.

Sales and solicitation of interests in a collective investment scheme (including a self-managed offering) constitutes a type II financial instruments business (FIEA, art. 28, para. 2, item 1 and item 2), while management to invest in securities or in derivatives transactions constitutes an investment management business (FIEA, art. 28, para. 4, item 3), and require registration of a financial instruments business.

(1) Definition of Interests in Collective Investment Schemes

The definition of interests in collective investment schemes consists of three elements; (i) the receipt of cash investments or contributions from investors, (ii) the conduct of business or investment activities using the cash that has been invested or contributed, and (iii) a right against a scheme in the form that earnings, etc. from the said activities are to be distributed to the investors.

With the exception of those cases that are excluded from application, those rights in which all of these three elements exist are subject to the FIEA as interests in collective investment schemes regardless of their form and irrespective of what type of business activities are to be conducted.

As examples of interests in collective investment schemes, the FIEA lists rights pursuant to a partnership agreement, rights pursuant to an anonymous partnership agreement, rights pursuant to an investment limited partnership agreement, rights pursuant to a limited liability partnership agreement, and membership rights in an incorporated association (FIEA, art. 2, para. 2, item 5).

In addition, not only rights pursuant to domestic law or regulation, but also rights pursuant to foreign law or regulation are treated as interests in collective investment schemes (FIEA, art. 2, para. 2, item 6).

(2) Rights Excluded from the Definition of a Collective Investment Scheme

Given that interests in collective investment schemes are defined in an overarching manner, a broad range of rights are included therein, which results in some rights being included for which there is no strong necessity for protection of investors under the scope of application of the FIEA.

For this reason, the following rights are excluded from the definition of interests in collective investment schemes, and moreover, those rights that are treated as securities under the FIEA, such as stocks, beneficiary certificates to investment trusts, membership rights in a limited liability partnership company (godo kaisha), and trust beneficial interests, etc. are treated as not
constituting interests in collective investment schemes:

(a) Rights of an equity investor in cases where all of the equity investors participate in the invested business as specified by a Cabinet Order;

(b) Rights of an equity investor where it is provided that equity investors will not receive dividend of profits or distribution of the assets of the invested business in an amount exceeding the amount invested or contributed by them (excluding rights listed in (a));

(c) Rights covered by application of another business law that applies the FIEA *mutatis mutandis*; or

(d) In addition to those set forth in (a) through (c) above, the rights prescribed by Cabinet Order as being those recognized to present no impediment to the protection of investors or the public interest even if these rights are not deemed to be securities.

The cases to be prescribed by Cabinet Order as set forth in a. above are stated as being both of the following (FIEA, art. 2, para. 2, item 5(a); FIEAEO, art. 1-3-2):

(i) That the execution of operations in connection with the invested business will be conducted on obtaining consent from all investors (which in the case where an agreement is made that consent from all investors shall not be required, including cases in which all investors make a statement of intent concerning whether they will consent to a decision to execution of business, with execution thereby being carried out); and

(ii) That all investors are constantly engaged in the invested business, or engage in the invested business exercising particularly specialized capabilities that are indispensable for the continuation of the invested business.

(3) **Special Exceptions for Specially Permitted Services for Qualified Institutional Investors, Etc.**

The FIEA has established an exceptional treatment for specially permitted services for qualified institutional investors, etc. in connection with those business operators that only handle funds that target professional investors, etc., thereby taking care not to obstruct financial innovation. One example of such exception is that only notification, not registration, is required to engage in these services. However, recently, equity interests in funds originally intended for professional investors have been offered to general investors contrary to the purpose of the system, causing damage to general investors. To cope with this issue, the amendment to the FIEA in 2015 strengthened regulations on specially permitted services for qualified institutional investors, etc.
(i) **Scope of Specially Permitted Services for Qualified Institutional Investors, Etc.**

The following requirements have been stipulated in connection with the scope of collective investment schemes that are covered by the specially permitted services for qualified institutional investors, etc. (FIEA, art. 63, para. 1):

(a) The investors in the collective investment scheme must be qualified institutional investors and those persons other than qualified institutional investors in a quantity that does not exceed the quantity prescribed by Cabinet Order; and

(b) The self-managed offering must be a private placement.

The Cabinet Order specifies, as the scope of collective investment schemes that are covered by the notification system, that the investors must include at least one qualified institutional investor, and there must be 49 or less investors other than qualified institutional investors (FIEAEO, art. 17-12, para. 1 through para. 3). The number of 49 or less investors is interpreted as not being the number of persons who are solicited to acquire an equity interest, but rather the number of persons who will come to hold an interest, having accepted a solicitation to acquire.

In addition to the limitation on the number of general investors who may invest in a fund for professional investors, the amendment in 2015 introduced the limitation by qualification, allowing only the following general investors to invest in funds for professional investors: (i) a certain scope of investors who are recognized to have ability to make investment decisions; and (ii) those who are closely related to business operators that have made notification for the specially permitted services. More specifically, investors eligible to invest in such funds include: listed companies, corporations with stated capital or net assets of 50 million yen or more, and individuals who have held an account for securities transactions for at least one year since the opening of the account and hold investment-type assets worth 100 million yen or more (in category (i)); and a parent company, etc. and subsidiary company, etc. of a business operator that has made notification for the specially permitted services and officers and employees of such business operator or its parent company, etc. or subsidiary company, etc. (in category (ii)) (FIEA, art. 63, para. 1, item 1; FIEAEO, art. 17-12, para. 1; FIBCOO, art. 233-2).

However, with regard to venture capital funds that are expected to supply growth money and drive economic growth, the scope of general investors who may invest in funds for professional investors has been expanded to include those who have a certain level of knowledge and experience in investment, by additionally designating officers of listed companies and officers and employees who have been engaged directly in corporate financial affairs etc. (FIEAEO, art. 17-2, para. 2; FIBCOO, art. 233-3). However, since the services provided in such case falls within the scope of the specially permitted services for qualified institutional investors, etc. for which protection of investors is particularly necessary, business operators engaged in the specially permitted services are required to submit to the
Prime Minister a copy of a contract regarding the rights pertaining to the said services (FIEA, art. 63, para. 9 and para. 10; FIEAEQ, art. 17-13-2; FIBCOO, art. 239-2). A contract must provide for particulars that include ensuring governance of the fund, disclosure of financial information, implementation of audits, and publication of the name of the public certified accountant. Also, appropriate systems for enabling these requirements must be put in place.

If investors in a collective investment scheme include a person such as an specific purpose corporation (SPC) in which many general investors acquire the asset backed securities thereof, or an operator of an anonymous partnership in which many general investors are anonymous partners, and if the collective investment scheme is treated as targeting professional investors, there is a risk that the investor protection regulations would not apply even though in substance many general investors contribute or invest in the fund.

From the perspective of protecting investors therefore, the FIEA excludes from qualified institutional investors those persons such as specific purpose corporation in which persons other than qualified institutional investors acquire the asset backed securities thereof, or the operators of anonymous partnerships in which persons other than qualified institutional investors become anonymous partners (FIEA, art. 63, para. 1, item 1(a) through (c); FIEA, art. 63, para. 1, item 2; FIBCOO, art. 234-2).

Furthermore, for the purpose of preventing investment limited partnerships that do not actually act as investors from participating in funds for professional investors, investment limited partnerships must be expected to have at least 500 million yen of outstanding assets under management (excluding borrowings) in order to act as qualified institutional investors in connection with the specially permitted services (FIBCOO, art. 234-2, para. 1, item 1).

In addition, if the amount invested by persons including those who have a close relationship with the business operator that has made a notification of a fund for professional investors accounts for more than half of the total investment, the services provided by the fund operator will not be recognized as the specially permitted services (FIBCOO, art. 234-2, para. 1, item 2 and para. 2).

(ii) Duty to Notify

A person who intends to engage in the specially permitted services for qualified institutional investors, etc. (excluding financial instruments business operators) must file in advance a notification with the Prime Minister, stating certain prescribed matters (FIEA, art. 63, para. 2; FIBCOO, art. 236 and art. 238). This notification must be accompanied by documents specified by Cabinet Office Ordinance, such as a document in which the notifying party pledges that the party does not fall within any of the categories of persons who are ineligible to engage in the specially permitted services (FIEA, art. 63, para. 3; FIBCOO, art. 238-2).

In addition, a financial instruments business operator, etc. that intends to engage in the specially permitted services for qualified institutional investors, etc. must also file a notification with the Prime Minister, stating that it will engage in such specific business activities and the type of activities (FIEA, art 63-3, para 1), except in the event that the financial instruments business operator, etc. has obtained a registration in connection with the...
specially permitted services for qualified institutional investors, etc. that the financial instruments business operator, etc. will carry out. The amendments in 2011 stipulate additional matters to be notified by financial instruments business operators who intend to engage in the specially permitted services for qualified institutional investors, etc. The amendment in 2015 specifies persons who are ineligible to engage in the specially permitted services for qualified institutional investors, etc. (FIEA, art. 63, para. 7).

The Prime Minister must make the matters specified by Cabinet Office Ordinance among those stated in a notification made by a person who is to engage in the specially permitted services available for public inspection (FIEA, art. 63, para. 5; FIBCOO, art. 238-4, para. 2). A notifying party of specially permitted services must, after making a notification, without delay prepare a document stating the matters specified by Cabinet Office Ordinance among those stated in the notification and keep this document at its principal business office or other office and at all of its business offices or other offices where it engages in the specially permitted services for qualified institutional investors, etc. to make the said document available for public inspection, or disclose the same via the Internet or by other means. (FIEA, art. 63, para. 6; FIBCOO, art. 238-5).

It is possible that a collective investment scheme that is formulated from the start as a fund targeting professional investors will subsequently no longer satisfy the requirements as a fund targeting professional investors, as a result of a change in the attributes of investors or contributors. It is further possible that a problem in protecting investors will occur in a case such as this if the collective investment scheme continues to be treated as targeting professionals.

For this reason, a duty is imposed on the notifying business operator that carries out investment management to file a notification with the Prime Minister if investors or contributors in the collective investment scheme no longer constitute qualified institutional investors, etc. (FIEA, art. 63, para. 13). Moreover, the Prime Minister can specify a period of not more than three months and order necessary action to be taken (FIEA, art. 63, para. 12).

(iii) Conduct Regulations

As a result of the amendment in 2015, a person who is a notifying business operator (the notifying party of specially permitted services) that carries out specially permitted services for qualified institutional investors, etc. is now also subject to the conduct regulations such as the duty to deliver a document prior to conclusion of contract, which apply to financial instruments business operators, etc. that handle funds which are offered to general investors (FIEA, art. 63, para. 1). Specifically, the notifying party of specially permitted services must comply with the following conduct regulations in addition to the prohibition of provision of false information (FIEA, art. 38, para. 1) and the prohibition of compensation for losses, etc. (FIEA, art. 39).

<General conduct regulations>

(a) Duty of good faith to customers (FIEA, art. 36, para. 1)
(b) Prohibition on name lending (FIEA, art. 36-3)
(c) Regulation of advertising, etc. (FIEA, art. 37)
(d) Delivery of document prior to the conclusion of a contract (FIEA, art. 37-3)
(e) Delivery of document upon the conclusion of a contract (FIEA, art. 37-4)
(f) Prohibition of provision of conclusive evaluation (FIEA, art. 38, item 2)
(g) Prohibition of acts specified by Cabinet Office Ordinance (FIEA, art. 38, item 9)
(h) Principle of suitability, etc. (FIEA, art. 40)
(i) Prohibition of trading, etc. without ensuring separate management (FIEA, art. 40-3)
(j) Prohibition of public offering, etc. where money has been diverted (FIEA, art. 40-3-2)

<Conduct regulations concerning investment management business>

(a) Duty of good faith and duty of care as a prudent manager (FIEA, art. 42)
(b) Prohibited acts in connection with investment (FIEA, art. 42-2)
(c) Duty of separate management (FIEA, art. 42-4)
(d) Duty to deliver investment report (FIEA, art. 42-7)

However, with a view to ensuring free transactions between professionals, transactions with professional investors are governed by the provisions concerning the duty to notify professional investors, and the procedures for the change of status from professional investors to general investors and vice versa (FIEA, art. 34 through art. 34-5).

(iv) Preparation and Preservation of Books and Documents, and Preparation and Submission of Business Reports, Etc.

A notifying party of specially permitted services must prepare and preserve books concerning its business so as to ensure the appropriateness of its business and soundness of its financial condition (FIEA, art. 63-4, para. 1; FIBCOO, art. 246-2).

In addition, in order to ensure effective audit on a notifying party of specially permitted services, it is a requirement for such party to prepare a business report for each business year and submit it to the Prime Minister within three months after the end of the business year (FIEA, art. 63-4, para. 2; FIBCOO, art. 246-3).

Furthermore, a notifying party of specially permitted services must disclose explanatory documents stating the matters deemed necessary for the protection of investors among the matters contained in a business report, such as the business status and financial conditions of the notifying party and of the fund, so that investors can ascertain the status of the fund (FIEA, art. 63-4, para. 3; FIEAEO, art. 17-13-4; FIBCOO, art. 246-5).

(v) Supervisory Actions, Etc.

As supervisory actions against notifying parties of specially permitted services, the Prime Minister may order them to improve, suspend or discontinue their business (FEIA, art. 63-5).

The Prime Minister may also order a notifying party of specially permitted services to submit reports or materials or may conduct an inspection when the Prime Minister finds this to be necessary and appropriate for the public interest or for the protection of investors (FIEA, art. 63-6).

Moreover, when the execution of operations in connection with specially permitted services for qualified institutional investors is extremely improper and is causing serious damage to the interests of investors, and there is urgent necessity to prevent the spread of
damage among investors, the court may issue orders to suspend or prohibit the sale or solicitation in relation to the fund (FIEA, art. 192, para. 1).

Financial Institutions and Financial Instruments Business

(1) Scope of Functions of Financial Instruments Business Operators and Financial Institutions

In general, banks, financial services cooperatives, and other financial institutions prescribed by Cabinet Order cannot engage in the securities-related business or the investment management business (FIEA, art. 33, para. 1, main clause).

The rationale for this rule is (i) if financial institutions, which are under a duty to return the deposits of customers, were to concurrently engage in the securities-related business or the investment management business, for which investment risks are incurred, that conflicts of interest will arise between the lending business and the financial instruments business, including having business companies issue securities and thereby collect on loans; or that (ii) financial institutions will have an excessive influence on the manufacturing industry through substantive control of the vehicles of financing on the part of companies; as well as that (iii) as the main activity of financial institutions is to accept deposits, financial integrity will be hindered if financial institutions engage in the financial instruments business given the high risks resulting from the financial instruments business, which will contravene the protection of depositors; and that (iv) historical experience is full of examples of cases where improprieties arose as a result of financial institutions engaging in both businesses concurrently.

However, the evolution in financial securitization has spurred the expansion of the business activities on the part of banks (expansion of activities in areas such as commercial paper), and these restrictions are relaxed under certain conditions in order to lower the fences separating both businesses in the development of new financial products.

(i) Securities-Related Business and Investment Management Business of Financial Institutions

Financial institutions are allowed to conduct the following securities-related business and investment management business (FIEA, art. 33, para. 1, proviso; id., para. 2):

i) Conducting sale and purchase, etc. performed on a customer’s account on receiving his/her written orders;

ii) Sale and purchase, etc. or intermediary, brokerage or agency service therefor, underwriting, secondary distribution or exclusive offer to sell, etc. for professional investors, dealing in public offering, secondary
distribution or private placement or exclusive offer to sell, etc. for professional investors with regard to Japanese government bonds, local government bonds, government-guaranteed bonds, specified bonds, short-term bonds, etc., preferred equity investment certificates under the Securitization Act, short-term investment corporation bonds, etc., beneficiary certificates for loan trusts, and beneficiary certificates for specified purpose trusts, beneficiary certificates for trusts issuing beneficiary certificates, commercial paper having a maturity date of less than one year, mortgage securities, certain securities that a foreign government or a foreign person issues, depository receipts of negotiable deposits that are issued by a foreign juridical person, school bonds, and deemed securities, etc. under each of the items in the FIEA, Article 2, Paragraph 2;

iii) Sales and purchase, etc. or intermediary, brokerage, or agency service therefor, dealing in public offerings or private placements of beneficiary certificates of investment trusts or foreign investment trusts, investment securities of an investment corporation, investment equity subscription right certificates, and investment corporation bonds, etc. (excluding short-term investment corporation bonds, etc.), or foreign investment certificates;

iv) Market transactions of derivatives or foreign market derivatives transactions in foreign government bond certificates, or the intermediary, brokerage agency service, intermediary, brokerage or agency service for entrustment, dealing in private placements, and the financial instruments intermediary business therefor;

v) Dealing in private placement in securities other than those listed in ii) through iv) above and membership rights of limited liability companies, and the financial instruments intermediary service;

vi) Among the over-the-counter transactions of derivatives involving securities, etc. described in ii) above and over-the-counter transactions of derivatives involving securities etc. described in iii) through v) above, those which use the net cash settlement method; and

vii) Brokerage for clearing of securities, etc. with respect to the sales and purchase, etc. of securities.

(ii) **Financial Instruments Intermediary Service**

The restrictions on banks in the financial instruments intermediary service were fully lifted by the amendments of 2004. Originally, banks and the like were registered with the Prime Minister and permitted to handle government bonds, local government bonds, CP and securitized products of SPCs, etc., and investment trusts. This amendment, however, makes it possible for banks to handle all securities, including stocks, bonds and government bonds
issued by foreign countries, within the scope of intermediation of trades and dealing in primary offerings.

Nevertheless, such transactions involving stocks must be commissioned from financial instruments business operators (FIEA, art. 33, para. 2, item 3(c) and item 4(b)). The application of firewall regulations is admitted for application to securities-related business conducted by banks in view of the concern about transactions such as those in which a bank exploits its superior position in the event that a bank handles share certificates, etc. (FIEA, art. 44-2 para. 2 and art. 44-3).

(iii) Registration of Financial Institutions

Financial institutions can conduct brokerage with written orders, some securities-related business, derivatives transactions, etc. other than transactions of securities-related derivatives, etc. (excluding those conducted for the purpose of investment pursuant to the provisions of other laws or on the account of a person that entrusts another to do so based on a trust contract, and commodity-related market transactions of derivatives on their own accounts), investment advisory and agency business, and securities, etc. management business after registering with the Prime Minister (FIEA, art. 33-2).

Procedurally, the same provisions governing the registration of financial instruments business operators are applied (FIEA, art. 33-3 through art. 33-6), and from the perspective of maintaining the functioning of capital markets, the conduct regulations of financial instruments business operators, etc. will apply to financial institutions who have been registered (hereinafter “registered financial institutions”), and also their officers or employees in order to protect investors.

(iv) Restrictions on Acts Involving a Corporation That Is a Parent or Subsidiary, Etc.

A registered financial institution or an officer or employee thereof shall not commit any of the following (FIEA, art. 44-3, para. 2), unless approval from the Prime Minister that the relevant matters are found not to pose an impediment to protection of investors or the public interest is obtained (id., proviso):

i. Conducting sales and purchase or other transactions of Securities or over-the-counter transactions of derivatives with the parent juridical person, etc. or subsidiary juridical person, etc. of the financial instruments business operator, etc. under terms and conditions that are different from ordinary terms and conditions and detrimental to the fairness of transactions;

ii. Conducting acts listed in the FIEA, Article 33, Paragraph 2, Item 4(b), knowing that the parent juridical person, etc. or subsidiary juridical person, etc. of the financial instruments business operator, etc. has granted credit to the customer on the condition that a contract for financial instruments business should be concluded with the financial instruments business operator, etc.;
iii. Giving advice intended to conduct a transaction with regard to his/her investment advisory business that is unnecessary in light of the policy of the transaction, the amount of the transaction or the market conditions, or making investment intended to conduct a transaction with regard to his/her investment management business that is unnecessary in light of the policy of the investment, the amount of investment property or the market conditions, for the purpose of securing the interest of the parent juridical person, etc. or subsidiary juridical person, etc. of the financial instruments business operator, etc.; or

iv. In addition to the acts as enumerated in each of items (i) through (iii) above, conduct such acts involving the parent juridical person, etc. or the subsidiary juridical person, etc. of the registered financial institution, which acts are designated by Cabinet Office Ordinance as ones that are insufficient in protection of investors or damaging the fairness of transactions, or will undermine the reputation of the registered financial institution.

(v) Prohibited Acts in Connection with Other Business Activities of a Registered Financial Institution

A registered financial institution or its officers or employees may not commit any of the following in the event of engaging in activities other than the registered financial institution activities (“other businesses of the registered financial institution”) (FIEA, art. 44-2, para. 2):

i. Act of accepting an entrustment, etc. for sales and purchase of securities on the condition of acceptance of a money loan or other credit granting should be conducted (excluding those specified by Cabinet Office Ordinance as being less likely to result in insufficient protection of investors);

ii. Giving advice intended to conduct a transaction with regard to its investment advisory business that is unnecessary in light of the policy of the transaction, the amount of the transaction or the market conditions, or making investment intended to conduct a transaction with regard to its investment management business that is unnecessary in light of the policy of the investment, the amount of investment property or the market conditions, for the purpose of gaining profit from other businesses of the registered financial institution; and

iii. In addition to the acts as enumerated in each of i. and ii. above, conduct such acts as designated by Cabinet Office Ordinance as ones that are either insufficient in protection for investors or damage the fairness of transactions, or will undermine the reputation of the registered financial institution business.
The Cabinet Office Ordinance stipulates the following acts (FIBCOO, art. 150):

i. Acts of conclusion of a contract for financial instruments transaction or solicitation thereof as the condition for the carrying out of agency service for or intermediary of conclusion of an agreement of loan financing or discounting of notes or extending a credit facility;

ii. Acts of conclusion of a contract for financial instruments transaction or solicitation thereof on condition that agency service for or intermediary of conclusion of agreement of loan financing or discounting of notes or extending a credit facility will be carried out;

iii. In addition to those provided for in i. and ii. above, acts of conclusion of a contract for financial instruments transaction or the solicitation thereof through the unfair use of its superior status in a transaction;

iv. In the cases as set forth below, intermediary of sales and purchase of securities (limited to those in which the securities shall be sold no later than the date that is six months from the date the commissioning financial instruments business operator underwriting the said securities became the underwriter) or the dealing in public offerings or secondary distributions or dealing in private placements or dealing in exclusive offer to sell, etc. for professional investors of securities without explaining the said effect to the customer:
   (a) In cases in which a party owing debts under loans to the registered financial institution is issuing the said securities; and knowing that the proceeds concerning the said securities shall be allotted to the repayment of the said debts; and
   (b) In cases in which a party to whom the registered financial institution is the main lender of loans is issuing the said securities (limited to cases which the fact that the registered financial institution is a lender is stated or recorded in the issuance disclosure documents provided for in the FIEA, Article 172-2, Paragraph 3 or the specified securities, etc. information provided or published pursuant to the FIEA, Article 27-31, Paragraph 2 or 4);

v. Acts by an officer or employee engaged in the financial instruments intermediary service to receive undisclosed loan, etc. information from an officer or employee engaged in the loan business or the financial institution agency business, or to provide the same to an officer or employee engaged in the loan business or the financial institution agency business. (Certain exceptions to this prohibition, however, have been stipulated.)

Additionally, financial institutions that have a transaction qualification to carry out
securities trading and market transactions of derivatives on the financial instruments exchange market are subject to the following provisions in connection with transactions involving the registered financial institutions business (FIEA, art. 112):

(i) Deposit of guarantee funds with the exchange (FIEA, art. 114);
(ii) Completion of transactions upon the loss, etc. of its transaction qualification (FIEA, art. 116);
(iii) Deposit of clearing margin with the exchange (FIEA, art. 119); and
(iv) Provisions governing administrative actions due to violations of the laws and regulations, administrative actions, self-regulations or principle of good faith in transactions (FIEA, art. 87), etc.

2 Financial Instruments Intermediary Service System

(1) Definition of Financial Instruments Intermediary Service

The “financial instruments intermediary service,” is a business of conducting any of the following acts on entrustment from a type I financial instruments business operator, an investment management firm or a registered financial institution, on behalf of the said financial instruments business operator, etc. (FIEA, art. 2, para. 11):

(i) Intermediary (excluding the PTS operating business as set forth in the FIEA, art. 2, para. 8, item 10) of the sales and purchase of securities;
(ii) Intermediary set forth in Article 2, Paragraph 8, Item 3 of the FIEA, (intermediary of entrustment of sales and purchase, etc. on a financial instruments exchange market, etc.; including the intermediary of entrustment of commodity-related market transactions of derivatives);
(iii) An act set forth in Article 2, Paragraph 8, Item 9 of the FIEA (dealing in public offering or secondary distribution of securities or dealing in private placement); or
(iv) Intermediary as set forth in Article 2, Paragraph 8, Item 13 of the FIEA (agency service for or intermediary of the conclusion of an investment advisory contract or a discretionary investment contract).

(2) Registration of Financial Instruments Intermediary Service

Notwithstanding the provisions of Article 29 of the FIEA, a person other than a bank, financial services cooperative, or a financial institution as prescribed by Cabinet Order (excluding officers or employees of a type I financial instruments business operator, or a registered financial
institutions) may obtain registration from the Prime Minister (whether such person is a juridical person or an individual) and engage in the financial instruments intermediary service (FIEA, art. 66).

To register, a person who wishes to receive the registration must file a registration application listing the following information and other necessary documents with the Prime Minister (FIEA, art. 66-2). Additionally, if an applicant does not fall under any of the reasons for rejecting registration set forth in Article 66-4 of the FIEA, the following items together with registration date and registration number will be included in the registry of financial instruments intermediaries service provider and shall be available for public inspection (FIEA, art. 66-3):

(i) Trade name, firm name or personal name;
(ii) If a juridical person, the personal names or firm names of its officers;
(iii) Name and location of business office or office in which the financial instruments intermediary service will be conducted;
(iv) Trade name or name of the financial instruments business operator (type I financial instruments business or the investment management business), or a registered financial institution (hereinafter “Entrusting Financial Instruments Business Operator, Etc.”) from which entrustment will be received;
(v) Type of other business if any; and
(vi) Such other matters as determined by Cabinet Office Ordinance.

(3) Restrictions on Business
A financial instruments intermediary service provider (excluding a financial instruments business operator) shall not engage in any act (the acts listed in the FIEA, art. 2, para. 8, all items) other than the financial instruments intermediary service that the financial instruments intermediary service provider carries out on entrustment from the Entrusting Financial Instruments Business Operator, etc. for the customer of the financial instruments intermediary service (FIEA, art. 66-12).

In addition, when a financial instruments intermediary service provider intends to engage in Financial Instruments Intermediary Acts, it shall clearly state the following in advance to the customers (FIEA, art. 66-11):

(i) Trade name or firm name of the Entrusting Financial Instruments Business Operator, Etc.;
(ii) That it has no right of representation of the Entrusting Financial Instruments Business Operator, Etc.;
(iii) The meaning of the provisions of the FIEA, Article 66-13 (prohibition of cash or securities deposit); and
(iv) Other matters prescribed by the Cabinet Office Ordinance.
In addition, a financial instruments intermediary service provider shall not under any name whatsoever in connection with the financial instruments intermediary service, accept a deposit of cash or securities from a customer, or allow a person prescribed by Cabinet Order, as a person having a close relationship with the financial instruments intermediary service provider, to accept a deposit of cash or securities of a customer (FIEA, art. 66-13). Furthermore, the FIEA provides that, with respect to the financial instruments intermediary service, a financial instruments intermediary service provider or its officers or employees may not engage in various prohibited acts, including the provision of a conclusive evaluation (FIEA, art. 66-14 and art. 66-15).

Moreover, a financial instruments intermediary service provider may not, in principle, conduct, in connection with trades in securities for professional investors, financial instruments intermediating acts concerning trades in securities for professional investors with general investors (FIEA, art. 66-14-2).

(4) Supervision, Etc. of Financial Instruments Intermediary Service Provider

If a financial instruments intermediary service provider falls under any of the following, the Prime Minister may revoke the registration of such financial instruments intermediary service provider, may order the financial instruments intermediary service provider to suspend all or part of its business for a designated period of not more than six months, may order the financial instruments intermediary service provider to change its method of business, or may order such other matters as necessary for supervision (FIEA, art. 66-20):

(i) If the financial instruments intermediary service provider becomes subject to the criteria set forth in the FIEA, Article 66-4, Item 1 through Item 5 (causes for rejecting registration);
(ii) If the financial instruments intermediary service provider has used improper means to obtain the registration; or
(iii) If the financial instruments intermediary service provider has violated a law, regulation or administrative action pursuant to a law or regulation in connection with a financial instruments intermediary service.

Also, the Prime Minister may order a financial instruments intermediary service provider or a person who engages in a transaction with a financial instruments intermediary service provider to submit a report or materials in connection with the financial instruments intermediary service of the said financial instruments intermediary service provider, or have the officials inspect the state of the financial instruments intermediary service if the Prime Minister recognizes that this is necessary and appropriate for the protection of investors or the public interest (FIEA, art. 66-22).

Additionally, the Entrusting Financial Instruments Business Operators, etc. of a financial instruments intermediary service provider shall, in principle, be liable to compensate a customer for any damages that the financial instruments intermediary service provider causes to the customer in connection with the financial instruments intermediary service (FIEA, art. 66-24).

The officers or employees of a financial instruments intermediary service provider who
engages in acts of financial instruments intermediary service or solicitation for such acts shall be registered as a sales representative (FIEA, art. 66-25).

3 Credit Rating Agencies

Rating companies broadly provide users with reference information for investment decisions (credit risk evaluations), but since unlike investment advisory services, they do not directly involve themselves in the trading of financial instruments, thus they had not been subject to regulation.

However, particularly in the wake of the U.S. corporate accounting scandals and the sub-prime loan problems, issues were raised over matters such as (i) the possibility of conflicts of interest, (ii) the adequacy of the ratings process, and (iii) the sufficiency of information disclosure at ratings companies. Furthermore, it was also pointed out that investors may rely too heavily on ratings, and they may not sufficiently evaluate the risks of securitized products. With this kind of consciousness of the problem in the background, a movement developed internationally to introduce and strengthen public regulations of ratings companies.

In 2013, the International Organization of Securities Commissions (IOSCO) published the final report on Supervisory Colleges for Credit Rating Agencies, which recommends establishing supervisory colleges for internationally active credit rating agencies (CRAs), and provides preliminary guidelines on how to constitute and operate them.

In addition to the problems mentioned above, in view of matters such as the importance of the role and influence borne by ratings companies in the financial and capital markets and the movement towards the introduction and strengthening of international regulations, in Japan too it has come to be seen as vital that regulations and supervision should be conducted as necessary in order that, on the one hand, ratings companies appropriately exercise desired functions in the financial and capital markets, while on the other hand, the ratings given by ratings companies do not distort investors’ investment decisions.

Consequently, a registration system for ratings companies was introduced and a framework for the regulation and supervision of registered ratings companies was prepared in the 2009 amendments.

3 1 Definition of Credit Rating/Credit Rating Services

Credit rating means a ranking (excluding those prescribed by Cabinet Office Ordinance as rankings to be determined mainly in consideration of factors other than a credit evaluation) for the results of an evaluation (hereinafter “credit evaluation”) of the credit status of a financial instrument or corporation (including equivalents thereto; the Cabinet Office Ordinance prescribes unincorporated groups, individuals conducting business, groups of corporations or individuals and
trust properties) that is indicated using symbols or numbers (including equivalents thereto; the Cabinet Office Ordinance prescribes simple sentences or letters indicating order) (FIEA, art. 2, para. 34; Definition Ordinance, art. 24).

Further, credit rating services are services to conduct the act of assigning credit ratings and then providing or submitting them for public inspection (excluding acts prescribed by Cabinet Office Ordinance that are found to have little risk of undermining investor protections in light of the scope of the other party to the act and other aspects of the act) in the course of business (FIEA, art. 2, para. 35; Definition Ordinance, art. 25).

The definitions of credit rating and credit rating services are important elements in demarcating the coverage of the regulations, and international consistency is desirable. Also, these definitions are important in order to specify the coverage for which explanations are required in a financial instruments business operator’s duty to explain (FIEA, art. 38, item 3).

3 2 Registration System

Corporations that conduct credit rating services (including organizations that are not corporations but which have provisions stipulating a representative or manager) may receive registration by the Prime Minister (FIEA, art. 66-27). A party that is registered is called a credit rating agency (FIEA, art. 2, para. 36).

Since the FIEA has created a system under which “registration is possible,” and then imposes a duty to explain on financial instruments business operators, etc. when they use ratings by an unregistered business operator (FIEA, art. 38, item 3), the FIEA provides for a mechanism for ensuring the registration of ratings companies that can have material influence on the financial and capital markets.

A party who wishes to be registered must submit to the Prime Minister a registration application form stating prescribed matters. In this case, foreign companies must designate a representative in Japan (limited to a person who will be responsible for business activities at all business offices or offices established in Japan by the relevant foreign corporation in order to conduct the credit rating services) or a person who corresponds to this as prescribed by Cabinet Office Ordinance and submit the relevant registration application form (FIEA, art. 66-28, para. 1; FIBCOO, art. 298).

Further, certain documents must be attached to the registration form (FIEA, art. 66-28, para. 2; Definition Ordinance, art. 299 and art. 300).

If there is an application for registration, the Prime Minister must make a registration in the credit rating agency register (FIEA, art. 66-29, para. 1) unless it falls under certain grounds for refusal of registration (FIEA, art. 66-30). The register is made available for inspection by the public (FIEA, art. 66-29, para. 2).
3 Duties of Credit Rating Agencies

(1) **Duty to Act in Good Faith**

A credit rating agency and the officers and employees thereof must perform their work independently and fairly and in good faith (FIEA, art. 66-32).

(2) **Duty to Put in Place an Operation Management System**

Credit rating agencies must put in place an operation management system pursuant to Cabinet Office Ordinance provisions in order to fairly and appropriately perform the credit rating services (FIEA, art. 66-33, para. 1; FIBCOO, art. 306).

This operation management system must include measures to manage the quality of work such as the posting of persons having specialist knowledge and skills, as well as measures to prevent harm to the interests of investors by the agency or persons related to the ratings (persons designated by Cabinet Office Ordinance as having an interest in the matters that are subject to a credit rating) pursuing their own interests, and other measures in order to ensure the proper execution of work (FIEA, art. 66-33, para. 2).

This kind of provision was established because the obligation to put in place an operation management system for credit rating agencies is considered to be, together with the duty of information disclosure, fundamental to the credit company regulations.

(3) **Prohibition Against Name Lending**

A credit rating agency must not allow another to conduct credit rating services under the name of the credit rating agency (FIEA, art. 66-34).

(4) **Prohibited Acts**

A credit rating agency or the officers or employees thereof must not conduct the following listed acts in connection with its credit rating services (FIEA, art. 66-35; FIBCOO, art. 312):

(i) Where the credit rating agency or an officer or employee thereof has a close connection as prescribed by Cabinet Office Ordinance with a person related to the rating, the act of providing or making available for inspection a credit rating for matters provided by Cabinet Office Ordinance as matters with which the relevant party related to the rating has an interest;

(ii) Where advice is given to a person related to a rating concerning a matter prescribed by Cabinet Office Ordinance as a matter that should bring about a material effect on the credit rating related to the relevant party related to the rating (excluding cases of giving notice of the content of the rating policy, etc. on request by the party related to the rating, as well as such cases as are
provided by Cabinet Office Ordinance as cases found to have little risk of undermining investor protection in light of the form of the advice), the act of providing or making available for inspection the relevant credit rating; and

(iii) Aside from the acts listed in (i) and (ii) above, such other acts as are prescribed by Cabinet Office Ordinance as being undermining investor protection or as causing a loss of trust in the credit rating services (specifically provided are: i) acts of providing a fixed credit rating prior to conducting a credit evaluation as the results of such credit evaluation, or agreeing with a person related to the rating to provide the same for public inspection, and ii) acts by a person in charge of rating to receive or requesting to receive or accepting the offer to deliver, cash or goods from a person related to the rating, etc.)

These acts are prohibited from the viewpoint of ensuring the independence of credit rating agencies, the avoidance of conflicts of interest, and the ensuring of fairness in the ratings process, etc.

(5) Publication of Ratings Policy, Etc.

Credit rating agencies must stipulate and publish the policy and methods (rating policy, etc.) for applying credit ratings, and for the provision and making available for inspection of credit ratings as prescribed by Cabinet Office Ordinance, and the same applies where the rating policy, etc. is changed (FIEA, art. 66-36, para. 1; FIBCOO, art. 313, para. 1).

This kind of disclosure duty is imposed because the policy and methods adopted when assigning credit ratings are conceivably material information when an investor uses the credit rating.

Specifically, the following requirements must be met with respect to the policies and manners concerning the assignment of a credit rating (rating policy, etc.) (FIBCOO, art. 313, para. 2):

(i) That it is rigorous and systematic;
(ii) That it comprehensively takes into account all information and materials concerning the credit conditions of the financial instrument or corporation collected (limited to those where the evaluation regarding such credit conditions are subject of credit rating);
(iii) That it states, in accordance with the categories and detailed items of matters subject of credit rating, i) the matters that are the premises of the evaluation and the criteria used for determining the grades indicating the results of the evaluation and ii) the outline of the manner concerning the assignment of
(iv) That it states the policy and manner to enable persons related to the rating to confirm any factual misperceptions with respect to the principal information used by the credit rating agency upon assignment of the credit rating prior to providing the credit rating or providing the same for public inspection (including the policy and manner for securing a reasonable amount of time necessary for such person related to the credit rating to express its opinion); and
(v) That it states the policy and manner where a credit rating is giving without the request of a person related to the rating.

Further, a credit rating agency must carry out its credit rating services in accordance with the rating policy, etc. (FIEA, art. 66-36, para. 2). Specifically, it must meet the following requirements with respect to the policy and manner of providing credit ratings or providing the same for public inspection (rating provision policy, etc.) (FIBCOO, art. 313, para. 3):

(i) That the act to provide the credit rating assigned or to provide the same for public inspection shall be implemented without delay after the assignment of such credit rating;
(ii) That the act to provide the credit rating assigned or to provide the same for public inspection shall be implemented to the general public;
(iii) That the provision of the credit rating assigned or the provision of the same for public inspection shall be made by publishing prescribed matters through the use of the Internet or other methods in principle;
(iv) That the provision of information regarding the withdrawal of the credit rating assigned shall be made without delay; and
(v) That no representation has been made which may be misunderstood as the Commissioner of the Financial Services Agency or other administrative agencies guaranteeing the reasonableness of the results of the credit evaluation.

A credit rating agency must publish its rating policy, etc. using the Internet or other manners so as to allow the easy public inspection of the same by investors and users of the credit rating at all times (FIBCOO, art. 314, para. 1).

Credit Rating Agency Accounting

A credit rating agency must prepare and preserve books of account as prescribed by the Cabinet Office Ordinance concerning its credit rating services (FIEA, art. 66-37; FIBCOO, art.
Also, a credit rating agency must prepare a business report for each business year as prescribed by Cabinet Office Ordinance, and must submit this to the Prime Minister within the period set forth by Cabinet Office Ordinance after each business year has elapsed (FIEA, art. 66-38; FIBCOO, art. 316).

Furthermore, a credit rating agency must for each business year prepare explanatory materials stating matters prescribed by Cabinet Office Ordinance as matters concerning the status of business, and must place this at all business offices and offices and make it available for public inspection for a period of one year from the day that a period as provided by Cabinet Office Ordinance has elapsed after the elapse of each business year, as well as publish it by a method as prescribed by Cabinet Office Ordinance such as using the Internet (FIEA, art. 66-39; FIBCOO, art. 318).

As matters concerning the status of business stated in the explanatory document of the credit rating agency, the following are provided for: (i) matters concerning the overview and organization of the credit rating agency, (ii) sales figures, statistic and other information regarding the change in the credit conditions of the financial instrument or the corporation, information regarding the history of the credit rating assigned (limited to ratings which 1 year has elapsed from the date of the rating), status of related business and other business, total number of rating analysts, status of the business of the credit rating agency including the general fees structure, etc., (iii) status of preparation of the operation management system of the credit rating agency, (iv) outline of the rating policy, and (v) status of the affiliate corporations and subsidiary corporations of the credit rating agency.

3 5 Credit Rating Agency Supervision

(1) Notification, Etc. of Closure, Etc.

If a credit rating agency has closed its credit rating services, or if a corporation that is a credit rating services has been extinguished or has dissolved due to merger, a decision to commence bankruptcy procedures, or due to other reasons, a prescribed person must give notice to that effect to the Prime Minister within thirty days from that day (FIEA, art. 66-40, para. 1; FIBCOO, art. 321). If a credit rating agency falls under any one of these grounds, its registration as a credit rating agency will cease to be valid (FIEA, art. 66-40, para. 2).

If a credit rating agency applies for deletion of its registration, closes its credit rating services, merges (limited to a merger where the relevant credit rating agency is dissolved due to the merger), dissolves for reasons other than merger and a decision to commence bankruptcy procedures, has another take over its entire business by means of a company split, or intends to assign all of its business to another, it must make a public announcement to that effect as provided by Cabinet Office Ordinance no later than thirty days before that day (FIEA, art. 66-40, para. 3; FIBCOO, art. 322).
(2) Business Improvement Orders

If it is deemed necessary and appropriate in order to protect the public interest and investors in connection with the status of operation of a credit rating agency’s business, the Prime Minister may, to the extent necessary, order the relevant credit rating agency to take necessary measures to change its method of business or take such other action as is necessary to improve its business operations (FIEA, art. 66-41).

Since it is necessary to act rapidly and appropriately to achieve sufficient investor protections against inappropriate business operations, etc. by credit rating agencies, the conditions for issuing business improvement orders, as with financial instruments business operators, etc., are not limited to violations of laws and regulations.

(3) Supervisory Actions

If a credit rating agency falls under any of the following items, the Prime Minister may revoke the relevant credit rating agency’s registration, or order the suspension of all or part of its credit rating services for a period of up to six months (FIEA, art. 66-42, para. 1):

(i) The credit rating agency falls under grounds for refusal of registration as a credit rating agency;
(ii) The credit rating agency obtained registration by improper means;
(iii) The credit rating agency has violated laws or regulations concerning the credit rating services or an administrative action based on laws and regulations;
(iv) There is a fact concerning the operation of the credit rating services that harms the interests of investors; or
(v) If the credit rating agency has acted improperly or extremely unfairly in connection with its credit rating services and the circumstances are particularly serious.

If a credit rating agency falls under any one of the grounds described in (i) through (v) above, and if the relevant credit rating agency continues to conduct its credit rating services as a credit rating agency, an investor who is not aware of the circumstances cannot help but make investment decisions using credit ratings that were assigned with the understanding that the relevant credit rating agency is properly registered and is in compliance with regulations.

Consequently, in order to make possible an appropriate response by the authorities against illegal acts by credit rating agencies, provisions are established against credit rating agencies for the revocation of registration and business suspension orders.

Also, it is provided that the Prime Minister may order the dismissal of a credit ratings...
agency’s officer if the relevant officer falls under certain grounds (FIEA, art. 66-42, para. 2).

Moreover, if the Prime Minister is not able to verify the location of a credit rating agency’s business office or office, or if the Prime Minister is not able to verify the location of an officer who represents a credit rating agency, as provided by Cabinet Office Ordinance, the Prime Minister may give public notice of that fact and if there is no notification from the relevant credit rating agency even after thirty days have elapsed since that public notice date, the Prime Minister may revoke the relevant credit rating agency’s registration (FIEA, art. 66-42, para. 3).

However, upon exercise of such authority, consideration shall be made so that no involvement shall be made into the specific details of individual credit ratings or method of credit evaluations (FIBCOO, art. 325).

(4) Collection of Reports and Inspections

If the Prime Minister deems it to be necessary and appropriate for the public interest and investor protection, the Prime Minister may order a credit rating agency, a person who has transactions with the credit rating agency, a person who is entrusted business by the relevant credit rating agency (including a person who has received entrustment from such person (including entrustment at the second or higher degree of separation from the original entrustment)), or a juridical person related to the relevant credit rating agency (the relevant credit rating agency’s subsidiaries, a juridical person that makes the relevant credit rating agency its subsidiary, or a subsidiary of a juridical person that makes the relevant credit rating agency its subsidiary (excluding the relevant credit rating agency)) to submit reports or materials that are of reference concerning the operations of the relevant credit rating agency, or may cause relevant staff to inspect the business conditions or materials or other articles of the relevant credit rating agency, a party that has been entrusted business by the relevant credit rating agency, or a juridical person related to the relevant rating agency (for a party that has been entrusted with business by the relevant credit rating agency or a juridical person related to the relevant credit rating agency, limited to necessary inspections concerning the operations of the relevant credit rating agency) (FIEA, art. 66-45).

However, upon exercise of such authority, consideration shall be made so that no involvement shall be made into the specific details of individual credit ratings or method of credit evaluations (FIBCOO, art. 325).

4 High Speed Traders

Along with the recent advancement of trading systems, the impact of High Speed Trading in shares, etc. has been increasing. High Speed Trading is a trading platform developed on the basis of high-specification computers and information and communication technology, whereby a large number of trading orders are made and cancelled in milliseconds with the use of algorithms pre-installed in the computers. This scheme is made possible by installing devices at a location
that is physically close to the location where the market operator’s trading system is placed and reducing the communication time (called “collocation”). There was a concern that this type of trading could cause various problems such as a rapid rise in the price volatility on the market, increased trading costs due to investors’ mid to long-term trading needs emerging in advance, the hindrance to the price formation based on mid to long-term corporate values, and vulnerability of the trading system. However, in Japan, it was impossible for the regulatory authorities or exchanges to sufficiently understand the actual state of High Speed Trading because of the lack of a regulatory framework that could allow them to collect trade information directly from High Speed Traders.

Accordingly, the FIEA was amended in 2017 to introduce a registration system for investors who engage in High Speed Trading and impose obligations, such as development of a risk management system and preservation of transaction records, on those High Speed Traders.

4 Definitions of High Speed Trading and High Speed Traders

(1) High Speed Trading

The term “High Speed Trading” means any of the following acts for which the determination on performance of the act is automatically made by an electronic information system, and the provision of information necessary for conducting the purchase and sale of securities or a market derivatives transaction based on that determination to a financial instruments exchange or any other person specified by Cabinet Office Ordinance is made by means of information and communications technology, which is specified by Cabinet Office Ordinance as a method for shortening the time normally required for the provision of information (excluding acts specified by Cabinet Order as those which, in consideration of their content and other factors, are found not to compromise the protection of investors) (FIEA, art. 2, para. 41; FIEAEO, art. 1-22; Definition Ordinance, art. 26):

(i) the purchase and sale of securities or a market transaction of derivatives;
(ii) entrustment of the act set forth in (i); and
(iii) in addition to what is listed in (ii), an act performed in connection with the act set forth in (i), which is specified by Cabinet Order as an act equivalent to the acts set forth in (i) and (ii).

In order to ensure the flexible adaptation to the advancement of information and communication technology in the future, the details of High Speed Trading are specified by Cabinet Order and Cabinet Office Ordinance.

(2) High Speed Trader

The term “High Speed Trader” means a person registered by the Prime Minister pursuant to Article 66-50 of the FIEA (FIEA, art. 2, para. 42).
Registration System

A person other than a Financial Instruments Business Operator, etc. and authorized transaction-at-exchange operator must be registered by the Prime Minister if the person seeks to perform High Speed Trading (FIEA, art. 66-50; FIBCOO, art. 326).

When applying for registration, the applicant must submit a written application for registration to the Prime Minister in which it states: the applicant’s trade name or name; if the applicant is a corporation, the amount of capital or total contribution, the names of its officers, and the name and address of its head office (and its principal office in Japan, if any); if the applicant engages in other business, the business type; and other particulars specified by Cabinet Office Ordinance (FIEA, art. 66-51, para. 1; FIBCOO, art. 328).

The written application for registration must be accompanied by: a document pledging that the applicant does not fall under any of the cases where registration should be refused; a document stating the things specified by Cabinet Office Ordinance as constituting the business outline and business methods for services pertaining to High Speed Trading; if the applicant is a corporation, the articles of incorporation and certificate of registered information; and other documents specified by Cabinet Office Ordinance (FIEA, art. 66-51, para. 2; FIBCOO, art. 329). Under this provision, the applicant notifies the regulatory authorities of the details and strategy of the High Speed Trading to be performed thereby.

If an application for registration is filed, unless it falls under any of the cases where registration should be refused (FIEA, art. 66-53; FIEAO, art. 18-4-9 and 18-4-10), the Prime Minister must register the particulars of the applicant in the High Speed Traders register (FIEA, art. 66-52, para. 1), which is to be made available for public inspection (id., para. 2).

Duties of High Speed Traders

(1) Obligation to Establish Operational Control System

A High Speed Trader must establish an operational control system for the appropriate performance of its services pertaining to High Speed Trading, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 66-55; FIBCOO, art. 336).

According to the Cabinet Office Ordinance, the operational control system to be established must satisfy the following requirements: (i) internal rules, etc. for securing the appropriate execution of the business pertaining to the High Speed Trading are established, and training for employees and other measures are conducted to ensure compliance with the internal rules, etc.; and (ii) the measures to ensure sufficient management of the electronic data processing systems and other facilities for the High Speed Trading have been taken.
Chapter 2. Financial Instruments and Exchange Act

(2) **Prohibition on Name Lending**

A High Speed Trader must not allow another person to engage in High Speed Trading using the name of said High Speed Trader (FIEA, art. 66-56).

(3) **Regulation on Business Operations**

A High Speed Trader must conduct its business in such a manner that the state of its business operations does not fall under any of the following (FIEA, art. 66-57; FIBCOO, art. 337):

(i) the electronic information system or any other equipment pertaining to High Speed Trading is in such a state that its management for preventing factors such as abnormal operation of the electronic information system from compromising the full utilization of the functions of the financial instruments market is found to be insufficient; or

(ii) beyond what is set forth in (i), the business operations are in a state specified by Cabinet Office Ordinance as one that is contrary to the public interest or that is likely to compromise the protection of investors.

(4) **Preparation and Preservation of Transaction Records, and Preparation and Submission of Business Reports**

A High Speed Trader must prepare and preserve books and documents for its business pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 66-58; FIBCOO, art. 338). This provision is introduced with a view to ascertaining the actual status of High Speed Traders.

Each business year, pursuant to the provisions of Cabinet Office Ordinance, a High Speed Trader must prepare a business report and submit it to the Prime Minister within three months after the end of the business year (FIEA, art. 66-59; FIBCOO, art. 339).

### Supervision of High Speed Traders

(1) **Notification of Business Discontinuance, Etc.**

In cases such as where a High Speed Trader discontinues services pertaining to High Speed Trading, or where a High Speed Trader is a corporation and that corporation disappears or is dissolved due to a merger, an order to commence bankruptcy proceedings, or any other reasons, the person specified for each such event must notify the Prime Minister of this fact within 30 days from the day of the event (FIEA, art. 66-61, para. 1; FIBCOO, art. 344). If a High Speed Trader comes to fall under any of these cases, its registration as a High Speed Trader ceases to be effective (FIEA, art. 66-61, para. 2).

(2) **Business Improvement Orders**

Whenever the Prime Minister finds it to be necessary and appropriate in the public interest or for the protection of investors concerning the state of a High Speed Trader’s business operations
or assets, the Prime Minister, within the scope of this necessity, may order the High Speed Trader to change its business methods or may otherwise order it to take measures that are necessary for improving the state of its business operations or assets (FIEA, art. 66-62).

(3) Supervisory Measures

If a High Speed Trader falls under any of the following, the Prime Minister may revoke its registration or order the suspension of all or a part of its business activities during a fixed period of no longer than six months (FIEA, art. 66-63, para. 1):

(i) The High Speed Trader comes to fall under any of the cases where registration should be refused;
(ii) The High Speed Trader obtains the registration by wrongful means;
(iii) The High Speed Trader violates a law or regulation or a disposition by a government agency which is based on a law or regulation, in connection with services pertaining to High Speed Trading or services incidental thereto;
(iv) In light of the state of its business or assets, the High Speed Trader is likely to become insolvent; or
(v) The High Speed Trader commits a wrongful or extremely unjust act in connection with services pertaining to High Speed Trading, and the circumstances surrounding this are particularly serious.

If an officer of a High Speed Trader falls under any of the prescribed cases, the Prime Minister may order the High Speed Trader to dismiss that officer (FIEA, art. 66-63, para. 2).

Furthermore, if the Prime Minister is unable to ascertain the location of the business offices or offices of a High Speed Trader or is unable to ascertain the whereabouts of a High Speed Trader (in the case of a corporation, the whereabouts of the officer representing the corporation), the Prime Minister, pursuant to the provisions of Cabinet Office Ordinance, may issue public notice of that fact and revoke the registration of the High Speed Trader if no filing is made by the High Speed Trader even after 30 days have elapsed since the day of the public notice (FIEA, art. 66-63, para. 3).

(4) Collection of Reports and Inspection

Whenever the Prime Minister finds it to be necessary and appropriate in the public interest or for the protection of investors, the Prime Minister may order a High Speed Trader, a person that conducts transactions with a High Speed Trader, or the person that a High Speed Trader has entrusted with its business (including a person who has received entrustment from such person (including entrustment via two or more layers)) to submit reports or materials that should serve as a reference with regard to the business of the High Speed Trader, or may have the relevant officials inspect the state of the business or assets, or the books and documents or any other articles, of the High Speed Trader or the person that the High Speed Trader has entrusted with its business (with regard to the person that the High Speed Trader has entrusted with its business, the
inspection shall be limited to what is necessary to understand the business or assets of the High Speed Trader) (FIEA, art. 66-67).

5

Financial Instruments Firms Association, Etc.

The FIEA allows a financial instruments firms association to have the form of an authorized financial instruments firms association or a certified financial instruments firms association, and also provides the system of a certified investors protection organization as a vehicle for addressing disputes, etc. that have occurred between an investor and a financial instruments business operator.

5 1

Authorized Financial Instruments Firms Association

(1) Significance

An authorized financial instruments firms association is a juridical person formed under the FIEA and organized by financial instruments business operators as a self-regulatory organization whose objective is to ensure the fairness and efficiency of trading and other transactions in securities as well as derivatives transactions, etc., and to contribute to the sound development of financial instruments business operators as well as the protection of investors (FIEA, art. 67, para. 1).

An authorized financial instruments firms association engages in the general rulemaking for the financial instruments business, and it is tasked with the implementation of the rules under the FIEA in actual practice, while at the same time it has the characteristics of an industrial organization. Self-regulation is permitted within the bounds of the law and these are not simply industry rules. Accordingly, rules such as the self-regulatory rules on the part of the Japan Securities Dealers Association, which is an authorized financial instruments firms association, have authority equivalent to laws and regulations. Based on the importance of authorized financial instruments firms associations, the FIEA includes detailed provisions governing them.

The importance of the rules must be evaluated in their relationship to the legal objective of achieving fair price formation, and thus rules by a self-regulatory institution may not be quickly judged as being of an inferior level to the stipulations in a statute. While the system of annual securities reports in which information disclosure is made once per year constitutes a system under the FIEA, timely disclosure which is a rule under financial instruments exchanges which provide information on changes in quality are far more important for the creation of a securities market, and without these a securities market cannot exist, and similarly, the authorized financial instruments firms association prescribes various important market rules which must be complied with laws and regulations as well.
Section 5. Financial Instruments Firms Association, Etc.

(2) Establishment

The authorization of the Prime Minister is necessary to establish an authorized financial instruments firms association (FIEA, art. 2, para. 13 and art. 67-2, para. 2). For this purpose, the application for an authorization stating required items must be submitted together with the articles of association and other rules of the association to the Prime Minister and receive its examination (FIEA, art. 67-3).

The articles of association must state the following matters (FIEA, art. 67-8, art. 68, para. 2 through para. 5, and art. 68-2):

(i) Purpose;
(ii) Name;
(iii) Location of offices;
(iv) Matters related to member firms;
(v) Matters related to general meeting;
(vi) Matters related to officers;
(vii) Matters related to council and other meetings;
(viii) Matters related to execution of business operations;
(ix) Matters related to improvements in qualities of officers and employees of the member firms, and qualities of the financial instruments intermediary service providers and their officers and employees;
(x) Matters related to preparation of rules;
(xi) Matters related to resolution of complaint filed by investors concerning the operations of the member firms or financial instruments intermediary service providers and dispute;
(xii) Matters related to sales and purchase or other transactions of securities solicited by member firms or financial instruments intermediary service providers;
(xiii) Matters related to an over-the-counter securities market;
(xiv) Matters related to investigation of the status of observance of laws and regulations, dispositions given by government agencies based on laws and regulations, or the articles of incorporation or other rules, or the fair and equitable principles of transactions by member firms and financial instruments intermediary service providers;
(xv) Matters related to membership fees;
(xvi) Matters related to accounting and assets; and
(xvii) Method of public notices.

Furthermore, any post-establishment amendments or modifications to the articles of association must be authorized by the Prime Minister (FIEA, art. 67-8, para. 2). Also, the Prime Minister possesses the authority to order amendments to the articles of association of an authorized financial instruments firms association (FIEA, art. 73). It can also order the dismissal
The Prime Minister possesses the authority to take administrative actions against violations of the laws and regulations, etc. (FIEA, art. 74), to order submission of reports and materials, and to conduct inspections of an authorized financial instruments firms association (FIEA, art. 75).

(4) Establishment, Etc. of Over-the-Counter Securities Markets

The FIEA states that an authorized financial instruments firms association is permitted to establish over-the-counter securities markets (FIEA, art. 67, para. 2).

Accordingly, regulatory measures concerning the over-the-counter securities market have been enacted, including the statement in the articles of incorporation of the authorized financial instruments firms association of matters concerning the holding of an over-the-counter securities market (FIEA, art. 67-8, para. 1, item 13), authorization by the Prime Minister of the regulations concerning the over-the-counter traded securities to be traded on the over-the-counter securities market (FIEA, art. 67-12), requisite measures taken by the Prime Minister concerning revocation of registration or re-registration, etc. (FIEA, art. 67-15), and the notification to the Prime Minister with respect to the halting of trading, or the lifting of such halt, etc. (FIEA, art. 67-16).

Additionally, provisions are included to ensure the credibility of the over-the-counter securities market. These include provisions requiring member firms to file a report with the authorized financial instruments firms association in cases where they trade securities for its own account, or engage in intermediation, brokering or agency to establish a trade (FIEA, art. 67-18), and requiring the authorized financial instruments firms association to make public announcements of certain information concerning trades of over-the-counter traded securities performed on the over-the-counter securities market (FIEA, art. 67-19).

With the amendments in 2008, an authorized association has also become allowed to open the so-called professional market (FIEA, art. 67, para. 3). The authorization by the Prime Minister is required (FIEA, art. 67-12, item 5).

(5) Measures to Ensure Member Firms’ Compliance with Laws and Regulations

The authorized financial instruments firms association is required to include a provision to the effect that member firms shall endeavor to coordinate their internal rules and management systems so as to prevent violations, etc. of laws and regulations and to secure the reliance of investors (FIEA, art. 68, para. 4).

The Financial Services Agency publishes its Inspection Manual for Financial Instruments Business Operators, Etc. in addition to the Financial Inspection Manual, and these are highly valued as a reference in establishing internal control, internal auditing and compliance systems (the Financial Inspection Manual is scheduled to be repealed by around the end of FY2018).

(6) Sales Representatives Registration Tasks

The authorized financial instruments firms association performs the tasks of registering the
sales representatives of financial instruments business operators and financial instruments intermediary service providers under a delegation of authority from the Prime Minister (FIEA, art. 64, para. 1, art. 64-7 through art. 64-9, and art. 66-23; FIBCOO, art. 254).

(7) Dispute Resolution System

If an authorized financial instruments firms association receives a request from an investor to resolve complaints concerning operations performed by a member firm or a financial instruments intermediary service provider, the authorized financial instruments firms association must provide consultation and necessary advice to the requesting party, as well as investigate the circumstances under which such complaint arose, inform the member firm or financial instruments intermediary service provider of the content of the complaint, and seek a quick handling of the matter (FIEA, art. 77, para. 1 through para. 4).

However, if an authorized financial instruments firms association has been designated pursuant to the provisions of Article 156-39, Paragraph 1, of the FIEA, this does not apply if the request for complaint is related to a complaint concerning the classification of services for dispute resolution, etc. related to the relevant designation (FIEA, art. 77, para. 5).

Additionally, when disputes arise with respect to securities trading or other transaction, or a derivatives transaction, etc. performed by a member firm or a financial instruments intermediary service provider, a person involved in the dispute may petition the authorized financial instruments firms association for mediation to settle the dispute (FIEA, art. 77-2).

5 2 Certified Financial Instruments Firms Association

(1) Recognition

A certified financial instruments firms association is a general incorporated association that financial instruments business operators have established, and which is accepted by the Prime Minister as being recognized to be covered by the following conditions (FIEA, art. 78, para. 1):

(i) The juridical person shall aim at ensuring fair and smooth transaction of securities, including sales and purchase or other transactions of securities, and derivative transactions, etc. as well as contributing to sound development of financial instruments businesses and protection of investors;

(ii) The juridical person’s articles of incorporation shall include a provision to the effect that its member firms shall be financial instruments business operators;

(iii) The juridical person shall have established the method for carrying out its operations necessary for conducting the activities of the certified financial instruments firms association appropriately and certainly; and

(iv) The juridical person shall have the knowledge, ability and financial basis necessary for conducting the activities of the certified financial instruments
firms association appropriately and certainly.

(2) Operations

A certified financial instruments firms association shall carry out the following activities (FIEA, art. 78, para. 2):

(i) To provide its member firms and financial instruments intermediary service providers with guidance and recommendation and to conduct other activities, for the purpose of having them observe the provisions of FIEA and other laws and regulations in the course of conducting financial instruments business;

(ii) To conduct investigations, to provide guidance and recommendation and to conduct other activities necessary for ensuring appropriateness in contracts and asset investment and for otherwise protecting investors with regard to financial instruments business conducted by its member firms and financial instruments intermediary service providers;

(iii) To investigate the status of observance of the FIEA, orders given thereunder, a disposition made under the FIEA or under such an order, its articles of incorporation or other rules, or the fair and equitable principles of transactions by its member firms and financial instruments intermediary service providers;

(iv) To resolve complaints filed by investors with regard to financial instruments business conducted by its member firms and financial instruments intermediary service providers;

(v) To resolve disputes with regard to financial instruments business conducted by its member firms and financial instruments intermediary service providers;

(vi) To carry out registration work with regard to sales representatives;

(vii) To establish rules or conduct other activities necessary for ensuring appropriateness in solicitation for sales and purchase or other transactions of securities conducted by its member firms and financial instruments intermediary service providers;

(viii) To conduct publicity towards investors or other activities necessary for achieving purposes of the certified financial instruments firms association; and

(ix) In addition to the items in the preceding items, operations contributing to the sound development of the financial instruments business or the protection of investors.

In addition, a certified financial instruments firms association must make efforts to promote
the sound development of the financial instruments business and the protection of investors through the dissemination of knowledge, educational activities, and public relations activities in connection with finance (FIEA, art. 78-2, para. 1).

(3) Supervision of Certified Financial Instruments Firms Associations

The Prime Minister has the authority to order a certified financial instruments firms association to submit reports and information, as well as the authority to carry out onsite inspections (FIEA, art. 79-4).

### Certified Investors Protection Organization

(1) Definition

The system of certified investors protection organization is a system by which a juridical person, which intends to engage in the following activities for the purpose of facilitating the trading and other transactions in securities as well as derivatives transactions, etc. and contributing to the sound development of the financial instruments business and to the protection of investors, may obtain certification from the Prime Minister (FIEA, art. 79-7):

(i) To resolve complaints filed with regard to financial instruments business conducted by a financial instruments business operator or a financial instruments intermediary service provider;

(ii) To mediate in the case of disputes arisen from financial instruments business conducted by a financial instruments business operator or a financial instruments intermediary service provider; and

(iii) In addition to what is listed in the preceding two items, activities that would contribute to the sound development of financial instruments businesses and protection of investors.

(2) Business Entities Covered

The business entities covered by the operations of a certified investors protection organization shall be the financial instruments business operators and the financial instruments intermediary service providers that are its members, as well as the financial instruments business operators and the financial instruments intermediary service providers, etc. that have consented to be covered by the certified activities (FIEA, art. 79-11).

(3) Handling of Complaints

If a request is made for resolution of a complaint by an investor in connection with the business activities conducted by a covered business entity, the certified investors protection organization...
organization shall provide consultation, and the necessary advice to the requesting party, as well as investigate the related complaint, notify the said member firm or financial instruments intermediary service provider of the content of the complaint, and seek a rapid disposition of the same (FIEA, art. 77 applied *mutatis mutandis* through FIEA, art. 79-12).

In addition if a dispute occurs concerning a trade or other transaction in securities or a derivatives transaction, etc. conducted by a covered business entity, the parties may petition the certified investors protection organization, and seek mediation to resolve the dispute (FIEA, art. 77-2 applied *mutatis mutandis* through FIEA, art. 79-13).

(4) Preparing and Publishing Investors Protection Guidelines

A certified investors protection organization must make efforts to prepare and publish guidelines (hereinafter referred to as “investor protection guidelines”) consistent with the provisions of the FIEA, concerning contents of agreements of financial instruments trades by covered business entities, asset management by covered business entities, and other matters necessary to protect investors, for the purpose of the sound development of the financial instruments business and the protection of investors (FIEA, art. 79-17, para. 1).

A certified investors protection organization shall endeavor to provide the necessary guidance, warnings and other measures towards the covered business entities in order to have them comply with such investor protection policies (FIEA, art. 79-17, para. 2).

In addition, a certified investors protection organization shall make efforts to promote the sound development of the financial instruments business and the protection of investors through the dissemination of knowledge, educational activities, and public relations activities in connection with finance (FIEA, art. 79-17, para. 3).

(5) Cancellation of Certification, Etc.

The Prime Minister may order a certified investors protection organization to improve the method of implementation of the operations, amend the investor protection guidelines, or implement any other measures necessary (FIEA, art. 79-18).

In addition, the Prime Minister may revoke the certification of a certified investors protection organization in the event that, *inter alia*, the certified investors protection organization is covered under any cause for disqualification, or no longer satisfies the criteria for certification, or does not comply with an order by the Prime Minister (FIEA, art. 79-19, para. 1).
6 1 Significance

Financial instruments business operators assume heavy responsibilities as the bearers of securities market functions; however, if these financial instruments business operators themselves should fail, the link between securities markets and investors’ investment decisions will be cut off, leading to a serious disruption of market functions. It will also cause investors unforeseeable damages that are unrelated to the investment decisions.

While the FIEA does impose a duty on financial instruments business operators of separate management of customer assets in order to avoid a situation of this nature, it is possible that because of a reason such as the financial instruments business operator’s negligence in this duty a situation of this nature may occur (i.e., a disruption in market function or damage to investors) at the time of a failure. The FIEA, consequently, has enacted the system of an investor protection fund in order to provide relief to investors and to maintain the continuity of market functions in these circumstances (FIEA, art. 79-21).

There are two main type of relief provided by an investor protection fund: (i) paying general investors, and (ii) lending to financial instruments business operators (FIEA, art. 79-49, para. 1, item 1 and item 2). In (i) the fund makes payment, on behalf of the failed dealer, to general investors for the losses that they have incurred. In the case of (ii), the fund will lend to a failed dealer in order that the failed dealer itself will be able to make a prompt return of customer assets.

In contrast to banking transactions for which the basic nature is a creation of credit which requires a deposit insurance system, it is important to remember that as long as a financial instruments business operator faithfully carries out the separate management of customer assets, customers should not be harmed by the failure of the dealer.

Pursuant to the amendments in 2012, the purpose and scope of business (scope of general investors and customers assets) of the investor protection funds were expanded to include commodity-related market transactions of derivatives and the incidental transactions thereof and, provisions were established to enable the investor protection fund to specify in its articles of incorporation that the scope of its business shall be limited to either the securities-related business or business related to commodity-related market transactions of derivatives.

6 2 Establishment of Investor Protection Fund

Membership in a fund is limited to financial instruments business operators (FIEA, art. 79-26, para. 1), and a type I financial instruments business operator must be a member of a fund.
However, type I small amount electronic offering handling business operators, and type I financial instruments business operators who intend to engage only in the type I small amount electronic offering handling business, are not required to become members of a fund (FIEA, art. 79-27, para. 1; FIEAEO art. 18-7-2, para. 1).

To establish an investor protection fund, at least 20 financial instruments business operators become promoters, draft the articles of incorporation and business regulations, hold an initial general meeting, follow the requisite procedures and obtain authorization of establishment from the Prime Minister and the Minister of Finance (FIEA, art. 79-29 through art. 79-33).

6.3 Claims Eligible for Indemnification

The claims that a fund will indemnify shall be claims that general customers (meaning investors other than qualified institutional investors, national/local public bodies, the investor protection fund, the Bank of Japan, an officer of the financial instruments business operator for which the finding is made or the parent juridical person, etc. thereof, or general customers who own customer assets under a different name or a pseudonym; FIEA, art. 79-20) of a failed business operator have against the relevant financial instruments business operator). These claims include: (i) money or securities deposited with the financial instruments business operator as margins in futures trading or margins in margins transactions; (ii) money or securities belonging to the account of the general customers, or the money and securities deposited with the financial instruments business operator from general customers concerning transactions pertaining to the financial instruments business, (other than transactions pertaining to over-the-counter transactions of derivatives, etc.); or (iii) money or securities held in safekeeping (provided that there are exceptions—see FIEAEO, art. 18-7) (FIEA, art. 79-20, para. 3 and art. 79-56; FIEAEO, art. 18-11).

Further, claims for damages based on tort are not included within the definition of claims subject to reimbursement.

It should be noted that amounts that a fund will pay to general customers will be a certain amount calculated on the basis of the amount of the claim (FIEA, art. 79-56; and art. 79-57), and that there is a maximum on the amount of payment that can be made (up to JPY10 million per customer) (FIEAEO, art. 18-12).

6.4 Management of Investor Protection Fund

A fund shall be managed in accordance with the resolutions of the board of governors, etc. bound by the provisions of the articles of incorporation (FIEA, art. 79-34 through art. 79-48).

If cancellation of registration of a member financial instruments business operator or other
cause has occurred, the fund shall on request by a general investor take the prescribed procedures and pay those claims in connection with customer assets for which it is found that the financial instruments business operator will have difficulty paying itself without impediment, to the maximum prescribed by Cabinet Order (JPY10 million) (FIEA, art. 79-56 through art. 79-58; FIEAEEO, art. 18-12).

To expedite the refund of customer assets, a fund will provide a loan of funds necessary for such refund to a member financial instruments business operator, conditional upon a finding of necessity by the Prime Minister (FIEA, art. 79-59).

A fund possesses the authority to take any judicial or extrajudicial action against a financial instruments business operator to protect the claims of the general customer, and has a duty to carry out all such actions in a fair and faithful manner with a duty of care of a prudent manager (FIEA, art. 79-60, para. 1 through para. 3).

Member financial instruments business operators must remit as dues their share of the amounts necessary to cover the expenses of the fund’s functions in accordance with the formula provided in the fund’s business regulations (FIEA, art. 79-64 through art. 79-66).

If a financial instruments business operator ceases to engage in the securities business, dissolves or has its registration revoked, it must also withdraw from the fund in accordance with the requisite procedures (FIEA, art. 79-28).

7 Financial Instruments Exchanges

7.1 Significance

A financial instruments exchange refers to a financial instruments membership corporation or stock company that establishes a financial instruments market (meaning a market on which securities are traded or market transactions of derivatives are carried out and excluding markets which solely carry out commodity-related market transactions of derivatives; FIEA, art. 2, para. 14), having obtained a license from the Prime Minister (FIEA, art. 2, para. 16, and art. 80, para. 1).

The distribution markets for financial instruments are created on financial instruments exchanges, on which prices are formed pursuant to the principles of transparency and fairness. A financial instruments market held by a financial instruments exchange is referred to as a financial instruments exchange market (FIEA, art. 2, para. 17).

Because a financial instruments market established by a financial instruments exchange is public goods of the citizens, the establishment thereof requires a license from the Prime Minister (FIEA, art. 80, para. 1, art. 81, and art. 82).
transactions without a license are strictly prohibited (FIEA, art. 167-3), subject to criminal penalty (FIEA, art. 200, item 19) and the transactions so conducted are considered null and void.

### Expansion of the Business of Financial Instruments Exchanges in Accordance with the FIEA Amendments

The amendments in 2008 enabled financial instruments exchanges to establish a specified financial instruments exchange market targeting only professional investors (FIEA, art. 2, para. 32; the so-called professional market).

On this professional market, general investors other than professional investors, etc. are prohibited from purchasing securities through entrustment (purchase by general investor, etc.) (FIEA, art. 117-2, para. 1), and on this premise, market rules can be designed relatively freely with respect to the manner and contents of information provision and disclosure, language, accounting standards, etc. To establish this professional market, matters such as issues related to the restriction of acceptance of entrustment of sales and purchase of securities, and the contents of the specified securities information and issuer information to be provided by or disclosed by the issuer of the specified listed securities and the manner of provision or disclosure and timing, etc. must be prescribed in the business regulations (FIEA, art. 117-2, para. 2). Therefore, amendments on business regulations require the authorization from the Prime Minister (FIEA, art. 149, para. 1). Securities listed only on a specified financial instruments exchange market are called “specified listed securities” (FIEA, art. 2, para. 33).

Furthermore, with the 2008 amendments likewise, a financial instruments exchange has become enabled to establish a market conducting emissions trading and other transactions similar to transactions in financial instruments (FIEA, art. 87-2; market for transactions similar to financial instruments trading). A financial instruments business operator that is already engaged in the type I financial instruments business or the investment management business may engage in emissions trading and intermediary service thereof (FIEA, art. 35, para. 2, item 7; FIBCOO, art. 68, item 16 and item 17), but because emissions are already the subject of on-exchange trades in Europe and the U.S., this has become admitted in Japan as well.

Moreover, with the 2009 amendments, in addition to emissions trading, a stock company financial instruments exchange may establish commodity futures markets and may carry out operations that are related to that. Pursuant to this, the cross entrance of financial instruments exchanges and commodity exchanges have become possible. A financial instruments exchange may also conduct these operations through an owned subsidiary that has been authorized by the Prime Minister (FIEA, art. 87-3, para. 1, proviso), and moreover, a financial instruments exchange holding company may conduct these operations through its operation and management of its subsidiary (FIEA, art. 106-23, para. 2 and art. 106-12, para. 1(a) through (d)).

To open such a market for transactions similar to financial instruments trading, the authorization of the Prime Minister is required (FIEA, art. 87-2, para. 1, proviso), and if such
operations may damage the trust in the public nature of the operations of financial instruments exchanges or may damage the sound and adequate operations of the establishment of a financial instruments exchange market or activities pertaining thereto, the authorization shall not be given (FIEA, art. 87-2, para. 2).

Also, if it is found that by conducting such operations there is a risk of damaging trust in the public nature of the business of the relevant financial instruments exchange or a risk of damaging the sound and adequate operations of the establishment and the like of a financial instruments market, the Prime Minister may revoke the relevant authorization (FIEA, art. 152, para. 1, item 3), and the same is true if these types of risks arise through the acts of a subsidiary (id., item 4).

In addition to the abovementioned amendments, under the amendments made in 2012, necessary provisions were established to facilitate a comprehensive exchange which can cross-sectionally and collectively deal with securities, financial instruments and commodities by removing the barriers among them.

Through the 2014 amendments, the business of designating numbers for identifying parties to financial instruments transactions (excluding transactions on financial instruments exchange markets) have been additionally included in the scope of business of financial instruments exchange markets (FIEA, art. 87-2, para. 1).

Furthermore, the 2017 amendments introduced a new scheme designed to enhance flexibility in terms of the division of operations within an exchange group, which enables the exchange to carry out some common and duplicate operations of the group members, such as system development (FIEA, art. 87-2, para. 1), while enabling the exchange group to continue to hold a foreign exchange, etc. as its subsidiary for a prescribed period (five years in principle) even where the foreign exchange’s business operations go beyond the scope of operations allowed for its subsidiary (FIEA, art. 87-3, para. 6 to para. 8).

7 2 Forms of Organization

The FIEA, Article 1 advocates the purpose of full exploitation of the functionalities of the capital markets through the assurance of proper operation of financial instruments exchanges, and upon a financial instruments exchange establishing a financial instruments market, its articles of incorporation, business regulations and brokerage rules are examined as to whether they are sufficient to achieve fair and smooth trading of securities and market transactions of derivatives on the financial instruments market of the exchange, and to protect investors (FIEA, art. 82, para. 1), and the financial instruments exchange must implement appropriate self-regulatory activities in order to achieve such purposes (FIEA, art. 84, para. 1).

There are two legal forms of organization for a financial instruments exchange, (i) a financial instruments membership corporation (a membership-type financial instruments exchange), and (ii)
a stock company (a stock company-type financial instruments exchange); however, they both are organizations for the purpose of achieving the objectives of the FIEA, Article 1, and the stock company vehicle is permitted only because it is possible to achieve the objectives in a proper fashion by using a stock company vehicle.

A financial instruments exchange is under the supervision of the Prime Minister. This includes, *inter alia*, cancellation of licenses and permits, dismissal of officers, collection and inspection of reports, various dispositions, and issuing of orders for improvement of business (FIEA, art. 148 through art. 153-5).

The Prime Minister may if necessary order changes to the articles of incorporation, business regulations or other rules, etc., or take such other supervisory measures as necessary (FIEA, art. 153), and may further order the submission of reports and documentation in connection with the business activities and financial condition, as well as have its official conduct inspections (FIEA, art. 151 and art. 188).

(1) **Requirements for Establishing a Financial Instruments Market and Financial Instruments Exchanges**

Normally, a license from the Prime Minister must be obtained in order to establish a financial instruments market (FIEA, art. 80, para. 1).

Only two types of entities may become a financial instruments exchange (i) a financial instruments membership corporation, and (ii) a stock company that complies with law and regulation (FIEA, art. 83-2). A market established by an exchange is truly a financial instruments market, and a person as set forth above must obtain a license if the said person desires to establish a financial instruments exchange.

In order to obtain this license, application for a license must be made that includes submission of (i) a license application (stating, *inter alia*, the firm name, and location of principal office, as well as the names of officers and members), (ii) the articles of incorporation, and (iii) the business regulations, brokerage rules and other documentation (FIEA, art. 81, para. 1 and para. 2).

The Prime Minister shall examine the same in view of the license screening criteria (*i.e.*, criteria including that the provisions of (ii) and (iii), etc. comply with law and regulation, and are sufficient to achieve a fair and smooth functioning market and to protect investors) (FIEA, art. 82).

(2) **Financial Instruments Membership Corporation**

To establish a financial instruments exchange as a financial instruments membership corporation, a financial instruments business operator, etc. must become a promoter (FIEA, art. 88-2), and follow the procedures for establishment.

The main procedures follow the steps of (i) drafting of the articles of incorporation by the promoter (FIEA, art. 88-3), (ii) calling and convening the organizational general meeting, approving the articles of incorporation and deciding other matters that are necessary for establishment (FIEA, art. 88-4), (iii) preparing the general inventory and the registry of members (FIEA, art. 88-11), (iv) recording the establishment (FIEA, art. 89-2), and (v) coming into effect.
The articles of incorporation must state the following matters and bear the names and seals of all promoters (FIEA, art. 88-3):

(i) Purposes; (ii) Name; (iii) Location of office; (iv) Matters concerning its foundation fund and contributions; (v) Matters concerning its members, etc. (meaning Regular Members or Trading Participants; hereinafter the same shall apply in this Chapter) ; (vi) Matters concerning monitoring of the state of compliance by its members, etc. with laws, regulations, administrative actions based on laws and regulations, the articles of incorporation and other similar regulations, and the principle of fair and equitable transactions; (vii) Matters concerning guarantee funds; (viii) Matters concerning allocation of expenditures; (ix) Matters concerning officers; (x) Matters concerning meetings; (xi) Matters concerning execution of operations; (xii) Matters concerning the preparation of regulations; (xiii) Matters concerning financial instruments exchange market; (xiv) Matters concerning accounting; and (xv) Method of public notice.

A financial instruments membership corporation is explicitly prohibited from engaging in business for profit (FIEA, art. 97). A stock company-type financial instruments exchange is also an institution to achieve the objectives of the FIEA as discussed above, and thus is not a for-profit institution either (there is absolutely no contradiction between the ability to distribute surplus and the objectives involving a high degree of public interest).

(3) Stock Company-Type Financial Instruments Exchanges

If a financial instruments exchange is to be established as a stock company, the stock company established in accordance with the provisions of the Companies Act will obtain a license to operate a financial instruments market. Establishment procedures generally follow the Companies Act (Companies Act, art. 25 through art. 103).

However, under the FIEA, the following matters must be stated in the articles of incorporation of a stock company-type financial instruments exchange, in addition to those set forth in Article 27 of the Companies Act (FIEA, art. 103):

(i) Matters concerning examinations of the status of compliance by transaction participants with the law and regulations, and the principle of good faith in transactions;
(ii) Matters concerning preparation of the regulations;
(iii) Matters concerning the financial instruments exchange market; and
(iv) In the event of establishing the self-regulatory committee, to that effect.

Furthermore, minimum capital amounts (JPY1 billion) (FIEA, art. 83-2; FIEAEo, art. 19) and regulations on stock acquisition and holding (see “7-4(3) Shareholders and Trading
Participants in a Stock Company-Type Financial Instruments Exchange” for details) are prescribed, stemming from the necessity of maintaining a certain financial base in order to preserve the public nature of the exchanges.

(4) Foreign Financial Instruments Exchange

A person who operates a foreign financial instruments market (meaning a market that is similar to a financial instruments exchange market, but which is located in a foreign country; FIEA, art. 2, para. 8, item 3(b)) may receive an authorization from the Prime Minister, and have financial instruments business operators and registered financial institutions engage in trades and transactions of financial instruments on foreign financial instruments markets by connecting an electronic information system and I/O units that are to be used by those persons (FIEA, art. 155 through art. 155-10 and art. 156).

A foreign financial instruments exchange shall mean a person who has obtained this authorization (FIEA, art. 2, para. 26).

(5) Organizational Conversion

A membership-type financial instruments exchange may convert to a stock company-type financial instruments exchange (FIEA, art. 101).

Conversion must follow the procedures for preparing a conversion plan and obtaining the approval of the general meeting (FIEA, art. 101-2), the authorization of the Prime Minister (FIEA, art. 101-17), resolving any creditor objections (FIEA, art. 101-4; Companies Act, art. 779), allotting shares to members (FIEA, art. 101-6), and posting capitalization in the statutory amount (FIEA, art. 101-7).

(6) Merger

Mergers between financial instruments exchanges incur restrictions which differ in their pattern depending on the form of organization of the exchange.

A membership-type financial instruments exchange can merge with another membership-type financial instruments exchange or a stock company-type financial instruments exchange. However, the surviving entity or the entity created in the merger is subject to the following restrictions (FIEA, art. 136, para. 1 and para. 2):

(i) In the case of a merger between two membership-type financial instruments exchanges, the entity must be a membership-type financial instruments exchange; and

(ii) In the case of a merger between a membership-type financial instruments exchange and a stock company-type financial instruments exchange, the entity must be a stock company-type financial instruments exchange.

In each of these cases a merger agreement must be prepared (FIEA, art. 136, para. 1), and approval by a general meeting (FIEA, art. 139-3, para. 3, art. 139-4, para. 2, art. 139-5, para. 3, and art. 139-8, para. 1), as well as authorization from the Prime Minister must be obtained (FIEA, art. 140).

Furthermore, pursuant to the amendments in 2012, the following provisions were established
with respect to the merger between a stock company-type financial instruments exchange and incorporated commodity exchange (FIEA, art. 142, para. 5 and 9).

(i) In the case where a stock company-type financial instruments exchange is to be newly incorporated as a result of the merger, the stock company-type financial instruments exchange shall succeed to the rights and obligations of the stock company-type financial instruments exchange that extinguishes by such merger on the date of completion of the merger.

(ii) The transaction, which has come into effect on the commodity market established by the incorporated commodity exchange that is to extinguish but for which the settlement has not been completed, shall be deemed to be a market transaction of derivatives that has come into effect under the same conditions on the financial instruments exchange market established by the stock company-type financial instruments exchange after the merger.

7 3 Self-Regulatory Committee and Self-Regulatory Organizations

(1) Significance of Self-Regulation

Financial instruments exchanges and financial instruments firms associations in and of themselves are referred to as self-regulatory organizations. This term is an expression of the historical nature of securities markets having been run autonomously or independently by business operators. This historical substance of self-regulation has waned given that as of the present time these organizations are under strict regulation by law from their establishment to all aspects of their operation, etc.

Since the regulation of securities markets must respond quickly to events that change constantly, it is indispensable for a self-regulatory organization to respond flexibly based on a hands-on approach. By way of example as there may be cases depending on the circumstances in which it is necessary to immediately suspend trades if a failure to make timely disclosure occurs. Delegating regulation to the exchange that knows the actual situation will better enable realistic action to be taken.

A financial instruments exchange in and of itself is a self-regulatory organization, and within the functions that it has of trading monitoring and oversight, listing examination and listing supervision have a particular need for neutrality and independence from all forces, as they are functions that truly carry the core of price formation. The FIEA refers to these latter functions particularly as self-regulation, and has created a regime for the purpose of maintaining their independence(Note).

(Note) It can be recognized that one aspect behind the direct statement in the FIEA of a regime of self-regulation of a financial instruments exchange is that the possibility exists of a conflict between the role of self-regulation that an exchange should
perform and the interests of an issuer of stock in the event that an exchange that takes the form of a stock company lists its own shares on the market (FIEA, art. 124 and art. 125).

It has further been mentioned that there is a possibility that an exchange will be lenient in applying rules and listing criteria to listed companies since one source of income for a financial instruments exchange is the various fees (trading commission, listing commission) that a financial instruments exchange collects from listed companies.

(2) **Self-Regulation of a Financial Instruments Exchange**

The FIEA stipulates that “a financial instruments exchange must properly carry out self-regulatory operations in accordance with this law, the articles of incorporation and other rules in order to achieve the fair trading of securities and market transactions of derivatives in the financial instruments exchange market and to protect investors” (FIEA, art. 84, para. 1).

The following are included in the self-regulatory operations that a financial instruments exchange must carry out (FIEA, art. 84, para. 2):

(i) **Operations regarding the listing and delisting of a financial instrument, financial index, or option;**

(ii) **Investigation of compliance on the part of a member, etc. with law and/or regulation, dispositions by an administrative agency pursuant to law and/or regulation, the articles of incorporation and other rules, as well as the principle of fair and equitable transactions; and**

(iii) **Such other operations as prescribed by Cabinet Office Ordinance as being necessary to secure fair transactions on a financial instruments exchange market.**

(3) **Structures for Implementing Self-Regulation**

In order to nullify problems of conflicts of interest in connection with self-regulation by a financial instruments exchange, and to enable a certain level of independence and objectivity in the conduct of self-regulatory activities, the FIEA stipulates as structures for the conduct of self-regulation that (i) the self-regulatory activities are to be delegated to a self-regulatory organization (FIEA, art. 85); or (ii) carried out by a self-regulatory committee (FIEA, art. 105-4). While a self-regulatory organization is a different organization from the company that operates the market, they are both organizations for the purpose of fair price formation.

The first structure above is a form that may be taken by either a membership-type or stock company-operated exchange. The exchange must obtain authorization from the Prime Minister if the exchange will delegate self-regulatory operations to a self-regulatory organization (FIEA, art. 85, para. 1). A self-regulatory organization here means a juridical person that is incorporated for
the purpose of carrying out self-regulatory operations (FIEA, art. 85, para. 1 and art. 102-2 through art. 102-7). A self-regulatory organization cannot be incorporated by any person other than a financial instruments exchange, a financial instruments exchange holding company or a parent commodity exchange, etc. (FIEA, art. 102-3, para. 1). A self-regulatory organization must obtain authorization from the Prime Minister in order to carry out self-regulatory operations (FIEA, art. 102-14), and a self-regulatory organization may not engage in activities on a for profit basis (FIEA, art. 102-21).

The second structure is a form in which a self-regulatory committee is established within the exchange. This form may be used only by a stock company-type financial instruments exchange (specified stock company-type financial instruments exchange; FIEA, art. 105-4). A self-regulatory committee is incorporated within the stock company-type financial instruments exchange, and its authority is to determine matters in connection with the self-regulatory operations of the financial instruments exchange (FIEA, art. 105-4, para. 2). A self-regulatory committee shall have at least three members, and the majority of the membership must be outside directors (FIEA, art. 105-5, para. 1). Selection is made by resolution of the board of directors, from among the directors of the stock company-type financial instruments exchange (FIEA, art. 105-5, para. 2).

(4) Investigation of High Speed Traders

Beyond what is provided for in Article 84 of the FIEA, a financial instruments exchange is to investigate the compliance of a person engaged in high speed trading utilizing with laws and regulations and dispositions by government agencies which are based on laws and regulations and to take any other necessary measures, in accordance with the FIEA and with its articles of incorporation and other rules, in order to ensure the fair purchase and sale of securities and market derivatives transactions on the financial instruments exchange market, as well as to protect investors (FIEA, art. 85-5, para. 1). The provisions of the FIEA (excluding Article 84) apply by deeming the services pertaining to these measures as self-regulatory services (id., para. 2). These rules have been introduced because, in order to ensure the effectiveness of the regulations on high speed trading, it was considered to be appropriate to empower the exchange, which operates the trading system and observes the market from the closest position, to investigate the conduct of high speed traders.

(5) Delegation of Specified Activities

The 2008 amendments have enabled financial instruments exchanges to establish the so-called professional markets, and in accordance therewith, financial instruments exchanges have become enabled to delegate among part of its self-regulatory activities concerning the specified financial instruments exchange market activities handling matters other than matters involving the fundamentals of investor protection (specified activities) to persons other than self-regulatory organizations (FIEA, art. 85, para. 4).

It is also possible for a self-regulatory organization that has been delegated from a financial instruments exchange self-regulation to sub-delegate only the specified activities upon consent of
the exchange (FIEA, art. 102-19, *proviso*). Furthermore, a specified stock company-type financial instruments exchange may similarly delegate [activities] upon determination by the self-regulatory committee (FIEA, art. 85, para. 6).

This system was designed upon reference to the Nomad (Nominated Adviser) system of U.K.’s London Stock Exchange AIM (Alternative investment Market). In the U.K., securities companies, law firms and audit firms act as advisers nominated by the exchange.

The professional market was envisaged as a relatively free market on the premise of the information collection and analysis ability or risk management ability of professional investors, however, for this reason, a person in a position to ensure the fairness of the markets is likely to be questioned strict responsibility. Not only the exchanges but persons being delegated of the self-regulatory activities must also conduct strict supervision for the ensuring of market fairness.

Exchanges must select an appropriate delegate to ensure the quality of self-regulation and shall be liable for the supervision thereof (FIEA, art. 85, para. 4 and para. 5; Cabinet Office Ordinance Concerning Financial Instruments Exchanges, Etc., art. 7-3).

7 4 Members and Trading Participants

(1) Members of a Financial Instruments Membership Corporation

(i) Qualification to Become a Member

Membership in a financial instruments membership corporation is limited to financial instruments business operators, etc. (FIEA, art. 91). A member shall contribute funds as stated in the articles of incorporation, and in principle shall have liability that is limited to the extent of the said contribution (FIEA, art. 92).

(ii) Withdrawal

A member may withdraw from the financial instruments membership corporation upon the approval of the financial instruments membership corporation (FIEA, art. 94). In this event, the member may obtain approval from the financial instruments membership corporation and assign its interest (FIEA, art. 93).

A member shall also withdraw if it no longer constitutes a financial instruments business operator, etc., or dissolves or is expelled (FIEA, art. 95). If a member withdraws, the financial instruments membership corporation must refund that member’s interest in the financial instruments membership corporation (FIEA, art. 96).

(iii) Member Rights and Duties

(a) Rights

Members, etc. have the right to conduct trades or other transactions on the financial instruments exchange market (FIEA, art. 111).
(b) Duties

A member has a duty to make the equity contribution (FIEA, art. 92, para. 1). Members, etc. must deposit a guarantee fund with the financial instruments exchange (FIEA, art. 114, para. 1 and para. 2).

(2) Trading Qualification on a Membership-Type Financial Instruments Exchange

In principle only members, etc. of a financial instruments exchange that holds the financial instruments exchange market shall be permitted to conduct transactions (FIEA, art. 111).

A membership-type financial instruments exchange may, however, make a stipulation in its articles of incorporation granting trading qualifications to financial instruments business operators, authorized transaction-at-exchange operators, and registered financial institutions (FIEA, art. 112, para. 1). Pursuant to the amendments in 2012, a membership-type financial instruments exchange can now grant the qualification to trade only for commodity-related market transactions of derivatives (FIEA, art. 112, para. 2).

(3) Shareholders and Trading Participants in a Stock Company-Type Financial Instruments Exchange

(i) Shareholders of a Stock Company-Type Financial Instruments Exchange

In principle there is no particular requirement to become a shareholder of a stock company-type financial instruments exchange other than to hold stock in the exchange. Nevertheless, the following stringent restrictions exist on holding voting rights, in view of the public nature, etc. of a financial instruments exchange (FIEA, art. 103-2):

(1) No person (excluding an authorized financial instruments firms association, a financial instruments exchange, a financial instruments exchange holding company, a commodity exchange, or a commodity exchange holding company) may acquire or hold 20 percent or more of the voting rights (FIEA, art. 103-2, para. 1). This base holding ratio is reduced to 15 percent if any event occurs that is presumed to have a material influence on decisions concerning financial and operational policies of the exchange;

(2) A person who has come to hold more than five percent of the voting rights must submit to the Prime Minister a notification of holdings in subject voting rights, stating the purposes of holding and other matters (FIEA, art. 103-3). If a false statement or omission is made in the notification of holdings in subject voting rights, the Prime Minister can order the submission of a report or documentation or conduct an investigation (FIEA, art. 103-4).

In order that local governments, etc. can invest in exchanges, an exception has been enacted to the restriction on the holding of voting rights, to the effect that entities such as local governments can hold up to 50 percent of the voting rights, after obtaining authorization from the Prime Minister (FIEA, art. 106-3 through art. 106-5).
(ii) Trading Participants on a Stock Company-Type Financial Instruments Exchange

A stock company-type financial instruments exchange may, by its business regulations, grant trading qualifications to financial instruments business operators, authorized transaction-at-exchange operators and registered financial institutions (FIEA, art. 113). Persons with trading qualifications are referred to as trading participants. Pursuant to the amendments in 2012, a stock company-type financial instruments exchange can now grant the qualification to trade only for commodity-related market transactions of derivatives (FIEA, art. 113, para. 2).

A trading participant may lose its qualification according to the stipulations of the business regulations of an exchange (FIEA, art. 94 and art. 113, para. 3). Moreover, a transaction participant shall lose its qualification if it no longer constitutes a financial instruments business operator, etc., or dissolves or is expelled (FIEA, art. 95 and art. 113, para. 3).

(4) Financial Instruments Exchange Holding Company

A financial instruments exchange holding company is a stock company that has as its subsidiary a stock company-type financial instruments exchange (= holding of a majority of the voting rights of all shareholders) incorporated upon the authorization of the Prime Minister or that has been authorized by the Prime Minister (FIEA, art. 2, para. 18).

A person (stock company) who wishes to make a stock company-type financial instruments exchange into a subsidiary (= holding of a majority of the voting rights of all shareholders) shall obtain prior authorization from the Prime Minister (FIEA, art. 106-10). The examination criteria for the authorization are as follows (FIEA, art. 106-12, para. 1):

(i) That the sole purpose of the applicant or the company incorporated upon authorization (applicant, etc.) is to own the stock company-type financial instruments exchange or the stock company-type financial instruments exchange and any of the following listed companies as its subsidiary;

(a) A company that conducts operations incidental to the establishment of a financial instruments exchange market;
(b) A company that conducts operations related to the establishment of a financial instruments exchange market;
(c) A company that conducts the business of establishing commodities markets; or
(d) A company that conducts business related to the establishment of markets necessary for carrying out commodity futures transactions;

(ii) That the revenue forecasts of the applicant and the stock company-type financial instruments exchange which is to become a subsidiary of the applicant are favorable;

(iii) That the applicant has the knowledge and experience, from the perspective of
its personnel composition, to perform appropriate and fair business management for the stock company-type financial instruments exchange which is to become a subsidiary; and

(iv) That the applicant has a sufficient reputation in society.

Restrictions on stock acquisition and holding similar to those for financial instruments exchanges are also provided in connection with financial instruments exchange holding companies, in view of their public nature (FIEA, art. 106-14 through art. 106-22).

Also, the regulations are essentially those imposed on financial instruments exchanges (FIEA, art. 87-2 and art. 87-3) in that the holding company cannot engage in any business other than business management of a subsidiary stock company-type financial instruments exchange, a subsidiary that conducts operations incidental to the establishment of a financial instruments exchange market, a subsidiary that conducts operations related to the establishment of a financial instruments exchange market, a subsidiary that conducts the business of establishing commodities markets, or a subsidiary that conducts business related to the establishment of markets necessary for carrying out commodity futures transactions, and related business (FIEA, art. 106-23), and that having a company as a subsidiary that engages in activities in connection with establishing financial instruments exchange markets, activities of establishing a commodity market, or activities related to the establishment of markets necessary for carrying out commodity futures transactions is possible on condition that authorization is obtained from the Prime Minister (FIEA, art. 106-24).

The Prime Minister may order the financial instruments exchange holding company or its subsidiary to submit a report or other reference materials concerning the operations or assets of such financial instruments exchange holding company or its subsidiary, or have officials conduct an inspection if the Prime Minister recognizes this to be necessary and appropriate for the protection of investors or the public interest (FIEA, art. 106-27).

In addition, the Prime Minister may, if the financial instruments exchange holding company has violated a law or regulation, or if the Prime Minister finds that in light of the circumstances of the activities of the financial instruments exchange holding company it is necessary to protect trust in the public nature and the sound and proper operations of its subsidiary stock company-type financial instruments exchange, cancel the authorization of the financial instruments exchange holding company or the authorization to have as a subsidiary a company that conducts operations related to the establishment of a financial instruments exchange market, that conducts the business of establishing commodities markets, or that conducts business related to the establishment of markets necessary for carrying out commodity futures transactions and order it to take such other necessary supervisory actions (FIEA, art. 106-28, para. 1).

Furthermore, the Prime Minister may, if a director, accounting advisor, corporate auditor or executive officer of a financial instruments exchange holding company has violated a law or regulation or an administrative action by an administrative agency pursuant to a law or regulation, order the financial instruments exchange holding company to dismiss the director, accounting advisor, corporate auditor or executive officer (id., para. 2).
Listing of Securities

Securities traded on a financial instruments market must satisfy certain criteria under which the financial instruments exchange is able to take responsibility for achieving fair price formation, and for which it is possible to recognize that economic significance for the nation exists in creating a market in connection with the securities. The acceptance of these by a financial instruments exchange and making them eligible for trading on the financial instruments exchange as securities of this type is called listing.

The characteristics of listing are not simply the execution of a listing agreement between the financial instruments exchange and the issuing company, and an essential duty of the listing company is demanded from the perspective of achieving the legal objectives of demonstrating the functioning of the capital markets and fair price formation.

When an application to list securities is received, the financial instruments exchange undertakes an examination in accordance with its listing regulations. If as a result the exchange intends to list the securities, the exchange must notify the Prime Minister to such effect (FIEA, art. 121). Except in certain cases, approval from the Prime Minister is also required in the event that a financial instruments exchange intends to list securities that it issues (FIEA, art. 122, para. 1). This applies to delisting as well (FIEA, art. 126).

Trading, Etc. of Financial Instruments on the Financial Instruments Exchange Market

A financial instruments exchange market must be managed and operated to assure fair and smooth trading in securities and market transactions of derivatives, as well as to contribute to the protection of investors (FIEA, art. 110).

For this reason, the following regulations have been implemented:

1. **Persons who may Conduct Transactions on the Financial Instruments Exchange Market**
   
   Only members, etc. of a financial instruments exchange that maintains the relevant financial instruments exchange market may engage in trading securities or market transactions of derivatives on such financial instruments exchange market (FIEA, art. 111).

2. **Restrictions on Trading and the Entrustment/Acceptance Thereof on the Financial Instruments Exchange Market**
   
   The financial instruments exchange prescribes business regulations in order to ensure that trading on a financial instruments exchange market proceeds in a fair and smooth manner (see FIEA, art. 117), and must prescribe Brokerage Rules so that customer orders entrusted or accepted by the members, etc. are performed in a good faith and fair manner (see FIEA, art. 133).
In the case of establishing a financial instruments market for commodity-related market transactions of derivatives, the financial instruments exchange must also prescribe, as part of its operational rules, detailed rules concerning financial instruments, etc. related to the relevant commodity-related market transactions of derivatives for each type of commodity-related market transaction of derivatives (FIEA, art. 117, para. 2).

The effect of the business regulations/brokerage rules are judged according to the meaning of the individual provisions in the market. They can be amended with the approval of the Prime Minister, and the Prime Minister has the authority to order their amendment; governors who do not comply with such orders may be removed (see FIEA, art. 152), and their nature can be interpreted as almost a quasi-Cabinet Order/ministerial ordinance in accordance with the individual provisions.

(3) Notification, Announcement of Total Transaction Balances

A financial instruments exchange must promptly notify members and other relevant parties and make a public announcement regarding the daily total transaction balances, the daily high, low, and closing price for each issue, the negotiated value, and price, etc. (FIEA, art. 130).

(4) Measures to Halt Trading, Etc.

In cases where trading, etc. cannot or may not be performed fairly and smoothly, the financial instruments exchange may halt transactions, but it must notify the Prime Minister in cases where it halts trading or when it lifts a halt on trading (FIEA, art. 128). The core function of the financial instruments exchanges is market management, or monitoring the conduct of transactions on an imperfect competitive market.

If inaccurate information is spread throughout the market, a temporary halt in trading is necessary to return market conditions back to a healthy state.

(5) Deposit of the Guarantee Funds

Members, etc. must deposit the requisite guarantee funds with the financial instruments exchange in accordance with the provisions of the articles of incorporation (or the business regulations in the case of a stock company-type financial instruments exchange) of such financial instruments exchange (FIEA, art. 114, para. 1). Persons who consigned trades, etc. to members, etc. on the financial instruments exchange market have the right to receive satisfaction out of this guarantee fund ahead of other creditors (id., para. 4). This rule was enacted as part of the investor protection scheme.

Further, when a member, etc. causes damage to another member, etc., or the financial instruments exchange as a result of not performing its obligations based on trades or other transactions on a financial instruments exchange market, the injured member, etc., or the financial instruments exchange has the right to receive satisfaction ahead of other creditors from the guarantee funds of the member, etc. causing the injury. However, these rights are junior to the aforementioned claims of the general investor who entrusted such member, etc. with a trade or other transaction (FIEA, art. 115).
8 Financial Instruments Clearing Organizations, Etc.

8 1 Financial Instruments Clearing Organization

(1) Significance

A financial instruments clearing organization is a person who has obtained a license or approval from the Prime Minister and carries out the business activities of financial instruments obligations assumption service as well as activities related thereto (FIEA, art. 2, para. 29, art. 156-2, and art. 156-19). The counterparty to the activities of financial instruments obligations assumption service is referred to as a clearing participant (FIEA, art. 156-7, para. 2, item 3). If a financial instruments exchange will become a financial instruments clearing organization, the financial instruments exchange will only be required to obtain approval from the Prime Minister (FIEA, art. 156-19).

By the amendments in 2010, a juridical person incorporated in accordance with the laws of a foreign country that conducts the same type of business as the business activities of financial instruments obligations assumption service in a foreign country may be licensed by the Prime Minister to engage in the business activities of financial instruments obligations assumption service (FIEA, art. 156-20-2).

In addition, under the same amendments, a financial instruments clearing organization may be permitted by the Prime Minister to conduct the business activities of coordinated financial instruments obligations assumption service (to conduct as business of having a third party bear the obligations of a clearing participant regarding subject transactions other than the transactions provided for in Article 156-62, Item 1 of the FIEA, and to conduct the acts prescribed by Cabinet Office Ordinance as acts of bearing the obligations of the counterparty of the clearing participant concerning the said subject transaction) upon executing an agreement regarding the business activities of coordinated financial instruments obligations assumption service with a coordinated clearing organization, etc. (meaning other financial instruments clearing organization, foreign financial instruments clearing organization or a person incorporated in accordance with the laws of a foreign country that conducts the same type of business as the business activities of financial instruments obligations assumption service in a foreign country) (FIEA, art. 156-20-16, para. 1).

(2) Function

Since many trades and transactions are carried continuously and repeatedly with numerous counterparties on a financial instruments market, it is impossible to track the changes in each transaction, necessitating batched processing of trades.

A financial instruments clearing organization (normally referred to as a clearinghouse) stands between both parties to a transaction, and processes a large volume of clearing work in the form of assuming the respective claims and liabilities in connection with the securities and payment for
the same on the part of the parties. In this manner settlement of trading parties on the entire
market is centralized with one person.

By highlighting this function of a financial instruments clearing organization, this type of
facility is also referred to as a “central counterparty.”

Since a financial instruments clearing organization assumes claims and liabilities, the
clearing participants will be able to carry out transactions without being particularly concerned
with the credit risk of the counterparty to the trade, which will ensure that transactions in the
market are conducted in an ongoing manner.

A financial instruments clearing organization carries out netting by calculating the net
margins on the part of a transaction participant that engages in trades with numerous parties, and
settling only the difference. This eliminates waste in transporting cash and securities back and
forth, and enables efficient use thereof.

(3) Nature

The proper, accurate and sound operations of a financial instruments clearing organization,
which fulfills the functions discussed above, constitutes a support for the smooth operations of the
market.

The FIEA, consequently, requires that a license from the Prime Minister be obtained in order
to carry out the financial instruments obligations assumption service, and stipulates that a
prescribed screening be conducted (FIEA, art. 156-4 and art. 156-20-4).

Because of the nature of the role that is fulfilled by financial instruments clearing
organizations, stipulations have been made in the form of a prohibition against improper
discriminatory treatment of specified clearing participants (FIEA, art. 156-9 and art. 156-20-8),
the duty to maintain confidentiality (FIEA, art. 156-8 and art. 156-20-7), and restrictions on
business activities (FIEA, art. 156-6).

(4) Business Methods Manual

A financial instruments clearing organization must prepare a business methods manual and
carry out its activities in accordance with the same (FIEA, art. 156-7, para. 1 and art. 156-20-6,
para. 1). The business methods manual shall state the types of transactions that create the
obligations to be addressed by the business activities of financial instruments obligations
assumption service as well as the financial instruments that cover these transactions, matters
relating to the requirements for clearing participants, matters concerning the bearing of and
performance on obligations by the assumption, novation or other methods conducted as the
business of financial instruments obligations assumption service, matters concerning the achieving
of performance by clearing participants on obligations, matters concerning brokerage of securities,
etc. clearing, and other matters as prescribed by Cabinet Office Ordinance (FIEA, art. 156-7, para.
2 and art. 156-20-6, para. 2).

(5) Incurring of Losses, Etc.

A financial instruments clearing organization shall set forth, in its business methods manual,
that a clearing participant shall bear the entire amount of any losses that are incurred in the
financial instruments obligations assumption service, and take other action to ensure faithful
execution of the financial instruments obligations assumption service (FIEA, art. 156-10). The
ultimate reliability of the clearing organization depends on the reliability of clearing participants.

If a financial instruments clearing organization stipulates clearing deposits in the business
methods manual, and a clearing participant through failing to discharge an obligation causes loss
to the financial instruments clearing organization, the financial instruments clearing organization
that incurred the loss shall have a right to collect payment in preference to other creditors in
connection with the clearing deposit of the clearing participant who caused the damage (FIEA, art.
156-11).

(6) Supervision

Stipulations have also been made including, inter alia, minimum capital regulations (FIEA,
art. 156-5-2); authorization of changes to the articles of incorporation or the business methods
manual (FIEA, art. 156-12); public inspection of the total number of issued shares, etc. (FIEA, art.
156-12-2); authorization of capital reduction, etc. (FIEA, art. 156-12-3); notification of change of
the business offices, etc. (FIEA, art. 156-13); order to dismiss an officer (FIEA, art. 156-14; art.
156-20-14); orders to submit reports and documentation, as well as inspections (FIEA, art. 156-15
and art. 156-20-12); orders to improve the conduct of business (FIEA, art. 156-16 and art. 156-20-
13); and the canceling of a license or order to suspend business (FIEA, art. 156-17 and art. 156-
20-14).

(7) Regulations Concerning Major Shareholders

If a certain major shareholder exercises undue influence on the management of a clearing
organization, the clearing organization may not be able to fully perform its role as a market
infrastructure. Accordingly, in order to ensure the enforcement of the foundation of a clearing
organization incorporated in Japan, the amendments in 2010 has introduced regulations on major
shareholders.

(i) Submission of Notification of Holdings in Subject Voting Rights

A person holding voting rights in excess of 5% of the voting rights of all shareholders of
a financial instruments clearing organization shall submit to the Prime Minister without delay
as prescribed by the Cabinet Office Ordinance a notification of holdings in subject voting
rights stating the ratio of the subject voting rights held to the voting rights of all shareholders
of the financial instruments clearing organization, the purpose of holding and other matters
prescribed by Cabinet Office Ordinance regarding the subject voting rights (FIEA, art.
156-5-3, para. 1).

(ii) Authorization Concerning Major Shareholders, Etc.

A person who wishes to acquire or hold subject voting rights of 20% (if there is a fact
prescribed by Cabinet Office Ordinance as a fact which enables the presumption of having a
material effect on the determination of its financial and management policies, 15%;
hereinafter the “holding base ratio”) or more of the voting rights of all shareholders of a
financial instruments clearing organization, or a person who wishes to incorporate a company or other corporation that wishes to acquire or hold subject voting rights no less than the holding base ratio of the voting rights of all shareholders of the financial instruments clearing organization must obtain the authorization of the Prime Minister in advance (FIEA, art. 156-5-5, para. 1).

In addition, if there is no increase in the number of subject voting rights held or in other cases prescribed by Cabinet Office Ordinance, a person acquiring or holding subject voting rights no less than the holding base ratio of the voting rights of all shareholders of the financial instruments clearing organization (hereinafter referred to as the “specified holder”) shall file a notification to the Prime Minister without delay stating the effect that it has become a specified holder and other matters prescribed by Cabinet Office Ordinance (FIEA, art. 156-5-5, para. 2 and para. 3).

In such case, unless authorized by the Prime Minister, the specified holder must take measures necessary for becoming a holder of the subject voting rights less than the holding base ratio of the financial instruments clearing organization within 3 months of the date it became a specified holder (FIEA, art. 156-5-5, para. 4).

(iii) Collection of Reports and Inspections on Major Shareholders

The Prime Minister may, if considered necessary and appropriate for public interest or investor protection, order a major shareholder of a financial instruments clearing organization (meaning a holder of voting rights of no less than the holding base ratio of the financial instruments clearing organization that has been incorporated upon authorization under Article 156-5-5, paragraph 1 of the FIEA, or authorized under the said Paragraph or the proviso to Paragraph 4 of the said Article) to submit reports or materials that are of reference to the business or assets of the financial instruments clearing organization, or have its officials inspect the documents or other items of the major shareholder (limited to inspections necessary on the business or assets of the financial instruments clearing organization) (FIEA, art. 156-5-8).

(iv) Supervisory Actions Against Major Shareholders

If a major shareholder of a financial instruments clearing organization is in violation of laws and regulations, or if the acts of the major shareholder are considered to harm the sound and proper operation of the business of the financial instruments clearing organization, the Prime Minister may revoke the authorization of the major shareholder and order other measures necessary for supervision to be taken (FIEA, art. 156-5-9, para. 1).

The Prime Minister must conduct a hearing upon ordering necessary measures (id., para. 3).

8 2

Securities Finance Companies

(1) Significance

Securities finance companies are companies licensed by the Prime Minister that are engaged
in functions of extending loans of the cash or securities necessary to settle margin transactions to members, etc. of a financial instruments exchange or members of an authorized financial instruments firms association by utilizing the settlement scheme of the financial instruments exchange market operated by the financial instruments exchange (FIEA, art. 2, para. 30 and art. 156-24).

A securities finance company must be a stock company whose capital amount is at least equal to the amount determined by Cabinet Order as the amount necessary and proper in order to perform the abovementioned functions (minimum capital amount of JPY100,000,000) (FIEA, art. 156-23; FIEAE, art. 19-5).

At present, Japan Securities Finance Co., Ltd. is the only security finance company.

(2) Functions

The four principal functions of securities finance companies are as follows:

(i) Loans for Margin Transactions ...... Loans to financial instruments business operators who are members, etc. of an exchange, of the cash or securities necessary to settle margin transactions;

(ii) Bond Financing ...... Loans collateralized by government bonds, etc. to financial instruments business operators requiring short-term funds to perform their functions as bond underwriters or dealers, and loans collateralized by bonds to customers of financial instruments business operators to allow them to purchase or hold bonds;

(iii) General Loans ...... Loans of money or securities advanced to financial instruments business operators or their customers secured by securities or cash; and

(iv) Intermediary of Bond Lending ...... Borrowing or lending bonds in order to intermediate bonds lending between financial instruments business operators and financial institutions, etc.

Securities finance companies’ source of funds for loans include call money, bank loans, commercial paper proceeds and their own capital, etc.

(3) Concurrent Business

Securities finance companies can conduct the following activities as concurrent business after filing a notification with the Prime Minister, to the extent that this does not interfere with the business activities discussed above (FIEA, art. 156-27, para. 1 and para. 2):

(i) Securities lending (excluding the business activities listed in (2)(i) above) or the performance of intermediation or acting as agent with respect to a securities lending;

(ii) Loans of money to financial instruments business operators;
(iii) Loans of money to customers of financial instruments business operators; and
(iv) Other business as prescribed by Cabinet Office Ordinance.

If a securities finance company will engage other business activities in addition to this, the securities finance company must obtain approval from the Prime Minister (FIEA, art. 156-27, para. 3).

(4) Oversight

The FIEA includes provisions concerning restrictions on concurrency (FIEA, art. 156-27), approval of an amendment in the content of business, etc. (FIEA, art. 156-28), orders to amend the manner, etc. of loans (FIEA, art. 156-29), restrictions, etc. on concurrent business of directors, etc. (FIEA, art. 156-31), orders to revoke the license or halt functions (FIEA, art. 156-32), orders to improve conduct of business, etc. (FIEA, art. 156-33), orders to submit reports/materials and inspections (FIEA, art. 156-34), and preparation and submission of business reports (FIEA, art. 156-35), etc.

(5) Duty to Enter into a Contract, Etc. with a Designated Dispute Resolution Organization

A securities finance company that engages in securities lending or performs intermediation or acts as agent with respect to a loan of securities, loans cash to customers of financial instruments business operators, or performs other business as prescribed by Cabinet Office Ordinance, must take measures to enter into a basic agreement for implementation of procedures relating to designated securities finance company services with one of the designated securities finance dispute resolution organization existing, if any, or if there is no designated securities finance dispute resolution organization, must devise measures respectively to respond to complaints as well as to resolve disputes concerning designated securities finance company services (FIEA, art. 156-31-2, para. 1).

If a securities finance company has taken measures to enter into a basic agreement for implementation of procedures, the securities finance company must publish the trade name and firm name of the designated securities finance company dispute resolution organization that is the other party to the relevant basic agreement for implementation of procedures (FIEA, art. 156-31-2, para. 2).

9 Designated Dispute Resolution Organizations

9 1 Significance

With the diversification and increased complexity of financial instruments and services, there
has also been an increase in disputes concerning financial instruments and services. If such disputes arise, it is possible to attempt a resolution through lawsuits based on civil rules. However, since litigation often carries a large burden for the parties, it is important to deal with disputes in a simpler and speedier form.

Accordingly in order to protect the users of financial instruments and services and to increase the trust of users, it was perceived as important to introduce into the field of finance a system of alternative dispute resolution, which is a simpler and speedier means of dispute resolution that has been used in various fields following the judicial system reforms.

With this in mind, a system of alternative dispute resolution (finance ADR) was established in the field of finance pursuant to the 2009 amendments.

### Designation of Dispute Resolution Organizations

#### (1) Requirements for Designation

Pursuant to an application by an organization that meets the following requirements, the Prime Minister may designate the organization as being one that provides dispute resolution services (FIEA, art. 156-39, para. 1):

(i) The organization is a juridical person (including organizations that are not incorporated but that provide for a representative or manager, and excluding corporations that are established under foreign law or regulation and other foreign organizations);

(ii) The organization is not one whose designation as a designated dispute resolution organization has been revoked and five years have yet to elapse since the date of that revocation, or the organization is not one whose designation pursuant to another law as being an organization determined by Cabinet Order to be involved in services corresponding to services for dispute resolution, etc. has been revoked and five years have yet to elapse since the date of that revocation;

(iii) The organization is not one that has violated a provision of this law or the Attorneys Act or a foreign law or regulation that corresponds to these and has been sentenced to a fine (including a penalty under a law or regulation of a foreign country that is equivalent to this) where five years have not elapsed since the date of execution of such penalty, or from the date on which the said person became no longer subject to execution of the same;

(iv) An organization that, among its officers, does not have a person who falls under certain grounds for disqualification (including, in an organization that is not a corporation, a representative or manager who is appointed as representative or manager);
(v) An organization that has the accounting and technical basis necessary to implement dispute resolution services in an appropriate manner;

(vi) An organization whose officer and employee composition will not risk bringing about an obstacle to the fair implementation of services for dispute resolution, etc.;

(vii) An organization whose regulations concerning the implementation of services for dispute resolution, etc. (business regulations) are in compliance with laws and regulations, and are sufficient for the fair and appropriate implementation of services for dispute resolution, etc. pursuant to the provisions of this law; and

(viii) An organization regarding which, as a result of the hearing of opinions, the ratio of the number of businesses operators connected with financial instruments trading who raised objections to matters concerning the cancellation of basic contracts for implementation of dispute resolution procedures and the other contents of basic contracts for implementation of dispute resolution procedures and other contents of the business regulations, to the total number of businesses operators connected with financial instruments trading comprises a ratio that is equal to or less than the ratio that is prescribed by Cabinet Order. The Cabinet Order prescribes the ratio as one-third (FIEAEO, art. 19-8).

If the Prime Minister intends to designate a dispute resolution organization, the Prime Minister must first consult with the Minister of Justice as to whether the organization falls under the conditions listed in items (v) through (vii) above (FIEA, art. 156-39, para. 3).

Also, if the Prime Minister has designated a dispute resolution organization, the designated dispute resolution organization’s trade name or firm name and the location of its main business office or office, the classification of dispute resolution, etc., services related to the relevant designation, as well as the date on which the designation was made must be published in the Official Gazette (id., para. 5).

(2) Application for Designation

A person who intends to apply for designation must first explain the details of the business regulations to businesses connected with financial instruments trading and ask their opinions as to whether or not they have any objection to those business regulations (if there is an objection, including the reason for the objection) and prepare a document that states the results thereof as prescribed by Cabinet Office Ordinance (FIEA, art. 156-39, para. 2; Cabinet Office Ordinance Concerning the Designated Dispute Resolution Organization Pursuant to the Provisions of Chapter 5-5 of the Financial Instruments and Exchange Act (hereinafter the “Designated Dispute Resolution Ordinance”), art. 3).

Also, a person who intends to obtain designation for a dispute resolution organization must submit to the Prime Minister a form applying for designation which states prescribed matters
Prescribed documents must be attached to the form applying for designation (FIEA, art. 156-40, para. 2; Designated Dispute Resolution Ordinance, art. 5).

(3) **Duty of Confidentiality, Etc.**

No person who is, or has been, a dispute resolution mediator or officer or employee of a designated dispute resolution organization shall divulge or use for his own interests information that the person came to know in connection with dispute resolution, etc. services (FIEA, art. 156-41, para. 1).

Moreover, for the purpose of applying the Penal Code or other penal provisions a person who engages in dispute resolution, etc. services and who is a dispute resolution mediator or officer or employee of a designated dispute resolution organization is regarded as an employee engaged in public service pursuant to the provisions of laws and regulations (id., para. 2).

### Business of Designated Dispute Resolution Organizations

(1) **Business Regulations, Etc.**

A designated dispute resolution organization must conduct dispute resolution, etc. as prescribed by the FIEA and the business regulations (FIEA, art. 156-42, para. 1).

A designated dispute resolution organization (including a dispute resolution mediator) may receive compensation in connection with the dispute resolution, etc. that it carries out such as dues or fees pursuant to the provisions of a basic contract for implementation of dispute resolution procedures or another agreement that it has entered into with a party who is a member person or firm involved in financial instruments transactions (meaning the business operator related to financial instruments transactions that is the other party to the basic contract for implementation of dispute resolution procedures that was entered into) or that party’s customer (including certain rights holders other than customers who are concerned with the investment management business) or with other persons (id., para. 2).

Also, a designated dispute resolution organization may not contract services for complaint processing procedures or dispute resolution procedures to a party other than another designated dispute resolution organization or a person who has been designated pursuant to the provisions of another law and has been prescribed by Cabinet Order as a person involved in services that correspond to dispute resolution, etc. (a contract dispute resolution organization) (FIEA, art. 156-43).

Designated dispute resolution organizations must establish business regulations concerning the following listed matters (FIEA, art. 156-44, para. 1; Designated Dispute Resolution Ordinance, art. 6):

(i) Matters concerning the content of the basic contract for implementation of
dispute resolution procedures;

(ii) Matters concerning the execution of the basic contract for implementation of dispute resolution procedures;

(iii) Matters concerning implementation of the dispute resolution, etc.;

(iv) Matters concerning dues borne by a member person or firm involved in financial instruments transactions for costs necessary for the dispute resolution, etc.;

(v) Matters concerning the relevant fees if fees are collected in connection with the implementation of dispute resolution, etc. from a member person or firm involved in financial instruments transactions that is a party or a customer thereof (a party);

(vi) Matters concerning coordination with other designated dispute resolution organizations and other national government agencies, local government agencies, private businesses, and other persons who consult, process complaints, or perform dispute resolution;

(vii) Matters concerning the processing of complaints concerning dispute resolution, etc.; and

(viii) Matters prescribed by Cabinet Office Ordinance as necessary for the performance of dispute resolution, etc., in addition to the matters set forth in items (i) through (vii) above.

Under the finance ADR system, detailed provisions are not made in the law for complaint processing and dispute resolution procedures, and the concrete details of these matters are to be provided in the business regulations and the basic contact for implementation of dispute resolution procedures and the like, in order to respect the independence of the designated dispute resolution organizations, and to enable the flexible reflecting of the results of practical approaches in respect to finance ADRs. Also, the approach of financial institutions to a finance ADR is regulated through the basic agreement for implementation of procedures.

The basic contract for implementation of dispute resolution procedures provides that a designated dispute resolution organization may, upon request from a customer of a party who is a member person or firm involved in financial instruments transactions, investigate the status of performance of the obligations provided for in the settlement through the dispute resolution procedures, and recommend the member person or firm involved in financial instruments transactions to perform such obligations (FIEA, art. 156-44, para. 2, item 11; Designated Dispute Resolution Ordinance, art. 7).

(2) Complaint Processing Procedures and Dispute Resolution Procedures

Designated dispute resolution organizations must endeavor to provide information and to provide advice and other support to member persons or firms involved in financial instruments transactions and other persons, in order to prevent complaints and disputes related to financial instruments service as well as to facilitate the processing of complaints and the resolution of
disputes related to financial instruments service (FIEA, art. 156-45, para. 2).

Also, if there is a request for resolution of a complaint related to financial instruments service from a customer of a member person or firm involved in financial instruments transactions, the designated dispute resolution organization must consult with and provide necessary advice to the relevant customer, and together with investigating the circumstances involved with the relevant complaint related to financial instruments service, the designated dispute resolution organization must notify the relevant member person or firm involved in financial instruments transactions of the details of the relevant complaint related to financial instruments service, and must demand rapid processing of the complaint (FIEA, art. 156-49).

Parties may petition for dispute resolution procedures to a designated dispute resolution organization in order to try to settle a dispute related to financial instruments service that involves a member person or firm involved in financial instruments transactions (FIEA, art. 156-50, para. 1). If a designated dispute resolution organization receives a petition for dispute resolution procedures, it will appoint a dispute resolution mediator (id., para. 2) to the dispute resolution procedure, and the dispute resolution mediator will advise the parties to accept settlement proposals or present special mediation proposals (id., para. 6).

However, the dispute resolution mediator shall not to carry out the dispute resolution procedure if the dispute resolution mediator finds that it is not appropriate to conduct dispute resolution procedures or finds that a party petitioned for dispute resolution without good reason and for an unfair purpose (FIEA, art. 156-50, para. 4, proviso).

The member person or firm involved in financial instruments transactions must accept a special mediation proposal presented by the dispute resolution mediator, except where the user side does not accept, a lawsuit is filed, a lawsuit that was filed cannot be withdrawn, or otherwise where the matter is settled (FIEA, art. 156-44, para. 6).

A designated dispute resolution organization must retain the records on the implementation of procedures for at least 10 years from the date the dispute resolution procedures it has implemented has been completed (Designated Dispute Resolution Ordinance, art. 13, para. 1).

Dispute resolution mediator shall be appointed from among persons with upright character and great judgment who fall under either of the following (FIEA, art. 156-50, para. 3):

(i) An attorney-at-law who has engaged in his/her profession for a total of at least five years;
(ii) A person who has engaged in financial instrument trading business, etc. for a total of at least ten years;
(iii) A person provided by Cabinet Office Ordinance as a person who has specialist knowledge and experience regarding matters concerning consumer affairs such as consultations involving complaints that arise between consumers and businesses concerning consumer affairs;
(iv) If the relevant petition is one that involves a dispute as provided in Article 3, Paragraph 1, Item 7 of the Judicial Scrivener Act, a judicial scrivener as provided in Paragraph 2 of that Article who has engaged for at least a total of
five years in summary court legal representation service and the like as provided in the said Paragraph; or

(v) A person provided by Cabinet Office Ordinance as being commensurate to those persons listed in items (i) through (iv) above (the Cabinet Office Ordinance provides a person holding the one or multiple positions from among a judge, assistant judge, attorney-at-law, professor or associate professor majored in law for a total period of 5 years or more, a person holding one or multiple positions from among a certified public accountant, certified tax accountant, professor or assistant professor majoring in economics or commerce for a total period of 5 years or more, a person who has engaged in the business of processing complaints related to the financial instruments service, or the investigation, guidance, recommendation, formulation of rules and other activities necessary for ensuring customer protection at a corporation conducting the business of processing complaints related to the financial instruments service for a period of 10 years or more, or a person deemed by the Commissioner of the Financial Services Agency as having the same or higher level of knowledge and experience as the persons above).

However, in order to secure the impartiality and fairness of the dispute resolution procedure, at least one dispute resolution mediator must be a person as provided in either (i) or (iii) above (if it is a case that involves a dispute as provided in (iv), a person who falls under either (i), (iii), or (iv)).

Also, provisions must be made in the business regulations for the method for appointing dispute resolution mediators and the method of excluding dispute resolution mediators who have interests in the matter (FIEA, art. 156-44, para. 4, item 2).

Provisions are established for tolling the statute of limitations (FIEA, art. 156-51) and the suspension of litigation procedures (FIEA, art. 156-52) for dispute resolution procedures.

94 Supervision of Designated Dispute Resolution Organizations

(1) Notifications, Etc.

A designated dispute resolution organization must notify the Prime Minister if there is a change to its trade name or firm name, the name and location of its main business office or offices and other business offices or offices at which dispute resolution, etc. services are conducted, or the personal name or trade name or firm name of its officers (FIEA, art. 156-55, para. 1).

If there has been a notification of the change of a dispute resolution organization’s trade name or firm name or a change in the location of its main business office or office, the Prime Minister must publish this in the Official Gazette (id., para. 2).
A designated dispute resolution organization must notify the Prime Minister as prescribed by Cabinet Office Ordinance (i) if it enters into a basic contract for implementation of dispute resolution procedures with a business operator related to financial instruments trading or if it ends the relevant basic contract for implementation of dispute resolution procedures, and (ii) as otherwise provided by Cabinet Office Ordinance (FIEA, art. 156-56; Designated Dispute Resolution Ordinance, art. 14). Moreover, a designated dispute resolution organization must prepare and submit to the Prime Minister a report for each business year concerning dispute resolution, etc. services relating to the relevant business year (FIEA, art. 156-57; Designated Dispute Resolution Ordinance, art. 15).

A designated dispute resolution organization must obtain the approval of the Prime Minister if it wishes to suspend or discontinue all or part of its dispute resolution, etc. services (FIEA, art. 156-60, para. 1).

(2) Order to Improve Business Operations

If the Prime Minister determines it to be necessary in order to secure the fair and appropriate performance of dispute resolution, etc., services in connection with the operation of dispute resolution, etc., and services by a designated dispute resolution organization, the Prime Minister may, to the extent necessary, order the relevant designated dispute resolution organization to take necessary measures to improve its business operations (FIEA, art. 156-59, para. 1).

In such case, the Prime Minister must first consult with the Minister of Justice (id., para. 2).

(3) Supervisory Action

If a designated dispute resolution organization falls under any of the following items, the Prime Minister may revoke the designation of the relevant dispute resolution organization or order a suspension of its business either in whole or in part for a period of not more than six months (FIEA, art. 156-61, para. 1):

(i) If the designated dispute resolution organization comes to fall under a ground for refusal of designation, or if it becomes clear that it fell under a ground for refusal of designation from the start;
(ii) If the designated dispute resolution organization obtained its designation by improper means; or
(iii) If the designated dispute resolution organization is in violation of a law or regulation or a disposition based on a law or regulation.

However, the Prime Minister must consult in advance with the Minister of Justice if the Prime Minister intends to issue a disposition or order (id., para. 2).

An organization whose designation has been revoked or that has been ordered to suspend its operations in whole or in part must give notification of the relevant action or order within two weeks of the day of the relevant action or order the parties for which complaint processing procedures or dispute resolution procedures were implemented on the day of the relevant action or
order, member person or firm involved in financial instruments transactions other than the relevant parties, and other designated dispute resolution organizations (FIEA, art. 156-61, para. 3).

If the Prime Minister has revoked the designation, the Prime Minister must publish that in the Official Gazette (id., para. 4).

(4) Collection of Reports and Inspections

If the Prime Minister determines it to be necessary for the fair and appropriate performance of dispute resolution, etc. services, the Prime Minister may order a designated dispute resolution organization to submit reports or materials concerning its business, or the Prime Minister may have the Prime Minister’s officials enter a designated dispute resolution organization’s business office, office, or other facility and ask questions concerning the business circumstances of the relevant dispute resolution organization or inspect its books and papers and other property (FIEA, art. 156-58, para. 1).

Also, if the Prime Minister determines it to be necessary for the fair and appropriate performance of dispute resolution, etc. services, the Prime Minister may, to the extent necessary, order a designated dispute resolution organization’s member person or firm involved in financial instruments transactions or organizations that have been contracted work by the relevant designated dispute resolution organization to submit reports or materials that should be of reference concerning the relevant designated dispute resolution organization’s business, or the Prime Minister may have the Prime Minister’s officials enter these parties’ business offices, offices or other facilities and ask questions concerning the business circumstances of the relevant dispute resolution organization or inspect the books and papers and other property of these parties (id., para. 2).

10 Trade Repositories, Etc.

10 1 Significance

Upon the recent financial crisis, in Europe and the U.S., because financial institutions were conducting huge quantities of over-the-counter derivatives transactions as negotiated deals, and the information of risk evaluation concerning individual transactions and the retention and accumulation of such information were not conducted properly, there were concerns on the bankruptcy, etc. of individual transaction parties which increased the concerns on the counterparty risk concerning over-the-counter derivatives transactions as well as concerns regarding systemic risk of financial institutions surfaced amidst the lack of transparency in the over-the-counter derivative market. Also, the supervisory authorities were unable to fully understand the actual conditions of the transaction, and had difficulty in taking necessary measures.
Based on these points, the amendments in 2010 introduced the system for retaining and reporting transaction information to enhance the regular monitoring of over-the-counter transactions of derivatives by the authorities as well as enabling prompt and appropriate measures upon a crisis and enhancing the transparency and predictability of the market through providing a part of the information to the market by the authorities.

Obligating the Use of Clearing Organizations Concerning Over-the-Counter Transactions of Derivatives, Etc.

A financial instruments business operator, etc. must have the person provided for in each of the following items bear the obligation of the financial instruments business operator, etc. and its counterparty upon conducting the transactions set forth below (FIEA, art. 156-62):

The use of a clearing organization has become mandatory with respect to certain transactions which are large in transaction scale in Japan and which the reduction of settlement risk by centralized clearing is considered necessary for stabilizing the Japanese market.

(i) Among over-the-counter transactions of derivatives and other transactions, transactions which the default of the obligations under such transaction may have a significant impact on the capital markets of Japan in light of the transaction volume and other circumstances of the transaction, and which are provided by Cabinet Office Ordinance as being necessary to be cleared in Japan in consideration of its characteristics.... a financial instruments clearing organization

(ii) Among over-the-counter transactions of derivatives and other transactions, transactions provided for by Cabinet Office Ordinance which the default of the obligations under such transaction may have a significant impact on the capital markets of Japan in light of the transaction volume and other circumstances of the transaction.... a financial instruments clearing organization (if the financial instruments clearing organization conducts the business activities of coordinated financial instruments obligations assumption service, including a coordinated clearing organization, etc.) or a foreign financial instruments clearing organization

The specific transactions that fall under this category are prescribed to be designated by the Commissioner of Financial Services Agency on the “Public notice on specifying the transactions to be designated by the Commissioner of the Financial Services Agency as prescribed in Article 1, Paragraphs 1 and 2 of the Cabinet Office Ordinance on Restrictions on Over-the-Counter
Retention of Trade Data

A financial instruments clearing organization, etc. (meaning a financial instruments clearing organization or a foreign financial instruments clearing organization) must prepare and retain records concerning matters provided for by Cabinet Office Ordinance with respect to data on centrally cleared trades (among information regarding transactions provided for in each Item of Article 156-62 of the FIEA or other transactions prescribed by Cabinet Office Ordinance in consideration of the circumstance, etc. of the transaction, information concerning the transaction which the financial instruments clearing organization, etc. has assumed the obligations under such transaction) in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 156-63, para. 1; OTC Derivatives Ordinance, art. 3 and art. 4). In addition, a financial instruments clearing organization, etc. must report the data on centrally cleared trades it holds to the Prime Minister in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 156-63, para. 2; OTC Derivatives Ordinance, art. 5).

A financial instruments business operator, etc. must prepare and retain records concerning matters provided for by Cabinet Office Ordinance with respect to trade data (meaning information regarding transactions prescribed by Cabinet Office Ordinance which are considered necessary to clarify the circumstance of the transaction for investor protection (excluding data on centrally cleared trades)) (FIEA, art. 156-64, para. 1; OTC Derivatives Ordinance, art. 6 and art. 7). In addition, a financial instruments business operator, etc. must report the trade data it holds to the Prime Minister in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 156-64, para. 2; OTC Derivatives Ordinance, art. 8). However, this shall not apply if the financial instruments business operator, etc. has provided the trade data to a trade repository or a designated foreign trade repository in the manner prescribed by cabinet Office Ordinance (FIEA, art. 156-64, para. 3).

Retention and Reporting of Trade Data by Trade Repositories

A trade repository must prepare and retain records concerning matters provided for by Cabinet Office Ordinance on trade data concerning transactions subject to the trade repository business (FIEA, art. 156-65, para. 1, OTC Derivatives Ordinance, art. 10, para. 1 and art. 4, para. 1). In addition, a trade repository must report the trade data it holds to the Prime Minister in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 156-65, para. 2; OTC Derivatives Ordinance, art. 11).

The Prime Minister shall publicly announce the scale and other matters necessary for
confirming the outline of the transaction with respect to transactions subject to reporting pursuant to the provisions of Article 156-63, Paragraph 2, Article 156-64, Paragraph 2 and Article 156-65, Paragraph 2 of the FIEA (FIEA, art. 156-66, para. 1). In addition, with respect to transactions covered by data on centrally cleared trades or trade data retained, the Prime Minister may, when it considers necessary, order a financial instruments clearing organization, etc. or a trade repository to publicly announce the scale and other matters considered necessary to clarify the outline of such transaction (id., para. 2).

10 5 Designation of Persons Conducting Trade Repository Business

(1) Criteria for Designation

The Prime Minister may designate as a person conducting the trade repository business a person meeting the following criteria upon application from the said person (FIEA, art. 156-67, para. 1):

(i) That it is a juridical person (including an unincorporated group with a provision on the representative or administrator, and excluding corporations incorporated under the laws of a foreign country or other groups of a foreign country);

(ii) That it has not lost the designation as a trade repository and for whom five years have yet to expire from the date of the said revocation;

(iii) That it has not violated the provisions of the FIEA or the laws of a foreign country equivalent to the FIEA and been sentenced to penalty (or a sentence equivalent thereto under the laws of a foreign country), and for whom five years have yet to expire from the date of completion of the said sentence or the date on which the said person became no longer subject to execution of the same;

(iv) That no officer (including the representative or administrator of an unincorporated group with a provision on the representative or administrator) falls under the prescribed disqualification causes;

(v) That it possesses financial basis sufficient to soundly perform the trade repository business, and that its prospect for income and expenditure concerning the trade repository business is good; and

(vi) That it has knowledge and experience to appropriately and securely perform the trade repository business, and is considered to have sufficient social credibility in light of its personnel composition.

The Prime Minister shall publicly announce in the official gazette the trade name or firm name of the trade repository and the location of the main business office or office and the date of
designation upon making a designation pursuant to the provisions of Article 156-67, Paragraph 1 of the FIEA (FIEA, art. 156-67, para. 2).

(2) Application for Designation

A person wishing to be designated as a trade repository must submit an application for designation stating certain matters to the Prime Minister (FIEA, art. 156-68, para. 1).

In addition, certain documents must be attached to the application for designation (FIEA, art. 156-68, para. 2; OTC Derivatives Ordinance, art. 12).

A trade repository must notify the Prime Minister of any changes in certain matters stated in the application for designation (FIEA, art. 156-77, para. 1).

The Prime Minister must publicly announce in the official gazette upon receiving any notice of change in the trade name or firm name, or the location of the main business office or office (id., para. 2).

10 6 Restriction of Concurrent Positions and Confidentiality

Unless authorized by the Prime Minister, the representative of a trade repository and officers engaged in daily business must not become the representative of a financial instruments business operator, etc. or other corporation prescribed by Cabinet Office Ordinance or engage in daily business thereof, or engage in the financial instruments business or other businesses prescribed by Cabinet Office Ordinance (FIEA, art. 156-69; OTC Derivatives Ordinance, art. 13 and 14).

An officer or an employee or a former officer or employee of a trade repository must not divulge secrets it has come to know with respect to the trade repository business, or plagiarize the same (FIEA, art. 156-70).

10 7 Businesses of Trade Repository

A trade repository shall conduct the trade repository business as prescribed by the provisions of Chapter 5-6, Section 3 of the FIEA and the business regulations (FIEA, art. 156-71).

A trade repository must prepare business regulations concerning the following matters on the trade repository business and obtain the authorization of the Prime Minister. The same applies to amendments thereof (FIEA, art. 156-74, para. 1 and par. 2; OTC Derivatives Ordinance, art. 19):

(i) Matters concerning the execution of an agreement to receive the provision of trade data (hereinafter the “contract for trade data collection”) with a financial instruments business operator, etc.;

(ii) Matters concerning transactions subject to the trade repository business;
(iii) Matters concerning the collection and retention of trade data;
(iv) Matters concerning the prevention of leakages, loss or damages to trade data and other matters concerning the safe management of trade data;
(v) Matters concerning the ensuring of the accuracy of trade data;
(vi) Matters concerning the fee (the fee regarding the trade repository business must be fair and accurate in light of a fair cost under efficient management of business);
(vii) If outsourcing a part of the trade repository business to another party, matters concerning measures the proper and secure performance of the business outsourced; and
(viii) Other matters prescribed by Cabinet Office Ordinance as matters necessary for the implementation of the trade repository business.

If the Prime Minister considers that the business regulations he/she has approved has become inappropriate for the proper and secure implementation of the trade repository business, he/she may order the trade repository to amend its business regulations (FIEA, art. 156-74, para. 3).

In addition, a trade repository shall not treat a specific financial instruments business operator, etc. in an unjustifiable discriminative manner (FIEA, art. 156-75).

10 8 Restriction of Concurrent Business

A trade repository may not conduct business other than the trade repository business and businesses associated therewith (FIEA, art. 156-72, para. 1, text). However, this shall not apply if the approval of the Prime Minister has been obtained in the manner prescribed by Cabinet Office Ordinance with respect to businesses which are unlikely to impede the proper and secure implementation of the trade repository business by the trade repository (id., proviso, OTC Derivatives Ordinance, art. 15).

A trade repository handles trade data regarding the business secrets of financial instruments business operators, etc. and is expected to perform important roles such as the retention, reporting and public announcement of trade data for ensuring the improvement of the transparency of the market. Accordingly, it is necessary to prevent it from becoming unable to continue the trade repository business due to the management deterioration of other businesses.

A trade repository must notify the Prime Minister in the manner prescribed by Cabinet Office Ordinance when it begins the approved business above (FIEA, art. 156-78, para. 1).
Outsourcing of a Part of the Trade Repository Business

A trade repository may outsource a part of the trade repository business to another party upon obtaining approval of the Prime Minister in the manner prescribed by Cabinet Office Ordinance (FIEA, art. 156-73, para. 1, OTC Derivatives Ordinance, art. 17).

A person who has been outsourced the trade repository business may sub-outsource a part of such business to another party upon obtaining the consent of the outsourcing trade repository (FIEA, art. 156-73, para. 2).

Such person may sub-outsource a part of the trade repository to another party upon obtaining the consent of the initial outsourcer and the second outsourcer (id., para. 3).

Supervision on Trade Repository

(1) Submission of Reports Regarding the Business and Assets

A trade repository must prepare and submit to the Prime Minister for each business year a report concerning the business and assets for that business year (FIEA, art. 156-79, para. 1).

The matters to be stated in the report, the due date of submission and other matters necessary with respect to the preparation and submission of the report are prescribed by Cabinet Office Ordinance (id., para. 2, OTC Derivatives Ordinance, art. 21).

(2) Collection of Reports and Inspections

The Prime Minister may, if he considers it necessary and appropriate for public interest or investor protection, order a trade repository, a person who has executed a contract for trade data collection with the trade repository or an outsourcee pursuant to the provisions of each Paragraph of Article 156-73 of the FIEA to submit report or materials that are of reference regarding the business or assets of the trade repository, or its officials to inspect the status of business or financial standing or books and documents or other items of the trade repository or the outsourcee under each Paragraph of the said Article (with respect to the outsourcee under each Paragraph of the said Article, limited to inspections necessary with respect to the business or assets of the trade repository) (FIEA, art. 156-80).

(3) Business Improvement Orders

If the Prime Minister considers it necessary and appropriate for public interest or investor protection with respect to the status of business or the financial standing of the trade repository business of the trade repository, the Prime Minister may order the trade repository to take measures necessary for the improvement of the management of its business or the financial standing to the extent necessary (FIEA, art. 156-81).
(4) **Revocation of Designation, Etc.**

If a trade repository falls under any of the following, the Prime Minister may revoke the designation or approval of the trade repository, order the suspension of all or a part of its business for a fixed term of 6 months or less, or order the dismissal of its officers (FIEA, art. 156-83, para. 1):

(i) In the event it falls under a cause for refusal of designation as a trader repository, or in the event it becomes clear that it had fallen under the cause for refusal of designation from the beginning;

(ii) In the event it has obtained the designation as a trade repository through fraudulent means; or

(iii) In the event it is in violation of laws and regulations or disciplinary action pursuant to laws and regulations.

The Prime Minister must make a public announcement in the official gazette if it has revoked the designation of a trade repository (*id.*, para. 2).

(5) **Order for Transfer of Trade Repository Business**

If a trade repository falls under any of the following, the Prime Minister may order the trade repository to have all or a part of the trade repository business conducted by another trade repository (FIEA, art. 156-84, para. 1).

In such case, the Prime Minister must make a public announcement thereof in the official gazette (*id.*, para. 2):

(i) Upon revoking the designation of a trade repository or ordering the suspension of all or a part of its business (limited to the trade repository business);

(ii) Upon authorizing the cessation or abolition of the trade repository business;

(iii) In the event there are any potential circumstances under which the repayment of debts due may be of significant hindrance to the continuance of the trade repository business or any facts may arise which shall be the cause of commencing bankruptcy proceedings; or

(iv) In the event it becomes difficult for the trade repository to implement all or a part of the trade repository business due to force majeure or other causes.

Since a financial instruments business operator using a trade repository is exempted from the obligation to retain and report trade data, the Prime Minister will become unable to obtain necessary trade data in the event a trade repository ceases or abolishes its business.

Accordingly, these measures have been set to transfer the trade repository business to another trade repository in advance.
11 Regulations on Specified Financial Indicator Calculation Agents

11 1 Significance

Financial indicators are generally used for calculating the basic interest rate for loans and the amount payable in derivatives transactions and also for calculating the value of securities. Thus, as the basis for financial transactions, they play an important role in financial and capital markets.

Conventionally, an act of calculating such financial indicators had not been subject to regulation. However, following the incident of manipulation of LIBOR (London Interbank Offered Rate), discussions were initiated on a global level for the introduction of public regulations on such act.

Along with this trend, the necessity to build a public regulatory framework was recognized in Japan as well with a view to strengthening the governance over financial indicator calculation agents and improving the transparency of the calculation process. Accordingly, regulations on specified financial indicator calculation agents were introduced via the 2014 amendment to the FIEA.

11 2 Definition of Specified Financial Indicator

The term “specified financial indicator” means a financial indicator specified by the Prime Minister as that which, in light of the mode of the derivatives transactions or transactions of securities pertaining to the said financial indicator, could have a material impact on Japan’s capital market if its reliability declines (FIEA, art. 2, para. 40).

Based on this definition, not all financial indicators calculated in Japan are subject to regulations, but such a financial indicator which is widely used as the basis for financial transactions in Japan, such as a reference index for a derivatives transaction, and which could have a material impact on Japan’s capital market if its reliability declines, should be designated as the subject of regulations. Specifically, TIBOR (Tokyo Interbank Offered Rate) has been designated as such a subject indicator, and Japanese Yen TIBOR and Euroyen TIBOR have been selected as specified financial indicators.
Designation of Specified Financial Indicator Calculation Agent

(1) Designation by the Prime Minister

When the Prime Minister finds that securing appropriate performance of specified financial indicator calculation business (meaning the business of calculating and publicizing specified financial indicators) conducted by a person engaged in specified financial indicator calculation business is necessary for the public interest or protection of investors, the Prime Minister may designate the said person as a specified financial indicator calculation agent (FIEA, art. 156-85, para. 1).

When the Prime Minister makes designation under the provision of the preceding paragraph, the Prime Minister must give written notice to that effect and of the name of the specified financial indicator(s) subject to the designation to the specified financial indicator calculation agent (FIEA, art. 156-85, para. 2).

However, the Prime Minister shall not make such designation when a person engaged in specified financial indicator calculation business is a person specified by Cabinet Office Ordinance as a person who is found to be under appropriate supervision with respect to its specified financial indicator calculation business by a foreign administrative organization or any other equivalent organization based on foreign laws and regulations (FIEA, art. 156-85, para. 6), in which case it is less necessary to apply regulations under the FIEA.

At present, JBA TIBOR Administration serves as a specified financial indicator calculation agent.

(2) Public Notice via Official Gazette

When the Prime Minister makes a designation, the Prime Minister must give public notice of the trade name or name and the location of the head office or principal business office or office of the specified financial indicator calculation agent (in the case of a foreign person who has a business office or office in Japan, including the location of its principal business office or office in Japan), and the name of the specified financial indicator(s) subject to the designation in the official gazette (FIEA, art. 156-85, para. 3). The same applies in the event of any changes in the foregoing matters.

(3) Submission of Documents

A specified financial indicator calculation agent shall submit a document to the Prime Minister in which it states the following particulars, within the period specified by Cabinet Order from the day it became subject to designation (FIEA, art. 156-86, para. 1; FIEAEO, art. 19-10; Financial Indicator Ordinance, art. 3):

(i) Its trade name or name;
(ii) The amount of capital or total contribution, if it is a corporation;
(iii) The names of its officers, if it is a corporation;
(iv) The name and location of its head office, principal business office or principal office;
(v) If it engages in other business, the business type; and
(vi) The name of its representative or administrator if it is an organization without legal personality for which a representative or administrator has been designated.

The abovementioned document must be accompanied by the articles of incorporation, the certificate of registered information, and other documents specified by Cabinet Office Ordinance (FIEA, art. 156-86, para. 2; Financial Indicator Ordinance, art. 4). However, if the articles of incorporation have been prepared as electronic or magnetic records, such electronic or magnetic records (limited to those specified by Cabinet Office Ordinance) may accompany that document in lieu of written documents (FIEA, art. 156-86, para. 3; Financial Indicator Ordinance, art. 5). If any of the particulars set forth in (i) to (vi) changes, the specified financial indicator calculation agent must notify the Prime Minister of this, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 156-86, para. 4; Financial Indicator Ordinance, art. 6).

11 4 Operational Rules

A specified financial indicator calculation agent must formulate operational rules concerning specified financial indicator calculation business pursuant to the provisions of Cabinet Office Ordinance and obtain authorization from the Prime Minister within the period specified by Cabinet Order from the day of receiving designation (FIEA, art. 156-87, para. 1; FIEAEO, art. 19-11). The operational rules must provide for the following matters and any other matters specified by Cabinet Office Ordinance (FIEA, art. 156-87, para. 2; Financial Indicator Ordinance, art. 9, para. 1):

(i) Matters concerning the policy and method of calculation and publication of specified financial indicators;
(ii) Matters concerning the operational control system for the proper performance of specified financial indicator calculation business;
(iii) Rules to be observed by a person who provides calculation basis data (data provider) (the “code of conduct”);
(iv) Matters concerning the conclusion of a contract (including a contract pertaining to the code of conduct) with a data provider;
(v) Matters concerning entrustment of specified financial indicator calculation business;
(vi) Matters concerning audits pertaining to specified financial indicator calculation business;
(vii) Matters concerning public inspection of explanatory documents pertaining to specified financial indicator calculation business; and
(viii) Matters concerning suspension or discontinuation of specified financial indicator calculation business.

The primary function of the operational rules is to make it a statutory obligation for specified financial indicator calculation agents to comply with the IOSCO principles. The Cabinet Office
Ordinance specifies the matters to be included in specified financial indicator calculation agents’ operational rules in accordance with the IOSCO Principles.

The IOSCO Principles provide for the specific matters that calculation agents of financial indicators, or “financial benchmark” as referred to in the IOSCO principles, should comply with in terms of: (i) governance (primary responsibility for the benchmark determination process, and identification, disclosure, management, mitigation or avoidance of conflicts of interest); (ii) quality of the benchmark (hierarchy of data inputs, establishment and publication of guidelines regarding the exercise of expert judgment); (iii) quality of the methodology (publication of the methodology used to make benchmark determinations, development and publication of the submitter code of conduct); and (iv) accountability (appointment of an independent internal or external auditor, retention of records, submission of documents to the regulatory authority). The obligation of specified financial indicator calculation agents to prepare and comply with operational rules constitutes the core of the regulations.

Authorization for operational rules is granted according to the following standards: (i) the operational rules comply with laws and regulations; and (ii) it seems to be possible to secure the proper execution of the specified financial indicator calculation business based on the operational rules in light of the system for execution of the said business (Financial Indicator Ordinance, art. 10).

When a specified financial indicator calculation agent intends to change its operational rules, it must obtain authorization from the Prime Minister (FIEA, art. 156-87, para. 3). After obtaining the authorization for its operational rules, a specified financial indicator calculation agent must conduct its specified financial indicator calculation business pursuant to the provisions of the operational rules (FIEA, art. 156-87, para. 4).

5 Supervision over Specified Financial Indicator Calculation Agents

The FIEA provides for the following supervisory rules in order to ensure the effective regulations on specified financial indicator calculation agents.

1 (1) Collection of Reports and Inspections

Whenever the Prime Minister finds it to be necessary and appropriate in the public interest or for the protection of investors, the Prime Minister may order a specified financial indicator calculation agent or the person that the specified financial indicator calculation agent has entrusted with its business (including a person who has received entrustment from such person (including entrustment via two or more layers)), to submit reports or materials that should serve as a reference in connection with the specified financial indicator calculation business, and may have the relevant officials inspect the state of the business, or the books and documents or any other articles, of the specified financial indicator calculation agent or the person that the specified financial indicator calculation agent has entrusted with its business (but may only have the
relevant officials inspect the specified financial indicator calculation agent as is necessary in connection with the specified financial indicator calculation business) (FIEA, art. 156-89, para. 1).

Whenever the Prime Minister finds it to be necessary and appropriate in the public interest or for the protection of investors, the Prime Minister, within the scope that is found to be necessary for confirming the accuracy of the calculation basis data provided to a specified financial indicator calculation agent, may order the data provider to submit reports or materials that should serve as a reference in connection with the calculation basis data, and may have the relevant officials inspect the state of the business, or the books and documents or any other articles, of the data provider (FIEA, art. 156-89, para. 2).

(2) Improvement Orders, Etc.

If the Prime Minister finds that improvement is needed in connection with operations of a specified financial indicator calculation business, the Prime Minister, within the scope of this necessity, may order the specified financial indicator calculation agent to take measures that are necessary for this improvement (FIEA, art. 156-90, para. 1).

If a specified financial indicator calculation agent violates a law or regulation or a disposition based on a law or regulation in connection with its specified financial indicator calculation business, the Prime Minister may order the suspension of all or part of its business activities during a fixed period of no longer than six months (FIEA, art. 156-90, para. 2). Irrespective of the category of proceeding for hearing statements of opinion under Article 13, paragraph (1) of the Administrative Procedure Act, before seeking to issue such an order as mentioned above, the Prime Minister must conduct a hearing (FIEA, art. 156-90, para. 4).

If the Prime Minister orders the suspension of all or part of business activities pursuant to the provisions of the preceding paragraph, the Prime Minister shall issue public notice of this in the official gazette (FIEA, art. 156-90, para. 3).

(3) Recommendation to Transfer Business

If a specified financial indicator calculation agent seeks to suspend or discontinue its specified financial indicator calculation business or in any other case specified by Cabinet Office Ordinance, the Prime Minister may recommend the specified financial indicator calculation agent to have all or part of its specified financial indicator calculation business conducted by another person (FIEA, art. 156-91; Financial Indicator Ordinance, art. 12).

It would be beneficial for a specified financial indicator to be calculated continuously as long as its reliability is secured. From this viewpoint, the abovementioned rule has been introduced to encourage a specified financial indicator calculation agent that seeks to discontinue its business to transfer its business to another agent.

(4) Rescission of Designation and Notification of Suspension or Discontinuation of Business

When the Prime Minister determines that the reason for designation of a specified financial indicator calculation agent no longer exists, the Prime Minister must rescind such designation and give written notice to that effect to the specified financial indicator calculation agent (FIEA, art,
When having rescinded designation, the Prime Minister must give public notice to that effect in the official gazette (FIEA, art. 156-85, para. 5).

If a specified financial indicator calculation agent seeks to suspend or discontinue its specified financial indicator calculation business, it must notify the Prime Minister of this in advance, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 156-88; Financial Indicator Ordinance, art. 11).

### 11 Regulations on Data Providers

Regarding data providers who provide calculation basis data to specified financial indicator calculation agents, the FIEA requires specified financial indicator calculation agents to include in their operational rules the code of conduct that contains rules to be observed by data providers and request compliance therewith (FIEA, art. 156-87, para. 2). Thus, a framework is set in place to regulate data providers not directly but via specified financial indicator calculation agents.

### 12 Regulations Imposed on Acts of Market Abuse (Regulations Against Unfair Trading)

The FIEA contains provisions prohibiting unfair transactions not only simply to ensure that financial instruments transactions, etc. proceed in a fair manner; their main objective is to prevent the breakdown of capital market functions that unfair transactions cause.

The British Financial Services and Markets Act of 2000 also refers to these acts using the general term of “market abuse.”

### 12 General Provisions

**1** General Provision Against Unfair Trading (FIEA, art. 157, item 1)

No person shall use wrongful means, schemes or techniques with regard to sales and purchase or other transactions of securities or derivative transactions, etc. This is the general provision concerning unfair transactions, and although its requirements are quite vague, it carries heavy criminal penalties (imprisonment of not more than 10 years or a penal fine of not more than JPY10 million; in the case of juridical persons, a penal fine of not more than JPY700 million, and in the case of an individual with a profit motive, a penal fine of not more than JPY30 million, any properties gained through crimes shall be disgorged or assessed—FIEA, art. 197, para. 1, item 5 and para. 2, art. 207, para. 1, item 1, and art. 198-2) (the same applies in (2) and (3) below).

This is a provision that constitutes a translation of the US Securities and Exchange...
Commission (SEC) Rule 10b-5. Although criticized for being ambiguous, the Japanese Supreme Court has ruled that the provision is constitutional. In the discussion below, it is necessary to keep in mind that since the utmost priority is placed on achieving the objectives of the law, for an act that severely impairs the market, the general provision is always available even if a regulation on the specific act is lacking, or even when the individual provisions are difficult to apply.

There is a portion of the comprehensive regulation on fraudulent transactions in the following paragraph, and in the event of a fraudulent transaction, the administrative monetary penalty system will apply. It is dangerous to assume that administrative monetary penalty will not be applied under this clause.

Furthermore, some sort of effort will most likely be necessary to specify to the extent possible the transactional types that fall within this provision such as by publishing guidelines, etc.

(2) Prohibition Against False or Untrue Statements (FIEA, art. 157, item 2)

No person may acquire money or other property, using a document or other indication which contains false indication on important matters, or lacks indication about important matters necessary for avoiding misunderstanding, with regard to sales and purchase or other transactions of securities or derivative transactions, etc.

(3) Against Use of False Market Quotations (FIEA, art. 157, item 3)

No one may use false quotations in order to induce sales and purchase or other transactions of securities or derivative transactions, etc. This is a form of market manipulation by using false quotations.

12 2 Spreading Rumors and Using Fraudulent Means (FIEA, art. 158)

No person shall spread rumor, use fraudulent means, or commit assault or intimidation for the purpose of carrying out a public offering, secondary distribution, sales and purchase or other transaction of securities or derivative transactions, etc. or causing a fluctuation of quotations on securities, etc. (FIEA, art. 158).

Persons who violate this prohibition will be subject to imprisonment for a term not to exceed ten years, a penal fine of not more than JPY10 million (JPY30 million in the case of a profit motive), or both (FIEA, art. 197, para. 1, item 5 and para. 2), and not more than JPY700 million in the case of a corporation (FIEA, art. 207, para. 1, item 1). Properties gained through crimes shall be subject to disgorgement or assessment (FIEA, art. 198-2).

The 2004 amendments have also imposed an administrative monetary penalty for causing a fluctuation in the market by spreading rumors or using fraudulent means.

Furthermore, through the 2008 amendments, on the idea that even if the laws and
regulations do not explicitly require the causal relationship between the act of violation and the market fluctuation, such causal relationship can be presumed externally and reasonably from the effect on the market and the purpose of the act, the requirement of “market fluctuation due to the act of violation” has been amended to “effect on the market through violation,” and the amount of administrative monetary penalty has been amended to be calculated not based on the “final profit/loss” but based on the “value of the positions upon the act of violation valued at the highest (lowest) price within one (1) month of the act of violation” (FIEA, art. 173) in order to increase the efficiency of the prevention of the acts of violation.

The section concerning the spreading of rumors for the purpose of causing a fluctuation of quotations is in practice a regulation against market manipulation. Recently, there have been cases exposed where the internet was used to spread rumors.

The provisions dealing with using fraudulent means in trades or other transactions of securities are general provisions, and cases have also been brought in connection with these as well. These prohibitions have functions similar to Article 157, mentioned above (art. 157 of the FIEA has its background in a similar U.S. provision; and this article has been unique to Japan since the Taisho era).

12 Market Manipulation (FIEA, art. 159)

Market manipulation artificially warps the price formation in markets related to securities and derivatives transactions, and consequently is strictly prohibited because of its disruption of the market.

If any person is found to have committed market manipulation, they will be subject to imprisonment for a term not exceeding 10 years, a penal fine of not more than JPY10 million, or in the case of a juridical person a penal fine of not more than JPY700 million; when such acts were conducted with a profit-motive, the penal fine for individuals jumps to not more than JPY30 million (FIEA, art. 197, para. 1, item 5 and para. 2 and art. 207, para. 1, item 1). In addition, properties gained through crimes shall be subject to disgorgement or assessment (FIEA, art. 198-2).

Persons who engage in market manipulation must pay damages to persons who incurred a loss thereby (FIEA, art. 160).

Furthermore, the levying of an administrative monetary penalty which was only applicable to market manipulation through actual transactions prior to the 2008 amendments became applicable to fictitious trades and wash trades as well as unlawful stabilization operation transactions (FIEA, art. 174 through art. 174-3).

Pursuant to the amendments in 2012, the provisions concerning market manipulation related to market transactions of derivatives under the FIEA shall also be applied to commodity-related
market transactions of derivatives.

Neither damage to the interests of investors nor an objective of earning profits is required in order to establish the crime of market manipulation. Market manipulation is held to occur solely with the intent to artificially distort the fair formation of prices on a market. Although spreading rumors and acts of using false information also constitute market manipulation in the broad sense of the term, our explanation here refers to market manipulation in the narrow sense of the term.

(1) Market Manipulation

(i) Fictitious Trades and Wash Trades (FIEA, art. 159, para. 1)

A fictitious trade (or fictitious sale) is a fake transaction completed for the purpose of misleading others concerning the status of transactions in connection with a trade in listed securities, etc., a market transaction of derivatives or an over-the-counter transactions of derivatives without purpose of transfer of rights or receiving money, etc. (FIEA, art. 159, para. 1, item 1 through item 3).

A wash trade (or wash sale) is an act, committed for the same purpose as that of a fictitious trade, to sell or buy securities, etc. or make an offer for derivatives transaction based on collusion made in advance with another party in which the other party promises to purchase or sell the relevant financial instruments at the same price (or the contracted value in the case of a derivatives transaction) or to accept the offer for the relevant derivative transaction around the same time of the sales or purchase of securities, etc. or offer for derivative transactions (FIEA, art. 159, para. 1, item 4 through item 8).

Intent to distort the market can be found in the fact that, notwithstanding that the substantive investment decision is economically offset and rendered meaningless, wash trades make it appear as though trading is active. The conduct of these transactions is of course prohibited, as well as the entrustment, etc. of such transaction, or the acceptance, etc. of entrustment of such transactions for such purposes (FIEA, art. 159, para. 1, item 9).

It is normally difficult to come up with a rational explanation for why such transactions were conducted and they are easily found to constitute market manipulation.

(ii) Market Manipulation Through Actual Transactions (FIEA, art. 159, para. 2, item 1)

For the purpose of inducing sales and purchase of securities, market transactions of derivatives or over-the-counter transactions of derivatives (referred to “sales and purchase of securities, etc.”), to conduct a series of sales and purchase of securities, etc. or make an offer, entrustment, etc. or accepting an entrustment, etc. therefor that would mislead other persons into believing that sales and purchase of securities, etc. are thriving or would cause fluctuations in prices of listed financial instruments, etc. in a financial instruments exchange market or prices of over-the-counter traded securities in an over-the-counter securities market is prohibited as market manipulation.
With the 2006 amendments to the SEL, “fake positions” (the act of sending an order with no intent to contract, and then canceling the order just when it is about to be executed) in which market manipulation is performed by a securities company making an offer to trade, became prohibited as an act of market manipulation liable to criminal sanction as well as administrative monetary penalty. It has become more likely that an attempt to mount a defense on the grounds that the orders were issued by mistake would not be successful.

Since this provision involves observing a series of trades and making a finding of market manipulation, it is necessary to prove that the party who engaged in the market manipulation had the subjective intent of inducing transactions.

However, in highly liquid markets, where transactions occur frequently, the subjective intent element is inferred based on the external form of the transactions, which make use of extremely complex and intertwined trading techniques. Even in these, persons having a position of market control are able to execute market manipulation without using conspicuous techniques. There is the dilemma that the easier it is to engage in market manipulation, the harder it is to catch.

In a market where trades are concluded only sporadically, even a small movement could warp the price formulation for a security. In these types of cases, the motives surrounding the transactions (new share issue, tender offer, etc.), and other ancillary information (articles recommending the shares in a newspaper, etc.) are the focus of the investigation, and the intent to induce transactions is inferred therefrom.

(iii) Spread of Information Alleging Market Manipulation (FIEA, art. 159, para. 2, item 2)

For the purpose of inducing sales and purchase of securities, etc. to spread a rumor to the effect that prices of listed financial instruments, etc. in a financial instruments exchange market or prices of over-the-counter traded securities in an over-the-counter securities market would fluctuate by his/ her own or other party’s market manipulation is also prohibited as a form of market manipulation. It is a wrongful act of market manipulation to use information that an illegal act might occur.

(iv) Market Manipulation Through False Information (FIEA, art. 159, para. 2, item 3)

To intentionally make a false indication or an indication that would mislead other parties with regard to important matters when making sales and purchase of securities, etc., for the purpose of inducing sales and purchase of securities, etc., is prohibited as market manipulation.

(2) Stabilizing Transactions (FIEA, art. 159, para. 3)

A series of sales and purchase of securities, etc. or make offer, entrustment, etc. or accepting an entrustment, etc. therefor for the purpose of pegging, fixing or stabilizing prices of listed financial instruments, etc. in a financial instruments exchange market can be said to be the very meaning of the word market manipulation since such acts artificially distort price formation in the market; however, there are instances where such acts are recognized as emergency relief measures, giving priority to the needs of companies in raising funds. This is called a stabilizing
transaction.

The FIEA provides that no persons shall engage in stabilization in violation of the provisions of the Cabinet Order.

In other words, if a large volume of securities flooded the market all at once upon a public offering or secondary distribution, it could cause a break down in the balance of supply and demand, making it difficult to procure funds; therefore stabilizing transactions are permitted under certain conditions.

Only certain persons are permitted to conduct stabilization, and only during a certain period, with mandatory restrictions on price, etc. (FIEAO, art. 20 through art. 26).

(3) Regulation of Short Selling (FIEA, art. 162)

Offering to sell securities that one does not own lacks the backdrop of the normal investment decision and generally does not constitute a transaction that should participate in price formation. Moreover, since such transactions are apt to be used in market manipulation, conducting such transactions is not acceptable. Additionally, the sale of securities borrowed from another, or the entrustment or acceptance of such sale is subject to the short sale regulations.

However, margin transactions and futures transactions that are standardized and that are established under certain regulatory formalities, and other transactions, are permitted (Securities Transaction Ordinance, art. 10 through art. 15).

As part of FSA’s Emergency Market Stabilization Measures in response to the recent financial crisis, measures to prohibit short selling without having conducted borrows at the time of sale (naked short selling) (FIBCOO, art. 117, para. 1, item 24-2 through item 24-5) and to obligate holders of short positions of a certain scale or more to report to the exchange through securities companies (0.2% of the total number of issued shares) as well as causing the exchange to disclose such information (0.5% of the total number of issued shares) have been taken (Securities Transaction Ordinance, art. 15-2 through art. 15-4).

Recently, it often happened that unusual fluctuations in share prices took place around the time of announcement of a capital increase through public offering, in response to which investment funds sold the relevant shares short and made profit. In order to prevent such unfair trading practice, a new regulation has been introduced to prohibit the settlement of short sales made during the period after a public offering or secondary distribution of securities is announced and before the issue price or trading price is determined, via securities acquired through such public offering or secondary distribution (as of January 1, 2011) (FIEAO, art. 26-6; Securities Transaction Ordinance, art. 15-5 through 15-8).
Insider Trading

If corporate insiders, such as an officer or employee of a company issuing securities, or persons who are in a position to easily obtain material information in connection with the said company from corporate insiders conduct transactions relating to the company’s securities based on the information they obtain by reason of their position before such information is made public (insider trading), these corporate insiders or persons cannot be said to have been motivated by an evaluation of the quality and value of the securities given that they have engaged in these transactions because they have the information that is not known to everyone, that is, by taking advantage of a disparity or a superior position in terms of information. These acts hinder fair price formation on securities markets. The FIEA makes trading of specified securities, etc. and transactions of derivatives (e.g., CDS and other credit derivatives) subject to insider trading regulations, and prohibits conducting insider trading. These transactions in which corporate insiders, etc. are involved fall under the category of insider trading even if a loss is incurred.

With the amendments in 2012, regulations for insider trading occurring in relation to reorganization were set in place. As a result, acquisition of specified securities of listed companies, etc. due to merger or company split has become subject to the insider trading regulations, while certain types of acquisition of shares through a business transfer, merger or company split that are unlikely to be exploited for insider trading are excluded from these regulations.

Under the amendments in 2013, transactions of securities, etc. issued by investment corporations were included in the scope of subjects of insider trading regulations.

(1) Elements of Insider Trading
(i) Corporate Insiders

The following is the extent of corporate insiders (FIEA, art. 166, para. 1):

(a) Officers, agents, employees or other workers (officers, etc.) of the listed company, etc. (an issuer of share certificates, share option certificates, corporate bond certificates, preferred equity investment certificates, or investment securities, investment equity subscription right certificates, investment corporation bond certificates or foreign investment securities prescribed in the ITA, which are listed on a financial instruments exchange, or an issuer of over-the-counter traded securities or handled securities (FIEA, art. 163, para. 1));

(b) A shareholder or equity member of the listed company, etc. who has the right to inspect the books and records of the listed company, etc. (Companies Act, art. 433, para. 1 and para. 3; including the officers, etc., in case where the shareholder or equity member is a juridical person or an entity similar to a juridical person, and the agent or employees of the...
shareholder or equity member in the case where the shareholder or
equity member is an individual or partnership, etc.); (c) An investor of the listed company, etc. or an investor that has the right to
inspect books and records of the listed company, etc. (including the
officers, etc. in the case where such investor is a juridical person, and the
agent or employees in the case where such investor is a person other
than a juridical person); (d) A person who has statutory authority over the listed company, etc., such
as licensing authority, authority to make on-site inspections, or authority
granted by the National Diet to conduct legislative investigations, etc., or
a person who has the right to request to inspect books of account, etc.;
(e) A person who has concluded, or is in negotiating to conclude, a contract
with the listed company, etc., such as its main bank, certified public
accountant, underwriter, attorney, etc. (including the officers, etc., in case
of a juridical person, and the agent or employees of an entity, in case of
an entity other than a juridical person); (f) An officer, etc. of a juridical person falling within (b), (c) or (e) above who
came to know material facts pertaining to business or other matters of a
listed company, etc. through the requisite conditions described in (b), (c)
or (e) above;
(g) Any person who is not presently a corporate insider, but was previously a
corporate insider, within one year after ceasing to be a corporate insider;
and
(h) These officers, etc. also include the officers, etc. of a parent company or
subsidiary company.

In addition, persons who receive the transmission of information from the
abovementioned corporate insiders (such persons are generally referred to as “initial
information recipients”) shall also be subject to corporate insider regulations as in the case of
corporate insiders themselves (FIEA, art. 166, para. 3)

(ii) Material Facts

Material facts pertaining to business or other matters of a listed company, etc. include
the following information (FIEA, art. 166, para. 2).

It is necessary to be aware that material facts include those of subsidiaries of a listed
company because subsidiaries are also subject to the regulation after the consolidated
financial statements system was introduced (FIEA, art. 166, para. 2, item 5 through item 8)

In the amendments in 2013, the similar provisions concerning material facts as those
applicable to listed companies, etc. were set out with regard to listed investment
corporations, etc. (meaning investment corporations that are listed companies, etc.) (FIEA,
art. 166, para. 2, item 9 through item 14).
(a) A decision by the organ of the listed company, etc. which is responsible for making decisions on the execution of the operations of the listed company, etc. to carry out any of the following matters, or a decision by the said organ not to carry out the matter which is decided to be carried out in such a decision (limited to acts that have already been publicized):
- Solicitation of persons who subscribe for shares issued or treasury shares disposed of by a stock company or solicitation of persons who subscribe for share options for subscription;
- Reduction of the amount of stated capital;
- Reduction of the amount of capital reserve or retained earnings reserve;
- Acquisition of its own shares;
- Allotment of share without contribution or allotment of share option without contribution;
- Share splits;
- Distribution of surplus;
- Share exchange;
- Share transfers;
- Merger;
- Company split;
- Transfer or acquisition of transfer of whole or part of its business;
- Dissolution (excluding dissolution due to merger);
- Commercialization of a new product or technology; and
- Business alliances or other matters provided for by Cabinet Order as those equivalent to the above-mentioned matters;

(b) Occurrence of any of the following events:
- Damages caused by disaster or other damages arising in the performance of its business;
- Changes in major shareholders (shareholders holding voting rights of 10% or more of the voting rights of all shareholders, etc.);
- Facts which could cause the delisting or revocation of registration of regulated securities (meaning shares, share options or bonds of a listed company, etc.; FIEA, art. 163, para. 1; FIAEO, art. 27-3) or options on regulated securities, etc.; and
- Facts deemed equivalent to the above-mentioned matters prescribed by Cabinet Order.

With respect to the facts described in (a) and (b) above, those fall within the standards prescribed by Cabinet Office Ordinance as those matters that are deemed to have an insignificant effect on the investment decisions (de-minimis standard) made by investors are excluded.
(Securities Transaction Ordinance, art. 49 and art. 50).

(c) Existence of a difference between, on one hand, the latest publicized forecasts (or publicized actual figures of the preceding business year in the case of lack of such forecasts) of net sales, current profits or net income (hereinafter referred to as “net sales, etc.”) or of the dividend or of sales, etc. of the corporate group to which the listed company, etc. belongs, and, on the other hand, new forecasts thereof newly prepared by the listed company, etc. or the results in the settlement of account for the business year of the listed company, etc., which falls under the standard prescribed by Cabinet Office Ordinance (Securities Transaction Ordinance, art. 51) as having material influence on investors’ investment decisions; or

(d) Material facts other than (a) through (c) above concerning the operation, business and assets of the listed company in question that could have a significant effect on the investment decisions made by investors.

Since this is a comprehensive provision pertaining to material facts, and due to the several recent examples of its application (Japanese Supreme Court judgment on the Nippon Shouji case), it should be noted that even if the facts at issue do not fall within a material fact spelled out in the FIEA, the insider trading restrictions may still be applied. It is more natural to assume that if the insider knowingly uses a disparity in information to conduct transactions, there will most likely be some sort of legal violation.

(iii) Publication of Material Facts

Material facts are deemed to have been publicized when any of the following occurs (FIEA, art. 166, para. 4):

(a) If the representative director or the executive officer of the relevant listed company or its subsidiary company, or the party who was entrusted by him/her with the announcement of the material facts, has announced the material facts to more than two press institutions, such as a daily newspaper, media company or broadcast institution, and more than 12 hours has elapsed since the announcement (FIEAEO, art. 30, para. 1, item 1 and para. 2);

(b) A listed company, etc. has made a notice in accordance with the regulations of the relevant financial instruments exchanges, etc. that list the securities issued by the said company, stating material facts or facts concerning a tender offer, etc. to the relevant financial instruments exchange, etc., and such material facts, etc. have been made available for public inspection by the financial instruments exchange (FIEAEO, art. 30,
para. 1, item 2). In such cases, the 12-hour rule is not applied and consequently if the information has been made available for public inspection over the timely disclosure system operated and used by the financial instruments exchange (e.g., the Timely Disclosure Network (TDnet) operated by the Tokyo Stock Exchange) it will be deemed to have been made available for public inspection and to have been immediately disclosed; or

(c) The material facts pertaining to business and other matters have been included in a securities registration statement or the attached documentation thereto, amended registration, shelf registration, shelf registration supplementary documents or attached documentation thereto, revisions of any of these, or an annual securities report or attached documentation thereto, or amended report thereof, confirmation statement, amended confirmation statement, internal control report or attached documentation thereto, amended report thereof, a quarterly report or an amended report thereof, semiannual report or an amended report thereof, an extraordinary report or an amended report thereof, or a report on status of parent company or an amended report thereof, and such document has been made available for public inspection in accordance with the provisions of the FIEA.

(iv) Exceptions

Even if the elements of insider trading are satisfied, conducting the following transactions would not be illegal: the acquisition of shares as a result of the exercise of the right to receive allotment of shares by the holder of the right; the acquisition of shares as a result of the exercise of share options by the holder of the share options: sale and purchase, etc. involving specified securities, etc. by exercising an option; sale and purchase, etc. based on the right to demand purchase of shares or right to demand purchase of investment equity; a purchase, etc. made upon a request that has been determined by the board of directors of the company, etc. in order to resist a tender offer, etc.; a purchase of shares, etc. based on a resolution of a shareholders meeting; a stabilizing transaction that is conducted in accordance with a Cabinet Order; certain types of sale and purchase, etc. involving corporate bond certificates, etc.; off-exchange transactions between the parties who both have knowledge of the material facts; succession to specified securities due to a merger, etc. wherein the ratio of the relevant securities to the succeeded assets is extremely low; issuance of treasury shares as consideration for a merger, etc.; sale and purchase, etc. made as performance, etc. under a contract that was entered into prior to becoming aware of the material information; a purchase through stock cumulative investment which meets certain criteria; acquisition of unexercised share options upon exercise under the call clause based on the plan and due date decided by the issuing company prior to gaining knowledge on important facts; and the sale of acquired share options to an underwriting company (FIEA, art. 166, para. 6; Securities
In other words, the insider trading regulations prohibit “utilizing” superiority in terms of acquired information in the formation of the investment decision itself.

Given these numerous exceptions it is almost impossible to envision a case that would be punishable for the reason of meeting the formal grounds for a crime even though there was no use of priority in terms of the acquired information.

(v) **Regulations Concerning Tender Offers**

The need for insider trading regulations regarding related parties in a tender offer as well as an act that is equivalent to the same (meaning an act of purchasing shares, etc. of at least five percent of the total voting rights of the issuing company) is similar to the need for insider trading regulations regarding corporate insiders. However, information concerning tender offers is different from the internal information of a company issuing listed securities, etc. Therefore, separate provisions are provided for insider trading with regard to tender offers (FIEA, art. 167; FIEAEQ, art. 31).

An administrative monetary penalty will be levied for violation (FIEA, art. 175, para. 2).

The elements of insider trading in tender offers are almost the same as the elements used in insider trading regarding corporate insiders.

Based on the amendments in 2013, the company subject to a tender offer, etc. and its officers and employees were included in the scope of a person concerned with a tender offer, etc. (FIEA, art. 167, para. 1). On the other hand, the amendments provide that a person who received information of a fact concerning the launch of a tender offer, etc. is excluded from the insider trading regulations regarding a tender offer, etc. in cases where the person disclosed the information in a tender offer notification, etc. when making a tender offer or where six months have passed from the day on which the person received the information (FIEA, art. 167, para. 5).

(vi) **Regulations for the Act of Providing Information or Recommending a Transaction**

A corporate insider who has come to know a material fact shall not provide such information or recommend a transaction to other persons for the purpose of having other persons gain profits or preventing them from incurring losses by having them conduct a transaction before the material fact is publicized (FIEA, art. 167-2, para. 1). This regulation was introduced as part of the amendments in 2013 in response to the recent insider trading incidents involving the leakage of information from the underwriting securities companies upon public offering of listed companies.

The same regulation applies to a person concerned with a tender offer, etc. who received information of a fact concerning a tender offer, etc. (FIEA, art. 167-2, para. 2).

(vii) **Punishment and Accomplice**

Violations of the regulations prohibiting insider trading are punishable by imprisonment for a term not to exceed 5 years, a penal fine of not more than JPY5 million (not more than JPY500 million in the case of corporations), or both (FIEA, art. 197-2, item 13, and art. 207,
A person who provided information or recommended a transaction to another person in violation of the regulations for such act is subject to the same punishment if such information recipient, etc. actually engaged in a transaction (FIEA, art. 197-2, item 14 and item 15, art, 207, para. 1, item 2).

There are cases in which persons who are not directly involved in the insider trading may be punished as an accomplice with respect to their participation in the violation. Insider trading by corporate insiders are levied an administrative monetary penalty as well (FIEA, art. 175). If a person other than a financial instruments business operator, etc. engages in insider trading on an account other than its own account, an administrative monetary penalty equivalent to the amount of remuneration, etc. is levied on such person (FIEA, art. 175, para. 1, item 3 and para. 2, item 3).

As a result of the amendments in 2013, an administrative monetary penalty is to be imposed on a person who provided information or recommended a transaction to another person in violation of the regulations for such act if such information recipient, etc. actually engaged in a transaction. The amount of penalty applicable to a securities company or any other intermediary or its officer or employee is much larger than that applicable to other persons (FIEA, art. 175-2).

Furthermore, in order to prevent asset management companies from engaging in insider trading on accounts other than their own, the amount of penalty to be imposed for such insider trading has been raised significantly (FIEA, art. 175, para. 1, item 3(a) and para. 2, item 3 (a)).

As a result of the 2014 amendment of the FIEA, the procedure for confiscation of electronic share certificates, etc. has been developed and made applicable to the violation of the insider trading regulations (FIEA, art. 209-4 through art. 209-7).

(2) Duty to Report of Officers and Major Shareholders of the Company

When officers and major shareholders (the term “major shareholder” in (2) to (5) below means a shareholder that holds voting rights constituting 10 percent or more of voting rights held by all shareholders, etc., in that person’s own name or in the name of another person; FIEA, art. 163, para. 1) of a company issuing securities listed in a financial instruments exchange, including share certificates, share option certificates, corporate bond certificates or preferred equity investment certificates, or investment securities, investment equity subscription right certificates, investment corporation bond certificates or foreign investment securities prescribed in the ITA, or a company issuing over-the-counter traded securities or handled securities, buy or sell the share certificates, share option certificates, or corporate bond certificates, etc. of the listed companies, etc. (hereinafter referred to as “specified securities”), or make a purchase, etc. or sale, etc. of securities representing an option in connection with the specified securities (“related securities”; hereinafter these are collectively referred to as “specified securities, etc.”) on their own account, then except as otherwise provided by Cabinet Order, they must file a report with the Prime Minister concerning such sale and purchase, etc. (FIEA, art. 163).
This provision is incorporated in order to ascertain insider trading.

(3) **Regulations on Short-Swing Trades of Officers or Major Shareholders**

When officers or major shareholders of a listed company, etc. realize a profit, for their own account, through purchase, etc. of specified securities, etc. of the listed company, etc., and sale of the same within the six months after the purchase or sales of the specified securities and purchase of the same within six months after the sale of the same, the listed company, etc. may demand that such persons return any profits earned (FIEA, art. 164).

This provision should first be understood as a check on company officers who might pursue short-swing profits through sales of the company’s own stock in dereliction of their duty of loyalty towards the company.

(4) **Prohibition on Short Sales of Company Shares by Officers or Major Shareholders**

The officers or major shareholders of a listed company, etc. are absolutely prohibited from short selling the company’s shares or engaging in a transaction that has the same effect (a “specified transaction”) (FIEA, art. 165).

This provision should be understood as being for the purpose of securing the performance of the duty of loyalty of officers, etc. to the company, by prohibiting officers, etc., from conducting transactions that generate more profits as the price of the company’s stock falls.

(5) **Regulations Concerning Specified Partnerships, Etc. (Fund Regulation)**

Traditionally, when making a determination of a “major shareholder” under the SEL, shares of stock held as partnership assets under a vehicle such as a Civil Code partnership, an investment LPS or a limited liability partnership that did not have juridical personality were considered to be held by each partner in accordance with the percentage of the share that each partner had in the shared interests, and not on the basis of the partnership as a whole. Consequently, these regulations did not apply even when the partnership as a whole held a share of 10 percent or more of the voting rights.

Nevertheless, it is foreseeable that the voting rights would be exercised as a block if the partners of a partnership, etc. under the Civil Code acted in a group as a partnership, when 10 percent or more of the voting rights are held as a group by the partnership.

Consequently, the FIEA imposes the regulations of (2) through (4) on a “specified partnership, etc.” of this nature (FIEA, art. 165-2, para. 1, para. 3 and para. 15).
Regarding the Prohibition of Insider Trading and Inappropriate Management of Confidential Corporate Information

Recently, insider trading by officers and employees of listed companies and inappropriate management of confidential corporate information by securities companies have become major issues (see chart).

In June 2012, an administrative monetary penalty payment order was issued against a major trust bank since its staff in charge of investments conducted the sales of shares and short-selling of borrowed shares prior to the publication of the important fact of capital increase through a public offering by a resource development company of which he/she was notified in the course of management of foreign investment trusts based on a discretionary investment contract. The officers and employees of Association Members belonging to the Japan Securities Dealers Association (hereinafter referred to as the “JSDA”) should take this frequent occurrence of insider trading seriously and engage in their business by fully recognizing that insider trading is an act strictly prohibited by the FIEA and that they are in a position to prevent the occurrence of such acts.

[Regarding the Prohibition of Insider Trading]

Then, why is insider trading prohibited? This must be understood in relation to the purpose of the FIEA.

The insider trading regulations under the current Act were introduced through the amendments to the SEL in 1988. At that time, it was explained that the basis for insider trading regulations was to ensure investor’s confidence in the fairness of the securities market. These regulations were another expression of investor protection, which was the purpose of the SEL, at that time. This explanation was based on the feeling that it is unfair to allow only the specific persons who know material information to make money by using such information. Moreover, since there was insufficient understanding that insider trading is a crime, focus was placed on spreading the fact that insider trading is an illegal act and the encouragement of voluntary management.

However, because the philosophy of securities market regulations was drastically changed from the conventional investor protection to ensuring functions of the securities market through fair price formation in the securities market, the insider trading regulations could no longer be based solely on the ensuring of investors’ confidence in the fairness of the securities market. Insider trading is prohibited because such trading harms fair price formation in the securities market and impairs the functions thereof. In other words, based on the fact that ensuring fairness in the market participants’ appropriate and timely access to information is the condition for fair price formation, the basis of prohibition of insider trading shall be the fact that the act of forming investment decisions by using the disparity in information (advantageous position in terms of information), which cannot be considered to be a sincere investment decision with respect to the trading object, interferes with the fair price formation in markets and harms the functions of the market and thus is against the public interest. Moreover, heavier criticisms should be placed on the officer or employees of...
a financial instruments business operator, etc. that plays a key role in the securities market for taking part in insider trading because their involvement would cause more serious interference to the market.

In Japan, the provisions concerning insider trading regulations are established formally; they uniformly provide in detail what “important facts” are, and which case satisfies the requirements such as “organ which is responsible for making decisions” and “publication.” In the past, focus was placed on the principle of no penalty without a law, and thus unless the relevant incident fell under these requirements in form, it was not considered to be an insider trading. However, the two recent judgments rendered by the Supreme Court in relation to an insider trading revoked the judgment of the High Courts that took the formal logic and pursuit for reasonable results by substantive decisions (the Nippon Shoji case concerning what important facts are and the Nippon Orimono Kako case concerning the significance of the organ which is responsible for making decisions with respect to the facts decided). As just described, the Supreme Court showed an attitude to reject legal loopholes by applying the formally established provisions of the current Act by prohibiting transactions conducted by using disparity in information or advantageous positions in terms of information through interpretation of catch all provision. This means that it is risky if we do not deal in transactions with the recognition that the numerous provisions provided in the FIEA in a formal manner are mere guidelines.

Association Members are required to deal with their customers with the abovementioned changes in the insider trading regulations in mind.

[Regarding the Management of Confidential Corporate Information]

Since insider trading must be strictly prohibited as an act of hindering the functions of securities market, a financial instruments business operator, etc. that plays a key role in the functions of the securities market shall assume high responsibility to prevent the occurrence of insider trading and the execution of an order for insider trading in the market. Accordingly, financial instruments business operators, etc. are restricted from conducting the following acts under the FIEA.

First, a financial instruments business operator, etc. or its officers or employees are prohibited from accepting orders when they know that the sale and purchase or other transaction of securities, etc. by a customer constitutes or is likely to constitute violation of insider trading regulations (FIEA, art. 38, item, 9; FIBCOO, art. 117, para. 1, item 13). These provisions have clarified that a financial instruments business operator, etc. or its officers or employees that are responsible for the securities market must not accept acts that may harm the market, etc. If they violate this provision, they may be subject to criminal liability as an accessory to the crime of insider trading.

Secondly, a financial instruments business operator, etc. or its officers or employees are prohibited from soliciting customers by providing to them confidential corporate information of the issuer of the relevant securities with respect to the sale and purchase and other transactions of securities, etc. or the derivatives transactions related to securities or the intermediary, brokerage or agency service therefor (FIEA, art. 38, item 9; FIBCOO, art. 117,
para.1, item 14). These acts may also be considered to be the act of solicitation by provision of special benefits, but, because they can increase the probability of the occurrence of insider trading or have the sense of being accessories to insider trading as an act of spreading undisclosed material information, the abovementioned provisions have been prescribed to call for special attention.

Thirdly, a financial instruments business operator, etc. or its officer or employee is prohibited from engaging in sale and purchase or other transactions of securities in relation to which they know confidential corporate information for its own account based on the said information (FIEA, art. 38, item 9; FIBCOO, art. 117, para. 1, item 16). As financial instruments business operators, etc. often receive confidential corporate information from their trading partners, etc., they are in a position to establish a rigorous internal administration system to prevent insider trading by themselves. Yet, because there are cases where it is difficult to prove the occurrence of insider trading, these provisions were established to prohibit in advance the transactions using confidential corporate information.

The confidential corporate information as mentioned here means undisclosed important information on the operation, business or properties of listed companies, etc. set forth in the FIEA, Article 163, Paragraph 1, which is found to have an impact on customers’ investment decisions and undisclosed information on a decision about the launch or suspension of a tender offer as prescribed in the FIEA, Article 27-2, Paragraph 1, the buying-up equivalent thereto in regard to the share certificates, etc. and a tender offer as prescribed in the FIEA, Article 27-2-2, Paragraph 1 (FIBCOO, art. 1, para. 4, item 14). Attention should be paid that this provision states the facts which have an impact on customers’ investment decisions. The scope of information which falls under the category of this information is wider than that of the material facts concerning insider trading regulations.

In order to secure the effectiveness of the abovementioned conduct control, a financial instruments business operator, etc. must take measures necessary and appropriate for the prevention of unfair transactions based on the confidential corporate information, in connection with the management of the confidential corporate information it handles or the management of the customer’s sale and purchase or other transactions of securities, etc. (FIEA, art. 40, item 2; FIBCOO, art. 123, item 5). Therefore, JSDA provided the “Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members,” and has required the Association Member to provide internal rules on the management of confidential corporate information in order to prevent the occurrence of unfair transactions using such information (JSDA Confidential Corporate Information Rules, art. 4). Association Members are further required to establish procedures that are necessary to manage the confidential corporate information such that officers and employees who acquire the confidential corporate information immediately report such acquisition to the management section (JSDA Confidential Corporate Information Rules, art. 5), to manage the section which is highly likely to acquire confidential corporate information (corporate section) so that the confidential corporate information is not communicated to other sections that do not need such information for their business, by means such as physically isolating...
the corporate section from other sections (JSDA Confidential Corporate Information Rules, art. 6, para. 1).

As described above, Association Members are required to be aware of the fact that they are playing a key role in the securities market and the need to create a system that prevents the occurrence of insider trading.

<table>
<thead>
<tr>
<th>Perpetrator of the Insider Trading</th>
<th>Date of Judgment or Disposition</th>
<th>Outline of the Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee of a securities company</td>
<td>June 2009</td>
<td>An employee of a securities company came to know that Bank D would make a tender offer of its own shares, and gained profits by purchasing the shares of the company prior to the publication of such fact. The first recipient of the information from the member also gained profits by purchasing the shares of the company. The FSA issued an administrative monetary penalty payment orders to the employee and the recipient for 440,000 yen and 380,000 yen, respectively.</td>
</tr>
<tr>
<td>Representative of a fund</td>
<td>June 2011</td>
<td>In November 2004, a representative of a fund, who was informed of the fact that Company F will buy up the shares of Company G for 5% or more, purchased the shares of Company G until January of the following year and then sold the shares and gained a huge amount of profits. He was arrested and prosecuted by the Tokyo District Public Prosecutors Office. Although the representative of the fund filed an appeal, the Supreme Court rendered a judgment to dismiss the appeal. Thereby, the Tokyo High Court’s judgment of imprisonment with work for two years, suspension of execution of sentence for three years, penalty of 3 million yen, and supplementary charges for 1.149 billion yen became final and binding.</td>
</tr>
<tr>
<td>President of a consulting firm</td>
<td>September 2011</td>
<td>A president of a consulting firm was arrested and prosecuted for conducting the sale and purchase of the shares of Company H, by using the undisclosed information of the company. The Tokyo District Court found the defendant guilty and sentenced him to imprisonment with work for three years, suspension of execution of the sentence for three years, penalty of four million yen, and supplementary charges for 117.96 million yen.</td>
</tr>
<tr>
<td>Major shareholder of a precision equipment company</td>
<td>June 2012</td>
<td>A major shareholder of a precision equipment company was arrested and prosecuted for purchasing the shares of the company prior to the publication of the company’s capital increase and then selling out the shares before their price dropped prior to the publication of the forfeiture of part of the shares. The Osaka District Court found the major shareholder guilty and sentenced him to imprisonment with work for three years, suspension of execution of the sentence for five years, penalty of four million yen and supplementary charges for about 380 million yen.</td>
</tr>
<tr>
<td>Trust bank</td>
<td>June 2012</td>
<td>The FSA issued an administrative monetary penalty payment order of 130,000 yen to a trust bank for unlawfully selling the shares of Company I and Company J prior to the publication of the information of capital increase through a public offering by Company I in June 2010 and by Company J in July of the same year. The entity which provided to the personnel in charge of sale and purchase in the relevant trust bank with the information on capital increase is said to be the lead manager securities company of the capital increase through the public offerings in question.</td>
</tr>
<tr>
<td>Investment advisory company</td>
<td>June 2012</td>
<td>The FSA issued an administrative monetary penalty payment order of 130,000 yen to an investment advisory company for unlawfully selling the shares of NSG group immediately prior to the publication of the information of capital increase through a public offering by Company K in August 2010. The entity which provided to the personnel in charge of investments at the investment advisory company the information on capital increase is said to be the lead manager securities company of the capital increase through the public offering in question.</td>
</tr>
<tr>
<td>Perpetrator of the Insider Trading</td>
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<tr>
<td>Employee of a securities company</td>
<td>August 2012</td>
<td>An employee of a securities company was arrested and prosecuted for exposing the confidential corporate information to outsiders and taking part in insider trading. It was subsequently found that the securities company had not established a management system of confidential corporate information from the report submitted to the FSA from the securities company pursuant to Article 56-2, Paragraph 1 of the FIEA, and thus the insider trading occurred. Therefore, the FSA issued a business improvement order to the securities company pursuant to Article 51 of the FIEA.</td>
</tr>
<tr>
<td>President of a fashion information company</td>
<td>September 2012</td>
<td>A president of a fashion information company gained profits by purchasing the shares of Company L, a major grocery store, prior to the publication of important facts pertaining to the tender offer of the company, after actively obtaining information on such material fact from his wife who was an external director of Seiyu. The Tokyo District Court found the defendant guilty and sentenced him to imprisonment with work for two years, suspension of execution of the sentence for three years, penalty of one million yen, penalty for the corporation for four million yen, and supplementary charges for about 37.25 million yen (jointly with the company).</td>
</tr>
<tr>
<td>Former METI senior officer</td>
<td>June 2013</td>
<td>In April 2009, a former senior officer of METI came to know of a material fact that Company M and Company N would merge into a new company, and purchased a total of 5,000 shares in Company M prior to the publication of the merger plan. He also purchased a total of 3,000 shares in Company O in May 2009 prior to the publication of the company’s recovery plan under the Act on Special Measures Concerning Industrial Revitalization, and earned profit of about 2.3 million yen from this series of transactions. The Tokyo District Court sentenced him to imprisonment with work for one year and six months, with suspension of execution of the sentence for three years, and to a fine of one million yen with supplementary charges of about 10 million yen.</td>
</tr>
<tr>
<td>Employee of an electronic appliance company</td>
<td>September 2013</td>
<td>Around late July 2012, an employee of an electronic appliance company heard from his colleague that the company would launch a tender offer for the shares of Company P, and prior to the publication of this news, he purchased 12 shares in Company P in his own account at a total of 3,907,500 yen. The electronic appliance company dismissed the employee. The FSA issued an administrative monetary penalty payment order of 2.89 million yen to him.</td>
</tr>
<tr>
<td>Executive officer of a major supermarket and his acquaintances</td>
<td>June 2014</td>
<td>An executive officer of a major supermarket came to know during an in-house meeting that his company was planning to make a tender offer for the shares of Company Q and make it a subsidiary. He himself purchased Company Q’s shares and also provided three persons of his acquaintance with the information of the tender offer by phone. After Company Q publicized the fact of being subject to the tender offer, the executive officer and his acquaintances sold its shares and earned profits of 390,000 to 1,280,000 yen, respectively. The FSA issued an administrative monetary penalty payment order of 680,000 to 1,970,000 yen respectively to them.</td>
</tr>
<tr>
<td>Legal advisor to a company</td>
<td>August 2014</td>
<td>A legal advisor to a major electronics retail company came to know the company’s plan to increase its capital through a public offering. He sold all of the 2,000 shares in the company that he had held before the publication of this plan, and avoided a loss of about 210,000 yen. After the Securities and Exchange Surveillance Commission issued the recommendation for an administrative monetary penalty, the legal advisor contract was terminated. The FSA issued an administrative monetary penalty payment order of 390,000 yen to the former legal advisor.</td>
</tr>
<tr>
<td>Overseas asset management company</td>
<td>December 2014</td>
<td>In 2010, the personnel in charge of asset management at an overseas asset management company, R, obtained information that a Japanese company, in which Company R invested funds, was planning to increase its capital through a public offering. Based on this information accessed before publication, Company R conducted short sale of the shares in that Japanese company. The FSA issued an administrative monetary penalty payment order of 8,040,000 yen to Company R.</td>
</tr>
<tr>
<td>Perpetrator of the Insider Trading</td>
<td>Date of Judgment or Disposition</td>
<td>Outline of the Case</td>
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<tr>
<td>Japanese individual</td>
<td>November 2015</td>
<td>A man in his 60s who was an office worker living in Japan came to know of the fact that a subsidiary of a mobile phone distributing company, U, was planning to make a takeover bid against an insurance company, W. Before this information was published, he provided it to his colleague, a woman in her 30s who was a company officer. Based on this information, she purchased shares in Company W before the takeover bid was announced. The FSA ordered the man and woman to pay an administrative monetary penalty of 250,000 yen and 510,000 yen, respectively.</td>
</tr>
<tr>
<td>Physician</td>
<td>December 2015</td>
<td>A physician of the Medical School of University V was engaged in a clinical trial of an eye drop under a clinical trial agreement concluded between the university and a pharmaceutical company, X, but was notified by Company X of the suspension of the trial. Before this fact was published, the physician sold short 800 shares in Company X in a margin transaction, and then bought back shares in the company after the share price fell due to the announcement of the suspension of the trial. The FSA ordered the physician to pay an administrative monetary penalty of 600,000 yen. Company V suspended the physician from work for three months.</td>
</tr>
<tr>
<td>Former chairperson of a company</td>
<td>November 2016</td>
<td>B, the former chairperson of Company A, which was listed on the TSE Mothers, provided two of his relatives with the unpublished information on the forecast that the company would post an ordinary deficit for the term ending December, thereby enabling them to avoid a loss by selling off the company's shares they held. The Tokyo District Court sentenced B to imprisonment for two years with three-year suspension and a fine of two million yen. This is the first case in which the court applied the provision of the FIEA that prohibits a person from providing another person with unpublished information in an attempt to enable the latter to avoid a loss.</td>
</tr>
<tr>
<td>Former financial consultant</td>
<td>June 2017</td>
<td>A former financial consultant, C, was ordered by the FSA to pay an administrative monetary penalty of 60,000 yen for gaining profit based on the unpublished information acquired from a securities company's employee which was related to an electricity company's capital increase through public offering. Dissatisfied with this, C filed a suit against the State to seek revocation of the FSA's order. The Tokyo District Court upheld C's claim and revoked the order, and the Tokyo High Court supported the decision of the prior instance and dismissed the appeal filed by the State. This is the case in which the FSA's payment order was revoked by the court for the first time since the administrative monetary penalty was introduced in 2005.</td>
</tr>
<tr>
<td>Recipient of information from a company officer</td>
<td>June 2018</td>
<td>A man in his 30s living in Japan obtained information regarding the upward revision of the business results and the share split of a new electricity company, E, from the company's officer before the information was published, and, based on this information, the man purchased 13,400 shares in that company on his own account. The FSA ordered the man to pay an administrative monetary penalty of 11.67 million yen.</td>
</tr>
</tbody>
</table>

12 Other Unfair Transactions

(1) Prohibition of Public Notice, Etc. of False Quotations (FIEA, art. 168)

No person shall publicly notify false quotations on market prices of securities, etc., or prepare or distribute documents that contain false quotations on market prices of securities, etc. for the purpose of publicly notifying or distributing the documents. Moreover, no person shall, in
response to a request of an issuer, a person engaged in secondary distribution of securities, an underwriter or financial instruments business operator, etc. prepare or distribute documents that contain fake statement on any important matters pertaining to securities issued by, apportioned to or dealt by such persons for the purpose of publicly notifying or distributing the documents.

Violators of this regulation will be subject to imprisonment for not more than a term of one year, a penal fine of not more than JPY1 million, or both (FIEA, art. 200, item 20).

(2) Restriction on Expression of Opinion in Newspaper, Etc. for Which Consideration Is Received (FIEA, art. 169)

When a person publishes in a newspaper or a magazine, or indicates by means of documents, broadcasting, motion picture or other means to the public, his/her opinion which would convey his/her decision regarding investment on securities, issuers or tender offerors in exchange for consideration received from or under a promise to receive consideration from any issuer, person engaged in secondary distribution of securities, underwriter, financial instruments business operator, etc. or tender offeror, etc., such a person shall indicate, together with the opinion, that the opinion is published or indicated in exchange for consideration received or under a promise to receive consideration.

However, that this shall not apply to cases where a person who has received or is promised to receive advertisement fees indicates such an opinion as an advertisement made in exchange for the advertisement fees.

Violators of this provision will be subject to imprisonment for not more than six months or a penal fine of not more than JPY500,000 (FIEA, art. 205, item 20).

(3) Prohibition of Indication of an Advantageous Purchase, Etc. (FIEA, art. 170)

Transactions in equities and other securities entail risks and may generate losses, which are, of course, borne by the investor.

Therefore, upon making solicitation of an application to acquire newly issued securities or solicitation of an application to sell or purchase already-issued securities to many and unspecified persons, no person shall make an indication to many and unspecified persons to the effect that the person or other person will purchase the securities acquired by members of the said many and unspecified persons at a predetermined price or higher or will make an arrangement for selling such securities at a predetermined price or higher, or shall make an indication that is likely to be understood as meaning to that effect.

The intent of this provision is to secure the fairness of the primary market, and violators of this provision will be subject to imprisonment of not more than one year or a fine of not more than JPY1 million, or both (FIEA, art. 200, item 21).

(4) Prohibition of Indication of Fixed Dividends, Etc. (FIEA, art. 171)

Upon a public offering or secondary distribution of securities, advertisements such as “annual dividends of JPYXX per share or annual dividends of YY% of profits will continue,” or that a certain amount of money will be provided are prohibited since such advertisements could distort
the primary market.

Violators of this provision will be subject to imprisonment for not more than one year or a fine of not more than JPY1 million, or both (FIEA, art. 200, item 21).

(5) Prohibition Against Off-Market Netting Transactions (FIEA, art. 202)

An act for the purpose of exchanging the difference by using quotations on a financial instruments exchange market without resorting to the financial instruments exchange market constitutes an act solely of exchanging a margin without having the financial instruments or the funds enabling a transaction of the financial instruments. An act of this nature is prohibited as it is one of only taking profits without participating in the market on the basis of a true investment decision.

A person who commits this act is subject to imprisonment for a term not exceeding one year, a penal fine of not more than JPY1 million, or both.

However, certain over-the-counter transactions of derivatives in which a financial instruments business operator, etc. is one of the parties or carries out brokerage of the same are exempted from this prohibition.

(6) Creation of a Rule for Nullifying Transactions Conducted Through the Selling of Unlisted Shares, Etc. by Unregistered Business Operators

A person who is to engage in selling shares, etc. in the course of trade must be registered under the FIEA, but there was no special rule under civil law for regulating violation of this requirement of registration. Because of this, it often happened recently that unregistered business operators enticed elderly people to buy unlisted shares at high prices, by saying that these shares were going to be listed soon and guaranteeing a profit.

Investors who acquired unlisted shares and suffered loss can claim damages under tort law (Article 709 of the Civil Code) or Article 5 of the FISA, and they can also assert nullification or rescission of their transactions under the Consumer Contract Act. However, these legal provisions were criticized as failing to provide sufficient protection for investors because they imposed the burden of proof on investors. Therefore, in order to enhance relief for victims, a new rule was created through the amendments in 2011 for nullifying the sale of unlisted shares by unregistered business operators.

Specifically, where an unregistered business operator (referring to a person who, in violation of the FIEA, Article 29, engages in type I financial instruments business defined in the FIEA, Article 28, Paragraph 1 or type II financial instruments business defined in Paragraph 2 of the said Article, without obtaining registration from the Prime Minister) conducts sales, etc. of unlisted securities (“sales, etc.” refers to sale or intermediary or agency services thereof, dealing in public offering or secondary distribution, or any other act specified by Cabinet Order as an act equivalent to these acts), the subject contract (referring to the contract pertaining to such sale, etc. or contract concluded through such sale, etc., under which the customer is to acquire the unlisted securities) shall be null and void (FIEA, art. 171-2, para. 1, main clause; FIEAEO, art. 33-4-4).

However, this provision shall not apply if the unregistered business operator or the seller or
issuer of the unlisted securities pertaining to the subject contract (limited to those who are the
parties to the contract) proves that the sale, etc. in question does not result in insufficient
protection of the customer in light of the customer’s knowledge, experience, status of property or
purpose of concluding the subject contract or that the sale, etc. does not constitute unjust
enrichment (FIEA, art. 171-2, para. 1, proviso). This is because such sale, etc. is not found to be
against the principle of investor protection even when it is conducted by an unregistered business
operator.

“Unlisted securities” mentioned here refer to corporate bond certificates, share certificates,
share option certificates, and other securities specified by Cabinet Orders as securities for which it
is particularly necessary to ensure proper trading, and which do not fall under any of the following
(FIEA, art. 171-2, para. 2; FIEAO, art. 33-4-5):

(i) Securities listed on financial instruments exchanges;
(ii) Over-the-counter traded securities or handled securities; or
(iii) In addition to what is set forth in (i) and (ii), securities specified by Cabinet Order as
securities for which the information on the trading price or issuer thereof can easily be
obtained.

13 Information Disclosure, Accounting, Auditing Systems and Internal Control

13 1 Significance

Where a large volume of securities is offered to general public and distributed, it is necessary
for the issuing company to disclose certain information concerning the status of its business,
financial position, management results, etc. so that investors can make an informed investment
decision.

Fair price formation in the capital markets is made possible by the accumulation of different
judgments with respect to the quality and value of a particular security, and without being able to
know the price for the object of the transaction, it is impossible for the securities market to
function. The information disclosure system exists not only to protect the general investor, but is
also necessary at times in order to protect professional investors.

The content of the information to be disclosed varies depending on (a) whether the product
characteristics, particularly its structure, risks and other individual information are widely known
with respect to the object of transaction (i.e., securities). The structure and risks of shares of stock,
for example, are widely known, and therefore only the disclosure of company information
becomes an issue. For a product with a new structure, however, the disclosure of all information
concerning the structure and product characteristics of a product is necessary.

Next, when (b) the product characteristics may change, it is necessary to disclose up-to-the-
minute information pertaining to such change. With respect to share certificates, continuing disclosure (secondary disclosure) is requested from this perspective.

Finally, when (c) the transacting party (investor) is proficient in the said product, it is unnecessary to disclose information towards such persons. There is a system that does not call for information disclosure (or more precisely refer to the first paragraph of the registration statement for the public offering or secondary distribution) to sophisticated investors (qualified institutional investors or professional investors) known as QII private placement or professional investor private placement (see “13-2 Disclosure of Corporate Affairs and Other Related Matters” for details).

13-2 Disclosure of Corporate Affairs and Other Related Matters

The information disclosure system, which covers mainly shares of stock, takes the form of the disclosure of corporate affairs and other related matters in view of the general theory concerning information disclosure described above. The information disclosure system (disclosure) under the FIEA has been formalized because the targets for these “explanations” are many and unspecified persons, and it is necessary to confirm that this is an extension of the concept of providing a direct person to person explanation. Consequently, even if the disclosure regulations do not apply under the FIEA (certain interests in collective investment schemes and small number private placements, etc.) this does not mean that a direct explanation to the person in question is not required (FIEA, art. 37-3; FISA, art. 3).

The disclosure system of corporate affairs and other related matters can be classified broadly into disclosure in the primary markets and disclosure in the secondary markets. In the primary market, a registration of primary offering or secondary distribution is made to the Prime Minister by way of a securities registration statement, and it becomes possible to recruit investors or sell to investors once the registration statement becomes effective after being inspected by the government. At this time, disclosure must be made directly to the investor by means of delivering a prospectus. Moreover, in the case of the secondary market, various systems exist under the FIEA, consisting of annual securities reports that are to be filed each business year, quarterly reports that are to be filed each quarter, extraordinary reports that are to be submitted when certain material information has come into existence, and the timely disclosure which is a rule on the part of the financial instruments exchanges.

In order to secure and maintain the truthfulness, accuracy and clarity of the disclosure documents prepared for these purposes, the FIEA provides for accounting systems and the system of auditor certification by a certified public accountant or auditing firm. A system of reporting on internal control and confirmation statements has been enacted in order to assure the reliability of information disclosure on secondary markets.

The securities subject to the disclosure system of corporate affairs and other related matters are fundamentally securities pertaining to a public offering or secondary distribution in the
primary market (provided, however, that the disclosure system does not apply to national bonds, municipal bonds, bank debentures, government guaranteed bonds, and certain interests in collective investment schemes which have low market liquidity (FIEA, art. 3)). Securities involved with asset securitization as well as beneficiary certificates of an investment trust and investment securities issued by an investment corporation are covered by a special disclosure system as “specified securities” (FIEA, art. 5, para. 1; this definition is different from that of “specified securities” in 12-4(1)(ii)(b) above), and may require a full disclosure including the product mechanism and detailed information of each asset.

Moreover, although the duty to prepare and file with the Prime Minister a securities registration statement as an offering disclosure (FIEA, art. 5, para. 2), and a duty to prepare and file annual securities reports, etc. as an continuous disclosure (FIEA, art. 24, para. 2 and art. 24-5, para. 2) are imposed on a small offering where the issue price or secondary distribution price is between JPY100 million to JPY500 million, the content of the information disclosure is simplified (it is foreseen that venture companies will fall under this regime).

Furthermore, since the company, companies of which such company owns a majority of the voting shares, and companies or groups (company groups) that meet the requirements of the Cabinet Office Ordinance as persons who have a close relationship with such company engage in activities as a corporate group, requiring each company to conduct disclosure on an individual basis would not accurately reflect the actual state of the company, and for this reason the state of accounts, etc. on a consolidated basis as a corporate group is to be presented, inter alia, in the securities registration statement and the annual securities report (FIEA, art. 5, para. 1, item 2, art. 24, para. 1, and art. 24-4-7).

Although consolidated information was of secondary significance prior to the 1998 SEL amendments, after the amendments, consolidated information became the primary basis for disclosure. Finally, the concept of a subsidiary company subject to consolidation applies a de facto control test (“Financial Statement Regulations,” art. 8, para. 3 and para. 4). Companies to which the equity method that is a partial consolidation is applicable are referred to as affiliate companies (Financial Statement Regulations, art. 8, para. 5 and para. 6).

Share buyback report was introduced with the liberalization in 2001 of the regulations on acquiring treasury shares (FIEA, art. 24-6). In addition the 2005 amendments to the SEL imposed a requirement on the parent company, etc. of a listed company, etc. to submit a status report of parent company, etc. (FIEA, art. 24-7, para. 1), and permitted a foreign company that is subject to obligation to file an annual securities report to a similar type of report in English language (foreign company report) and supplemental documentation (FIEA, art. 24, para. 8).
Disclosure System in the Primary Market

(1) Significance of Public Offerings and Secondary Distributions

(i) Public Offering of Securities

A “public offering of securities” here means those solicitations for applications to acquire newly issued securities (including those solicitations that are similar to this as prescribed by Cabinet Office Ordinance (acts similar to solicitations for acquisition)) that in connection with Paragraph 1 Securities (securities and rights to be indicated on securities or specified electronically recorded monetary claims) are (i) made to a large number (50 or more; qualified institutional investors shall be excluded from this calculation) of persons (FIEA, art. 2, para. 3, item 1; provided, however, solicitations made only to professional investors are excluded), and (ii) fall under none of the following: (a) a solicitation made only to qualified institutional investors and for which the securities are not likely to be transferred from the acquirer to any person other than a qualified institutional investor (i.e., a QII private placement); (b) solicitation made only to professional investors and for which the solicitation for acquisition (excluding cases where the counterparty is a national government, the Bank of Japan or qualified institutional investors) is consigned to a financial instruments business operator or conducted by the financial instruments business operator, etc. for itself, and the securities are not likely to be transferred from the acquirer to any person other than a professional investor or a non-resident (i.e., a private placement to professional investors); or if a solicitation is made to a small number of general investors, and the securities are not likely to be transferred to a large number of persons (i.e., a small number private placement) (FIEA, art. 2, para. 3, item 2).

With respect to the deemed securities set forth in each item of the FIEA, Article 2, Paragraph 2 (hereinafter referred to as “Paragraph 2 Securities”) a public offering of securities means that a considerable number of persons (500 or more; FIEAEO, art. 1-7-2) will own the securities in connection with the offering (FIEA, art. 2, para. 3, item 3). In principle, the disclosure regulations in connection with Paragraph 2 Securities are applied only to interests in investment-type collective investment schemes which invest in securities as their main business (FIEA, art. 3, item 3).

(ii) Private Placement of “Securities That Have Low Market Liquidity”

The information disclosure system does not apply to interests in enterprise-type collective investment schemes, which are considered to be securities that are excluded from application, as securities that have low market liquidity (FIEA, art. 3, item 3). The filing of a registration statement is not required in either the case of a QII private placement as well as a small number private placement, as long as they are private placements.

Nevertheless, this does not necessarily mean that no explanation is required. As the providing of information and an explanation is required even in the case of securities that have low market liquidity (FIEA, art. 37-3). In the case of small number private placements, a registration is unnecessary because an explanation can easily be provided to investors.
Moreover, even if the other party is a professional there may be cases in which an explanation must be given concerning all of the product characteristics, etc. in the case of, *inter alia*, a new product.

(iii) Secondary Distribution of Securities

A major revision of “secondary distributions of securities” was carried out pursuant to the 2009 amendments.

Formerly, a secondary distribution of securities was defined as being an offer to sell or a solicitation for offers to purchase securities that have already been issued that is made “under uniform conditions” to “large number of persons” (prescribed as at least fifty people (FIEAEO, art. 1-8)) as the other party, and a secondary distribution of securities could not be carried out unless the issuer of the relevant securities submitted a securities registration statement to the Prime Minister.

However, it was commented that in the actual practice of securities transactions, the condition that a secondary distribution be “under uniform conditions” was exerting a harmful influence. In other words, it was pointed out that pursuant to the interpretation that it is possible to avoid mandatory disclosure if it does not meet the formalistic condition that it be “uniform,” it is possible to get around the mandatory disclosure requirement by slightly changing the sales price for every forty-nine solicited persons. On the other hand, in a case such as where a securities company once settles foreign securities for its own account and then later sells them to investors, it can be viewed as simply having carried out the brokering of the securities. However, if in form the investors who are the other parties are large number (fifty or more) of persons, this activity would fall under a secondary distribution of securities and it is possible that mandatory disclosure, which properly speaking should not be necessary, would be required. It is believed that a lack of functioning of the formalistic requirement for “uniform conditions” is the cause of these problems.

Accordingly, for disclosure regulations related to “secondary distributions of securities,” instead of making a decision based on the formalistic standard of “uniform conditions,” it was decided to revise the definition for “secondary distribution of securities” so that it is in line with reality by requiring mandatory disclosure in what are in economic reality primary-type sales solicitations (circumstances that call for issuance disclosure in order to correct a gap in information between the seller side and investors concerning information and the like concerning the solicited securities or the issuing body, such as where a large amount of securities are disposed of all at once and sales pressure may occur), and by not requiring mandatory disclosure in the case of secondary-type sales solicitations (sales soliciting that can be considered to conform in actual practice to brokering between the secondary market and customers in connection with securities that already are in circulation in the market and for which information concerning those securities and the issuing body is widely available).

Specifically, it was revised as follows.

First, in the definition of secondary distribution of securities, “uniform conditions,” which is one of the conditions for whether or not a sales solicitation for Paragraph 1
Securities constitutes a secondary distribution, has been deleted (FIEA, art. 2, para. 4, item 1). Attendant upon this, in order to decide whether or not the other condition that is “large number of persons” applies, a new provision was established to the effect that it is decided by totaling the number of solicited parties of the solicitation of sale, etc. conducted within a fixed period of time (FIEA, art. 2, para. 4, item 2 (c)).

Second, even if it is a solicitation for already issued securities, those for which it is appropriate to apply disclosure regulations as a public offering of securities instead of as a secondary distribution of securities (acts similar to solicitations for acquisition) are included in public offerings of securities (FIEA, art. 2, para. 3, main paragraph, and para. 4, main paragraph).

Third, the scope of exemption from disclosure was newly established and expanded. Mandatory disclosure is excused in the following three cases.

The first case is a solicitation or transaction that does not fall under a “secondary distribution of securities,” and that includes (i) a solicitation for an application for an offer to sell securities, etc. that does not fall under a “solicitation of sale, etc.” (the provision of information on such securities given as a notice under Article 67-19 of the FIEA and other provision of information to be performed as statutory obligations concerning such securities are prescribed), as well as (ii) a securities transaction that does not fall under “secondary distributions of securities” (financial instruments exchange market transactions, transactions in OTC securities market, and the like are prescribed) (FIEA, art. 2, para. 4, main paragraph; FIEAEO, art. 1-7-3; Definition Ordinance, art. 13-2).

The second case is a solicitation, etc. that falls under a “secondary distribution of securities,” but exempted form mandatory disclosure. Secondary distributions of foreign securities that meet certain conditions (foreign securities distribution (FIEA, art. 27-32-2)) (FIEA, art. 4, para. 1, item 4) fall under this case. In this case, the financial instruments business operator, etc. that conducts the foreign securities distribution which is exempted from mandatory disclosure is required to provide or publish “foreign securities information” as a simplified provision of information. However, the obligation to provide or to publish foreign security information is excused for foreign government bonds that meet certain conditions (FIEA, art. 27-32-2).

The third case is a solicitation, etc. that falls under a “private secondary distribution,” and it provides for (i) “qualified institutional investor private secondary distributions” (where the offering is made only to qualified institutional investors, and where, as prescribed by Cabinet Order, it is not likely that the relevant securities will be transferred from the acquirer to persons other than qualified institutional investors), (ii) “professional investor private secondary distributions” (where the offering is made only to professional investors, and in which if the counterparty to the relevant offer to sale is a person other than the Government of Japan, the Bank of Japan or a qualified institutional investor, then the financial instruments business operator, etc. carries out the relevant offer to sale pursuant to a entrustment by the customer, or for itself, and where, as prescribed by Cabinet Order, it is not likely that the relevant securities will be transferred from the acquirer to persons other than professional investors)
investors), and (iii) “small number secondary distribution” (cases other than (i) and (ii) above, where it is not likely that the relevant securities will be owned by a large number of persons as prescribed by Cabinet Order) (FIEA, art. 2, para. 4, item 2).

For Paragraph 2 Securities, this means a case in which the securities related to the secondary distribution will be owned by considerable number of people (five hundred or more people; FIEAEO, art. 1-8-5) (FIEA, art. 2, para. 4, item 3). The treatment of Paragraph 2 Securities as being exempted securities other than the securities of a collective investment scheme that mainly invests in securities is the same as for a public offering (FIEA, art. 3, item 3).

Under the FIEA, the traditional treatment is to regulate public offering and secondary distribution together from the perspective of protecting investors, but it is possible to understand a secondary distribution as being a phenomenon of dispersing a “clump” of previously issued securities, which would be the opposite of a tender offer, which would be an agglomeration of dispersed securities. Accordingly, a secondary distribution differs from the traditional theoretical significance of the concept of a public offering in which new markets are formed or a market is expanded by adding new securities.

(iv) Reorganization

The FIEA has stipulated that cases of issuing securities as a result of a corporate reorganization shall be covered under the disclosure regulations, and has enacted new procedures in connection with reorganizations that issue securities (acts in connection with a merger, company split, share exchange or other company reorganization) (FIEA, art. 2-2, para. 1), referring to these as “procedures relating to securities issuance for reorganization” (FIEA, art. 2-2, para. 2). Cases in which a large number of persons are the owners of shares of a reorganized company, such as a company absorbed in an absorption-type merger, or a wholly owned subsidiary company in a share exchange (“shareholders, etc. of the reorganized company”) will be included in being covered under a “public offering of securities,” in the form of “specified procedures relating to securities issuance for reorganization” (FIEA, art. 4, para. 1).

In addition, in the same manner as the above, previously issued securities will be covered under a “secondary distribution of securities,” in the form of “procedures relating to securities delivery for reorganization” or “specified procedures relating to securities delivery for reorganization.”

In either event, if information disclosure has not been carried out for a reorganized company, the offering disclosure regulations will apply, enabling investors to make appropriate investment decisions (a registration statement will not be required if disclosure has been carried out—FIEA, art. 4, para. 1, item 2).

(v) Stock Options

A registration statement is not required if the counterparty to a public offering or secondary distribution acquires or is easily able to acquire information concerning the relevant securities (FIEA, art. 4, para. 1, item 1). This covers cases of providing stock options to officers such as directors or employees (FIEAEO, art. 2-12; Corporate Matters...
Disclosure Ordinance, art. 2, para. 1 and para. 2).

(vi) Secondary Offering in the Event That Disclosure Has Been Made

Since a secondary distribution of securities, described above, involves the partitioning of securities that have already been issued, a company that files annual securities reports is not subject to the secondary distribution regulations per se (registration statement unnecessary; FIEA, art. 4, para. 1, item 3). Upon the actual solicitation, however, a prospectus must be delivered (FIEA, art. 13, para. 1). Note that it is still clear here that the absence of a registration does not necessarily mean that no disclosure is required.

(vii) Qualified Institutional Investors and Professional Investors

Qualified institutional investors include, inter alia, financial institutions such as financial instruments business operators, etc., and various funds and corporations and individuals that have filed a notification as holding investment securities balance of JPY1 billion or more (Definition Ordinance, art. 10, para. 1). However, although private placements are excluded from the registration and disclosure requirements for public offering and secondary distributions, since they are subject to business regulations and restrictions against unfair trading, there are instances in which non-disclosure towards qualified institutional investors may be illegal. Especially in the case of a QII private placement, which stands opposed to the concept of a public offering on the stock market, it is necessary to take special caution when selling structured products, for which a secondary market is not established, to persons who may lack a sophisticated knowledge of such products.

Meanwhile, professional investors refer to qualified institutional investors, national government, the Bank of Japan, investors protection funds, etc., specified purpose companies, listed companies, stock companies with a capital amount of JPY500 million or more, financial instruments business operators, persons that have filed a notification of specially permitted services for qualified institutional investors, foreign corporations and persons who became professional investors from general investors through certain procedures (FIEA, art. 2, para. 31; Definition Ordinance, art. 23; FIEA, art. 34-3 and 34-4).

For private placement to professional investors, information necessary for trading on the so-called professional market is to be provided or disclosed (FIEA, art. 27-31), however, it could be possible that business restrictions and unfair trading restrictions be applicable similarly.

Upon conducting a solicitation only for qualified institutional investors, etc., or solicitation for small number of investors, etc., or to transfer securities related thereto, the transferor must notify the counterparty that no registration statement has been filed with respect to the securities and that transfer of the securities is restricted and the contents thereof (FIEA, art. 23-13, para. 1 and para. 4), and similar notification has become required upon exclusive offer to acquire targeting professional investors, etc., and exclusive offer to sell, etc. to professional investors, as well (id., para. 3).

Similarly, a qualified institutional investor or a professional investor that has obtained securities in a private placement must file a registration statement with the Prime Minister if the qualified institutional investor or the professional investor intends to make an offer to sell
or solicitation of offer to buy these securities to persons other than qualified institutional investors or professional investors, respectively (“general solicitation for securities acquired by a qualified institutional investor” or “general solicitation for securities acquired by a professional investor, etc.”) (FIEA, art. 4, para. 2 and para. 3).

(2) Registration Statement upon Public Offering or Secondary Distribution

A public offering or secondary distribution of securities cannot be made unless the issuer files a registration statement concerning the public offering or secondary distribution with the Prime Minister (FIEA, art. 4).

Once registered, the content of the registration becomes immediately available for public inspection (FIEA, art. 25), and soliciting of the securities for which the public offering or secondary distribution may be conducted by using the prospectus or sales materials for securities in soliciting. The registration statement must be in effect, however, before the recipient is actually allowed to acquire the securities or the sale is made (FIEA, art. 15, para. 1).

Once the Prime Minister accepts the registration filed by the issuing company, the registration generally becomes effective after 15 days elapsed since the date of acceptance (FIEA, art. 8). During this time, the Prime Minister examines the information disclosure; however, this examination is in no way a guarantee of the quality of the securities (FIEA, art. 23).

The deadline for filing a registration statement for a rights offering or an offering giving preference to existing shareholders is 25 days prior to the date of the allotment (FIEA, art. 4, para. 4). In other cases, there are no specific restrictions on timing, but since acquisitions or sales cannot take place until registration becomes effective, the procedures generally require at least 16 days before the date applications will start to be accepted.

Even in cases that are not classified as public offering/secondary distributions for which registration statement are required, a written notice should be submitted to the Prime Minister if the relevant public offering/secondary distribution falls within the category of specified public offering, etc. (securities notice; FIEA, art. 4, para. 6).

The following cases require the submission of a securities notice:

(i) A secondary distribution of securities in cases where disclosure has been made (FIEA, art. 4, para. 1, item 3) and the total secondary offering price is JPY100 million or more;

(ii) A public offering or secondary distribution where the total issue price or the secondary distribution price is less than JPY100 million but more than JPY10 million, provided that there exceptions in which this does not apply (FIEA, art. 4, para. 1, item 5); and

(iii) Those general solicitations for securities acquired by qualified institutional investors and general solicitations for securities acquired by professional investors, etc. that do not constitute a secondary distribution of securities, and for which disclosure has not been made in connection with the said securities.
(3) Securities Registration Statement

The securities registration statement must be filed with the Prime Minister in order to register a public offering or secondary distribution of securities (FIEA, art. 5). The content and form of the securities registration statement is prescribed in the Corporate Matters Disclosure Ordinance. By way of example, a domestic company will use Form 2 (Corporate Matters Disclosure Ordinance, art. 8, para. 1).

The content of the securities registration statement that must be filed consists of information concerning the public offering or secondary distribution (securities information) and information concerning the issuer (company information; with respect to “specified securities,” information concerning the fund or the securitized assets or related parties). The securities information is a description of the outline of the public offering or secondary distribution and is always required (even for private placements, in some cases, such information must be stated on an extraordinary report), but company information is not required to be disclosed upon each issue if sufficient information disclosure has been made in the secondary market, and may be entrusted to the continuous disclosure of securities reports, etc. Accordingly, if certain conditions (filing of securities reports and past records of trading volume, etc.) are met, for the company information in the securities registration, it shall be sufficient to state that the most recent securities report, etc. “shall be referred to” (FIEA, art. 5, para. 4), so disclosure of only the offering information is required.

A company to which this disclosure system is applied is a company eligible for incorporation by reference, which is an extremely important concept as the concept of a company that can rely on the secondary market functions (companies to which the shelf registration system described in (5) below applies are also companies eligible for incorporation by reference).

For the company information stated on the securities registration statement and the annual securities report, the consolidated information is considered to be of paramount importance, and the individual company information is considered to have secondary importance. The concept of a company subject to consolidation, in other words, what constitutes a parent company or subsidiary company, is based on a substantial approach (control approach).

For small amount public offerings, etc. where the total amount of offering or distribution price is less than JPY500 million, a simplified disclosure is allowed (FIEA, art. 5, para. 2).

The amendments in 2011 expanded the scope of disclosure documents that may be filed in the English language. A foreign company which is required to file a securities registration statement may, instead of filing a securities registration statement, file (i) a document stating in the Japanese language the matters concerning the public offering or secondary distribution and (ii) documents which are prepared in the English language and which are similar to a securities registration statement, etc. disclosed in a foreign country (collectively referred to as “foreign company statements”; FIEA, art. 5, para. 8), if this would not impede the public interest or investor protection (FIEA, art. 5, para. 6; Corporate Matters Disclosure Ordinance, art. 9-6). In such case, the foreign company shall attach, to these documents, Japanese translations of the summaries of the matters necessary and appropriate for the public interest or investor protection among the matters stated in those English documents (FIEA, art. 5, para. 7; Corporate Matters Disclosure Ordinance, art. 9-6).
Disclosure Ordinance, art. 9-7, para. 2 through para. 4).

Furthermore, as a result of the amendments in 2013, if a public offering or secondary distribution of the specified securities has already been conducted continuously for a certain period with regard to specified securities such as investment trust beneficiary certificates, it is not necessary to submit a securities registration statement but it is sufficient to submit a simplified document containing subscription requirements, etc. instead (FIEA, art. 5, para. 10 through para. 12).

(4) Prospectus

The prospectus is a document that states an explanation of the business of the issuer of the securities and other relevant matters at the time of a public offering or secondary distribution of securities, or a general solicitation involving securities acquired by a qualified institutional investor or a general solicitation involving securities acquired by a professional investor, etc. It must be delivered directly to the counterparty or must be delivered at the request of the counterparty (FIEA, art. 2, para. 10).

When the issuer, secondary offeror, underwriter, financial instruments business operator, etc., or financial instruments intermediary service provider will by means of a public offering or secondary distribution cause the acquisition of or sell securities for which a registration statement is required or that have already been disclosed, it must in principle deliver the prospectus to the investor in advance of, or simultaneously (FIEA, art. 15, para. 2, main text, referred to as Delivery Prospectus). No prospectus with false statements or which undermines statement of matters to be stated may be used (FIEA, art. 13, para. 4).

However, delivery of the prospectus is unnecessary in cases (i) where the acquisition or sale is with respect to a qualified institutional investor, or (ii) if the securities are to be acquired by or sold to a person who already owns securities of the same issue as the securities in question, or if a person who lives with the said prospective acquirer or purchaser has already received the prospectus, or is expected to receive the prospectus without fail, and the prospective acquirer or purchaser consents to the waiving of delivery of the prospectus (FIEA, art. 15, para. 2, proviso).

Although the information stated in the prospectus should be what is stated in the securities registration statement as well as other special notes, under the amendments in 2004, it was decided that it would not be appropriate to demand the same level of detailed information in connection with securities regarding investment trusts or investment corporations, for which the disclosure of investment performance is principle, as would be required for shares of stock. The law as amended states that the matters to be stated in a prospectus may be divided into three parts consisting of (i) matters that have an extremely material effect on the investment decisions of investors, and (ii) matters that have a material effect on the investment decisions of investors (FIEA, art. 13, para. 2).

In view of this, for certain securities as prescribed by Cabinet Order (securities regarding investment trusts or investment corporations), it is adequate to provide a delivery prospectus containing matters described in (i) above, and, with respect to the matters described in (ii) above, it is sufficient to promptly deliver a prospectus upon request by an investor (FIEA, art. 15, para. 3;
referred to as “Delivery of Prospectus Upon Request”).

If materials other than the prospectus are to be used such as written documents, diagrams and graphics, voice recordings, etc. (including information that is displayed by means of electronic data), making any false or erroneous in such information is prohibited (FIEA, art. 13, para. 5).

Furthermore, pursuant to the 2009 amendment, the matters to be stated in a delivery prospectus for investment trust beneficiary certificates have been limited to investment information extremely significant for investment decisions and the matters to be stated have been considerably simplified as well as new provisions regarding the form of a delivery prospectus for investment trust beneficiary certificates have been established (Ordinance on Disclosure of Specified Securities, form 25; form 25-2).

Furthermore, pursuant to the 2009 amendment, if a secondary distribution of securities with respect to which disclosure has already been made is to be carried out by a person other than the issuer, a person related to the issuer, or the underwriter, delivery of the prospectus is excused (FIEA, art. 13, para. 1, second sentence; Corporate Matters Disclosure Ordinance, art. 11-4).

Since the issuer, persons related to the issuer, and the underwriter hold undisclosed information concerning the issuer or are in a position in which it is easy to obtain such information, in light of the issue of symmetry of information, they continue to be required to deliver a prospectus.

The amendments in 2011 introduced a flexible method for delivering a prospectus upon making a rights offering. In cases where the share options to be allotted by a rights offering are listed or are scheduled to be listed on a financial instruments exchange, and the fact that a securities registration statement, etc. concerning the share options have been filed is made public in a daily newspaper without delay after the filing, delivery of a prospectus is not required (FIEA, art. 13, para. 1, proviso, art. 15, para. 2, item 3; Corporate Matters Disclosure Ordinance, art. 11-5).

Along with the expansion of the scope of disclosure documents that may be filed in the English language under the amendments in 2011, a foreign company that is required to file a securities registration statement, etc. is now allowed to disclose a prospectus in the English language if it files foreign company statements and supplementary documents (FIEA, art. 13, para. 2).

(5) Shelf Registration System

An issuer that expects to conduct a public offering or secondary distribution one or more times, and which is a company eligible for incorporation by reference, will not be required to file a registration statement at the time of the issue if the company registers a shelf registration statement stating matters such as the amount of the securities that it expects to issue during the anticipated issue period (one or two years; Corporate Matters Disclosure Ordinance, art. 14-6). This is referred to as the shelf registration system (FIEA, art. 23-3). Pursuant to the 2009 amendments, it has become possible to use the program amount method (method whereby a “maximum issue balance” is stated in the self-registration statement, and if the issue balance decreases due to redemptions and the like, the amount that may be issued increases only by that
redemption amount).

A shelf registration becomes effective on the fifteenth day after the date the shelf registration is filed (FIEA, art. 23-5 and art. 8). Persons conducting a public offering or secondary distribution under a shelf registration statement shall not begin actual sales unless the shelf registration is effective and the shelf registration supplements have been submitted to the Prime Minister for the public offering or secondary distribution (FIEA, art. 23-8).

The shelf registration supplements contain almost the same securities information as the securities registration statement and must be accompanied by a statement that the most recent reference documents should be referenced, the minutes of the board of directors resolution, etc., a document stating any material facts that occurred after the date of the most recent securities report was filed, an overview of the business, and a document providing a precise and simple explanation of developments in the management indicators (the so-called highlights) (Corporate Matters Disclosure Ordinance, art. 14-12).

Under the shelf registration system, no registration statement is required for a public offering or secondary distribution made during the anticipated issue period; however, a shelf registration prospectus must be prepared and delivered for the purpose of solicitations (FIEA, art. 23-12, para. 2 and para. 3, art. 13, para. 1 and art. 15, para. 2).

However, under the amendments in 2011, where the issuer of securities has delivered, in advance, a document stating the matters that should be stated in a shelf registration statement and shelf registration supplements thereof (excluding the issue price) as well as stating to the effect that the issue price, etc. will be announced separately and specifying the method of announcement, and the issue price, etc. are announced by such specified method, the said document shall be deemed to be a prospectus, and the announcement of the issue price, etc. shall be deemed to be the delivery of a prospectus (FIEA, art. 23-12, para. 7). Therefore, in such case, the issuer shall be released from the obligation to deliver a shelf registration supplementary prospectus.

(6) Provision or Disclosure of Specified Securities Information, Etc.

With respect to the issuance and distribution of securities that may be traded on the so-called professional market introduced with the 2008 amendments, a special system for provision and disclosure of information was established.

Namely, as a system equivalent to offering disclosure, for the specified solicitation for acquisition such as the so-called private placement for professional investors and the specified offer to sale, etc. such as private secondary distribution for professional investors, etc. (collectively referred to as “specified solicitation, etc.”), the issuer of the securities concerning the specified solicitation, etc. must provide to the counterparty of or disclose “specified securities information,” the basic information to be clarified to the investor with respect to the said securities and the said issuer by the time of conducting such specified solicitation, etc. (FIEA, art. 27-31, para. 1; Securities Information Ordinance, art. 2).

As the manner of provision or disclosure of specified securities information, the issuer of the said securities must provide the securities information by itself or upon entrustment to others, or
disclose the same by using the Internet or by other methods (FIEA, art. 27-31, para. 2; Securities Information Ordinance, art. 3). Furthermore, as a system equivalent to continued disclosure, an issuer of securities for professional investors and an issuer that has provided or disclosed specified securities information must provide or disclose the issuer information to the holder of the said securities at least once every business year (FIEA, art. 27-32, para. 1; Securities Information Ordinance, art. 7).

The so-called professional market is premised on the participation of professional investors with information collection and analysis ability and risk management ability, and from the judgment that whether or not to make an investment shall be left to the self-responsibility of professional investors, no uniform regulations have been established. However, even such professional investors may not be in a position to request provision of information to the issuer or directly collect information, a minimum scheme for provision and disclosure of information concerning the issuer has been established (provision and disclosure of specified securities information and issuer information).

The content of information to be provided or disclosed and the manner and timing of provision/disclosure is to be provided for in the business regulations of financial instruments exchanges (FIEA, art.117-2), but the concrete contents thereof (form, language, accounting standards, etc.) are to be set flexibly by the rules of the exchange in accordance with the needs of corporations and investors.

As mentioned above, the so-called professional market has been granted such flexible system designs, but this should not result in the provision/disclosure of untrue information.

From this standpoint, compensation liability, administrative monetary penalty and criminal penalty apply to the provision/disclosure of untrue information (FIEA, art. 27-33, art. 27-34, art. 172-9, art. 172-10, art. 172-11, art. 197, para. 1, item 4-2, art. 197-2, item 10-2 and item 10-3, etc.).

13 Disclosure System in the Secondary Market

(1) Companies Subject to Secondary Market Disclosure

For financial products whose value changes daily, like share certificates, continuous information disclosure is an absolute necessity in allowing investors to form an investment decision.

To this end, the continuing information disclosure system under the FIEA, which is designed mainly for share certificates, provides for annual securities reports, which are disclosure documents filed once per year (annual reports), quarterly reports (or semiannual reports), and extraordinary reports which must be filed immediately upon the occurrence of certain prescribed matters. In addition to these reports, the financial instruments exchanges set forth rules for timely disclosure.

A securities report is an annual or almanac document which once a year compiles and...
preserves the timely disclosure that are made on a daily basis. The FIEA prescribes an information disclosure system for secondary markets which focuses on companies that are filers of detailed annual securities reports.

Under the FIEA, the following four types of companies are obligated to disclose information in the secondary market (FIEA, art. 24, para. 1, item 1 through item 4):

(i) Issuers of listed securities (listed companies) ..... Issuers of securities that are listed on a financial instruments exchange; provided, however, specified listed securities listed on the so-called professional market are excluded;

(ii) Companies issuing over-the-counter trading securities ..... The text of the FIEA states that these are issuers of securities that are prescribed by Cabinet Order (FIEAEO, art. 3) as those whose status of distribution is similar to securities listed on a financial instruments exchange; provided, however, specified over-the-counter traded securities which are over-the-counter traded securities for professionals are excluded;

(iii) Persons other than those described in (i) and (ii) above that issued securities (limited to share certificates and preferred equity investment certificates; FIEAEO, art. 3-5, para, 1) that require the filing of a registration statement with the Prime Minister in a public offering/secondary distribution ..... In cases where the number of holders as of the last day of all of the preceding five business years is less than 300 (FIEAEO, art. 3-5, para. 2), or the issuer is in liquidation or has ceased its business for a substantial period of time, or the number of persons owning such securities is less than 25 persons, such issuers may apply for an exemption from the requirement to file securities reports with the Prime Minister (FIEA, art. 24, para. 1, proviso; FIEAEO, art. 4, para. 2; Corporate Matters Disclosure Ordinance, art. 16, para. 2); and

(iv) Persons other than those described in (i) through (iii) above with capital of at least JPY500 million and with at least 1,000 shareholders listed on their shareholders register as of the last day of any of the most recent five business years (if the relevant securities are those directed towards professional investors, the number that is the number of professional investors calculated as prescribed by Cabinet Office Ordinance added to 1,000) (FIEAEO, art. 3-6, para. 4; this rule does not apply if the number of shareholders falls below 300; FIEAEO, art. 3-6, para. 1).

If a company meets the capital amount and number of shareholder tests stated in (iv) above, it will become subject to the FIEA; therefore, these two tests are called external criteria.

An optional method in the form of a “report substitute document” has been introduced under the FIEA with respect to specified securities, in order to create a means for providing information that will be easy for investors to understand, and to reduce the burden on issuers. Under this vehicle, with respect to annual securities reports, semiannual reports, quarterly reports and extraordinary reports, combined filing of the statements of a portion of the matters that are to be stated in these reports (the report substitute documents) and the matters that have not been stated in the report substitute documents (FIEA, art. 24, para. 14, art. 24-4-7, para. 12 and para. 13, and art. 24-5, para. 13 through para. 16).
(2) **Annual Securities Reports**

Securities reports must be filed to the Prime Minister within 3 months after the close of each business year (FIEA, art. 24; the approval of the authorities is required to extend the filing deadline due to unavoidable reasons). As stated above, since a “company” issuing securities is the person obligated to file the annual securities reports, business year in this case means each company’s fiscal year (however, the information disclosure provisions are also applied *mutatis mutandis* to cases where issuer is a person other than a company; FIEA, art. 27).

The unit of calculation for the financial instruments known as share certificates is one year. On the other hand, the securities which are financial instruments generated from a so-called collective investment scheme such as an asset securitization or investment trust (hereinafter referred to as “specified securities”) will sometimes adopt a trust structure, and in this case the unit of calculation is the unit of calculation for the trust (hereinafter referred to as the “specified period”; FIEA, art. 24, para. 5; Ordinance on Disclosure of Specified Securities, art. 23, item 2).

The annual securities report must contain the company’s trade name, the corporate group to which the company belongs, material matters concerning the status of the company’s accounting and a description of its business, and the other matters prescribed by Cabinet Office Ordinance as those necessary and proper for the public interest or to protect investors (FIEA, art. 24, para. 1, main clause—corresponds to the company information under the FIEA, art. 5, para. 1, item 2). The matters to be stated on the securities report and the method of statement are prescribed in detail in the Corporate Matters Disclosure Ordinance; domestic companies usually use Form Number 3 (Corporate Matters Disclosure Ordinance, art. 15, item 1 (a)).

The following company information must be stated in the securities report:

(i) **Company overview** (developments in major management indicators, history, description of the business, status of affiliated companies, status of employees);

(ii) **Overview of the business** (management policy, management environment, issues to be dealt with, business risks, analysis by the management of financial standing, operating results, and status of cash flow, significant management contracts, etc., and research and development activities);

(iii) **Status of capital expenditures** (overview of capital expenditures, etc., status of major expenditures, plans for new/removal of capital expenditures);

(iv) **Status of the filing company** (status of shares, etc. [total number of shares, status of share options, etc., status of exercise of share options regarding corporate bonds with moving strike options, total number of issued and outstanding shares, developments in capital formation, status by shareholder classification, status of major shareholders, status of voting rights, details of officer and employee share ownership plans, etc.], status of the acquisition of treasury stock, dividend policies, movements in share price, status of directors, status of corporate governance, etc.);

(v) **Status of accounting** (consolidated financial statements, etc., financial
In order to accommodate the globalization of the securities markets, and to reduce the cost of foreign companies, etc. in participating in the Japanese securities markets, the 2005 amendments allow these companies to provide disclosure in the English language.

If certain requirements are satisfied, a foreign company, etc. that must file an annual securities report may, in lieu of filing the annual securities report or quarterly reports (or semiannual reports), file a foreign company report or a foreign company quarterly report (or a semiannual report) that is stated in English, which is disclosed in the country of origin of the said foreign company, etc., and which is similar to an annual securities report or quarterly report (or a semiannual report) (FIEA, art. 24, para. 8, art. 24-4-7, para. 6, and art. 24-5, para. 7; Corporate Matters Disclosure Ordinance, art. 17-2, art. 17-16, and art. 18-2). A supplemental document stating a summary, etc. in the Japanese language must be attached to the same.

For confirmation letters, internal control reports and parent company, etc. status reports, documents stating the matters to be stated in such reports may be submitted (FIEA, art. 24-4-2, para. 6, art. 24-4-4, para. 6, art. 24-7, para. 5; FIEAO, art. 4-2-7, para. 3; Corporate Matters Disclosure Ordinance, art. 17-11 and 19-7). These are referred to as “foreign company reports,” etc. Initially this was applicable to foreign ETFs (tracking exchange traded investment trusts) and was expanded to securities issued by foreign companies, foreign governments and foreign funds, etc.

(3) Semiannual Reports, Quarterly Reports

If a listed company, etc. that is required to file an annual securities report has a business year in excess of three months, the company is required to submit to the Prime Minister a quarterly report for each three month period of the said business year, within 45 days from the end of each such period, stating the state of accounts of the corporate group containing the company and other material matters (FIEA, art. 24-4-7; the approval of the authorities is required to extend the filing deadline due to unavoidable reasons).

This system has been applied to business years from April 1, 2008. The Accounting Standards Board of Japan has enacted quarterly accounting standards in connection with consolidated quarterly financial statements and segregated quarterly financial statements in order to clarify the entries to be made in quarterly reports, and the Business Accounting Council has created standards for quarterly reviews as a guaranteeing procedure for quarterly financial statements. In addition to this financial information, it is planned that an analysis of fiscal situation and management results, the condition of the company and business, etc., and the condition of shares of stock, etc. shall in principle be disclosed on a consolidated basis.

If a company other than a company that is required to file a quarterly report has a business
year in excess of six months, then in accordance with the Cabinet Office Ordinance (Corporate Matters Disclosure Ordinance, art. 18—domestic companies use Form No. 5), it must file with the Prime Minister a semiannual report for each business year, stating the material matters in connection with the six month period from the date on which the said business year commences. This semiannual report must be submitted within three months after the expiration of this six month period (FIEA, art. 24-5, para. 1; the approval of the authorities is required to extend the filing deadline due to unavoidable reasons). The matters to be stated in the semiannual reports are slightly more simplified than those in the annual securities report.

(4) Letter of Confirmation

Given cases of false disclosure such as window dressing that have occurred, the FIEA has introduced a system of internal control reporting. On the assumption that a company has an effective system of internal control, a letter of confirmation system has been introduced under which the management will confirm that the content of the statements made in the annual securities reports, semiannual reports and quarterly reports are accurate in accordance with the FIEA, thereby improving the reliability of the system of information disclosure (FIEA, art. 24-4-2, art. 24-4-8, and art. 24-5-2). This system has been applied to fiscal years on and after April 1, 2008.

The entities that will be required to file a letter of confirmation shall be listed companies, etc. for which a distribution market with high market liquidity exists, in which broad strata of investors can be expected to participate. This requirement is also imposed on foreign companies. Penalties apply to, *inter alia*, failing to file a letter of confirmation (FIEA, art. 208, item 2 and art. 209, item 3 and item 4).

(5) Extraordinary Reports

When a company that is obligated to file annual securities reports falls within certain cases prescribed by the Cabinet Office Ordinance, it must without delay file an extraordinary report with the Prime Minister stating the contents thereof (FIEA, art. 24-5, para. 4; Corporate Matters Disclosure Ordinance, art. 19). In addition, a copy of the extraordinary report filed with the Prime Minister must without delay be submitted to the financial instruments exchange or the financial instruments firms association (FIEA, art. 24-5, para. 6 and art. 6).

If facts occur that require the filing of an extraordinary report, those facts automatically constitute matters subject to disclosure under the timely disclosure rules of the financial instruments exchange. In such cases, it is necessary to notify the financial instruments exchange of those facts as soon as possible, and to file an extraordinary report with the Prime Minister without delay.

The events which trigger the submission of extraordinary report as prescribed by Corporate Matters Disclosure Ordinance are the following (the matters to be described therein vary from case to case) (Corporate Matters Disclosure Ordinance, art. 19, para. 2 and art. 19-2):

(i) **Public offering/secondary distribution in a foreign country;**
(ii) Private placement, etc.;
(iii) Solicitations of share options certificates that do not fall within the definition of a primary offering;
(iv) Changes in parent/specified subsidiary companies;
(v) Change in major shareholders;
(vi) Demand for sale of shares, etc. by special controlling shareholders;
(vii) Calling of a shareholders meeting intended for the acquisition of all of the class shares subject to class-wide call;
(viii) Calling of a shareholders meeting intended for the consolidation of shares;
(ix) Occurrence of major disasters;
(x) Litigation;
(xi) Share exchange;
(xii) Share transfers;
(xiii) Company split;
(xiv) Merger;
(xv) Assignment/assumption of business;
(xvi) Decision of an organ which is responsible for making decisions to acquire a subsidiary for a consideration for more than a certain percentage;
(xvii) Changes in the representative director;
(xviii) Resolution on matters up for resolution at a shareholders meeting;
(xix) Amendment or disapproval of matters up for resolution at an annual shareholders meeting, as stated in an annual securities report submitted for the annual shareholders meeting;
(xx) Change of certified public accountant/accounting firm;
(xxi) Petition for commencement of bankruptcy proceedings or petition for commencement of corporate rehabilitation proceedings;
(xxii) Occurrence of a large amount of bad receivables, etc.;
(xxiii) Occurrence of matters which severely impact the financial position/management performance of the company required to file reports (material subsequent events);
(xxiv) Occurrence of a major disaster at a consolidated subsidiary company;
(xxv) Litigation against a consolidated subsidiary;
(xxvi) Conclusion by a consolidated subsidiary of a share exchange contract having an impact on the amount of consolidated asset or sales;
(xxvii) General meeting of shareholders in connection with a share transfer;
(xxviii) Company split of a consolidated subsidiary;
(xxix) Merger of a consolidated subsidiary;
(xxx) Assignment or acquisition of business on the part of a consolidated subsidiary;
( xxxi) Decision of an organ which is responsible for making decisions of a
consolidated subsidiary to acquire the subsidiary for consideration for more than a certain percentage;

(xxxii) Petition for commencement of bankruptcy proceedings with respect to a consolidated subsidiary, etc.;

(xxxiii) Occurrence of bad receivables at a consolidated subsidiary;

(xxxiv) Occurrence of an event which severely impacts the financial position/management performance of a consolidated subsidiary (material subsequent event); and

(xxxv) Occurrence or amendment of disclosure information concerning shares for a company required to file a securities registration statement.

“Specified subsidiary company” here means those subsidiary companies (i) whose sales to the filing company represent 10% or more of the total purchases of the filing company, or whose purchases represent 10% or more of the sales of the filing company; (ii) whose net assets equal 30% or more of the net assets of the filing company; and (iii) whose capitalization or amount of equity contribution equals 10% or more of the capitalization of the filing company (Corporate Matters Disclosure Ordinance, art. 19, para. 7). “Major shareholder” here means a shareholder who directly or indirectly holds 10% of the voting rights of all shareholders of the company (FIEA, art. 163, para. 1).

The amendments in 2011 expanded the scope of disclosure documents that may be filed in the English language. A foreign company that is required to file an annual securities report is now allowed to, instead of filing an extraordinary report, a document stating in the English language the matters that should be stated in an extraordinary report (hereinafter referred to as the “foreign company extraordinary report”), if this would not impede the public interest or investor protection (FIEA, art. 24-5, para. 15; Corporate Matters Disclosure Ordinance, art. 19-2-2, para. 1).


The parent company, etc. (excluding a company that files an annual securities report) of an issuer of securities (excluding specified securities) listed on a financial instruments exchange, etc. (referred to in this paragraph as a “filing subsidiary”) is required to submit a status report on parent company, etc. stating matters in connection with the person who owns shares in the parent company, etc. as well as other matters (FIEA, art. 24-7, para. 1).

Since the possibility exists that the parent company, etc. will have a material impact on the management of the filing subsidiary, it is necessary to have investors make investment decisions that take into consideration the information on the parent company, etc., and consequently, disclosure of information on the parent company, etc. is required. However, filing may be waived if approval is obtained on the grounds that no problem would be presented even if this report is not filed. This envisions a situation such as when the parent has suspended operation.

The status report of parent company, etc. must be filed with the Prime Minister, within three months from the end of the business year of the parent company, etc. A status report of parent company, etc. will be made available for public inspection (FIEA, art. 25).
The information to be stated consists of the status by owner of shares in the parent, the status of major shareholders, the status of officers and other accounting documents and the like. The specific details are prescribed by Cabinet Office Ordinance (Corporate Matters Disclosure Ordinance, art. 19-5).

Penal sanctions apply in an event such as a false statement in the status report of parent company, etc. (FIEA, art. 197-2, item 6, et al.)

(7) Share Buyback Report
When a listed company passes a resolution of the shareholders meeting or board meeting concerning the acquisition of treasury stock, it must prepare a “share buyback report” and file the same with the Prime Minister each month (FIEA, art. 24-6), as prescribed by Cabinet Office Ordinance (Corporate Matters Disclosure Ordinance, art. 19-3). With the removal of the prohibition on treasury stock (where the issuer acquires and holds its own shares) under the 2001 Amendments to the Commercial Code, the regulations governing treasury stock have been significantly strengthened.

If a listed company wishes to trade its treasury share certificates, certain preventative regulations must be complied with from the viewpoint of preventing market manipulation (FIEA, art. 162-2).

(8) Amendment of Registration Statements/Amendment Reports
If, after filing a securities registration statement or an annual securities report, etc., a change or the like has occurred in a material matter to be stated therein, the issuing company must file an amendment to registration statement or amendment report. There are instances in which the Prime Minister may order the submission of an amendment to registration statement or amendment report (FIEA, art. 7, art. 9, art. 10, art. 23-4, art. 23-9, art. 23-10, art. 24-2, art. 24-4-3, and art. 24-4-5, et al.).

(9) Timely Disclosure
In order to ensure fair price formation in the capital markets, correct information must be provided regarding the quality and price of the securities at the time of the transaction. In this sense, the financial instruments exchange rules requiring the timely disclosure of price sensitive information can truly be said to be the lifeline of the capital markets.

Once each year, the annual securities reports collect and preserve the timely disclosure made during the year as a sort of almanac or annual report, but this does not play a central role as material upon which investors base their minute-by-minute investment decisions. The argument that timely disclosure is important had been frequently made for some time, but in actual implementation, this was seen as nothing more than a rule by financial instruments exchanges in the form of self-regulatory organizations, and therefore that it was inferior to the requirements set forth in the law and regulations.

However, the financial instruments exchanges are institutions required by law in order to accomplish the legal objectives of the FIEA, and it is necessary to increase awareness by a large
measure of the importance of the financial instruments exchanges since they play a pivotal role in the markets. One way to look at enactment of the laws and regulations is that originally it became necessary to ensure the substance of rules of exchanges as the base of investors broadened.

Financial instruments exchanges must adopt market monitoring measures such as ad hoc suspensions of trading activities where the timely disclosure rules are infringed, and in this sense timely disclosure should be notified to the financial instruments exchange as quickly as possible (for details, see Chapter 5 “Articles of Incorporation and Various Regulations of the Exchanges”).

**13 5 Public Inspection**

Securities registration statements, shelf registrations, shelf registration supplements, annual securities reports, semiannual reports, quarterly reports, letters of confirmation, internal control reports, extraordinary reports, status reports of parent company, etc. and share buyback reports must be kept at specified places for public inspection for a specific period with respect to each type of document (FIEA, art. 25).

However, if the Prime Minister issues an order to file amendment to registration statements or amendment reports, etc. concerning the public documents, all or part of such documents may not be provided for public inspection (FIEA, art. 25, para. 6). In such case, the Prime Minister shall notify the said effect to the filing company, etc. or the financial instruments exchanges, etc. (FIEA, art. 25, para. 7) and persons receiving such notice is relieved from the obligation to provide such documents for public inspection (FIEA, art. 25, para. 8).

**13 6 Electronization of the Disclosure System for Corporate Matters**

In the 2000 amendments to the SEL, the legal conditions were put in place to enable submission and acceptance of annual securities reports and other disclosure documents, and the provisions of these for public inspection, as well as the online delivery of prospectuses, etc. Disclosure documents such as the annual securities reports, semiannual reports, quarterly securities report, securities registration statements, and tender offer registration statements, and report of possession of large volume, etc. have already been moved online. Online delivery of prospectuses has also become possible.

Under the FIEA, the “electronic information system for disclosure” means the electronic information system under which the computers (including input and output devices) used by the Cabinet Office and the input and output devices used by persons to complete disclosure procedures in accordance with the provisions of the FIEA as well as the input and output devices used by the financial instruments exchanges as well as the authorized financial instruments firms association as prescribed by Cabinet Order, are connected by telecommunications cables (this...
computer system is called EDINET (an abbreviation of Electronic Disclosure for Investors’ NETwork)) (FIEA, art. 27-30-2).

EDINET must be used by persons who follow electronic disclosure procedures (procedures required to file the annual securities reports, semiannual reports, quarterly securities report, extraordinary reports, securities registration statements, etc.) (FIEA, art. 27-30-3, para. 1). Persons who follow voluntary electronic disclosure procedures (procedures pertaining to the submission of the securities notice) may also use EDINET (id., para. 2). In these cases, when the disclosure information is stored in the file contained in the computer, the information is deemed to have reached the Cabinet Office (id., para. 3).

In cases where, due to a breakdown, etc. in the telecommunications cable, electronic disclosure procedures using an electronic information system for disclosure cannot be followed, and if the Prime Minister approves, the company can make disclosure through submission of a magnetic disk (FIEA, art. 27-30-4). Even if a magnetic disk is submitted, there are exceptional cases, such as if the Cabinet Office computer cannot read the information contained in the magnetic disk file, where submission in paper is permitted (FIEA, art. 27-30-5).

If the disclosure documents are submitted through EDINET, although a copy of the disclosure documents is supposed to be sent to the securities exchange or JSDA, it is deemed that notice was given to the financial instruments exchange, etc. at the time the file is recorded on EDINET, and it is presumed to have reached the appropriate addressee as of the expiration of the time normally required for output (FIEA, art. 27-30-6).

In cases where the disclosure documents are subject to public inspection, the monitor screens installed in the public inspection room at the Local Finance Bureaus, financial instruments exchanges, or the authorized financial instruments firms associations can be used (FIEA, art. 27-30-7, art. 27-30-8; Cabinet Order [FIEAEO], art. 14-12 and art. 14-13), however, the Prime Minister shall not provide all or part of the public documents (such portions referred to as specified portions) for public inspection, and if the Prime Minister has issued an order to amend with respect to the public documents, material reference information may be provided for public inspection in addition to the public documents (FIEA, art. 27-30-7, para. 2 and para. 5).

Portions excluding the specified portion shall be provided for public inspection at financial instruments exchanges, etc. as well (FIEA, art. 27-30-8).

EDINET can be accessed from the FSA website.

13 Fair Disclosure Rule

Until recently, Japan did not have rules specifying that, when issuers of securities provide securities analysts, etc. with undisclosed material information including their financial closing information, they should also provide other investors with the same information equally (“fair disclosure rules”; hereinafter referred to as the “FD rules”). In the administrative cases in which securities companies were punished for soliciting customers by providing them with insider
information of the issuers of securities, it was revealed that the issuers had provided the undisclosed information concerning their business performance only to the securities analysts of these companies. Regarding this as a problem, investors, etc. called for the introduction of FD rules in Japan as in other countries.

Under such circumstances, with the objective of ensuring fair price formation through fair and timely information disclosure, the FIEA was amended in 2017 to introduce new provisions which require that, when issuers of securities provide securities analysts, etc. with undisclosed material information including their financial closing information, they should disclose that information to the public concurrently if the provision of information is intentional, or promptly after the provision of information if it is not intentional (FIEA, art. 27-36).

(1) Person Who Has the Obligation to Disclose

The obligation to disclose is imposed on issuers of corporate bond certificates, share certificates, share option certificates, investment securities, etc. which are listed on a financial instruments exchange or which fall within the category of over-the-counter securities, and any other securities specified by Cabinet Order (FIEA, art. 27-36, para. 1; FIEAEO, art. 14-15 and art. 14-16; Material Information Ordinance, art. 2). Issuers were considered to be appropriate for assuming the obligation to disclose under the FD rules because the securities issued by them are widely traded on the market and the information concerning themselves affects the price formation of the securities.

(2) Information Provider Subject to the FD Rules

The information provider subject to the FD Rules is a listed company, etc. or an asset management company of a listed company, etc. which is an investment corporation, or an officer, agent, employee, or other worker of such company who has been assigned the duty to provide information to business associates (meaning information recipients subject to the FD Rules; discussed below) (FIEA, art. 27-36, para. 1). The scope of information providers has been limited to these parties because they have the role and responsibility in providing information in the course of conducting the business of the issuer of securities. An asset management company of a listed company, etc. which is an investment corporation, and an officer, etc. thereof, are included in this scope since information on the facts related to asset management is supposed to be acquired, held and managed by an asset management company under the ITA.

(3) Material Information

The “material information,” which means the information subject to the FD rules, is defined as “undisclosed material information about the operations, business, or assets of a listed company, etc. which has a material influence on investors’ investment decisions” (FIEA, art. 27-36, para. 1). This definition of “material information” is intended to enable the issuers to manage information appropriately in accordance with the FD rules, while also enabling the investors to judge whether the information they receive from the issuers is subject to the FD rules.
(4) Business Associate

The “business associate,” which means the information recipient subject to the FD rules, is defined as follows (FIEA, art. 27-36, item 1; Material Information Ordinance, art. 4 through art. 7):

(i) Financial instruments business operators, registered financial institutions, credit rating agencies, investment corporations, and any other persons specified by Cabinet Office Ordinance, or their officers, etc. (excluding the person specified by Cabinet Office Ordinance as a person who is not engaged in a financial instruments business in an entity that has taken the measures specified by Cabinet Office Ordinance as those necessary for appropriately managing material information); and

(ii) The persons specified by Cabinet Office Ordinance as those who receive material information concerning services pertaining to public relations aimed at investors in the listed company, etc. and who have a high probability of effecting purchase and sale, etc. of listed securities, etc. of the listed company, etc. based on investment decisions that are grounded in the material information.

The scope of information recipients subject to the FD rules has been defined as above to include those who are considered to be highly likely to be involved in the purchase and sale of securities.

(5) Cases Where Disclosure of Material Information Is Not Required

Material information provided by a listed company, etc. to a business associate is not required to be disclosed if the business associate has (i) the obligation not to provide the material information to any third party and (ii) the obligation not to engage in a purchase or sale of securities of the listed company, etc., before the disclosure of the material information (FIEA, the proviso to art. 27-36, para. 1). If the information recipient assumes these obligations against the issuer, the fair price formation on the market would not be disturbed even if such information is not disclosed.

(6) Obligation of a Listed Company, Etc. to Disclose Material Information Upon Learning a Business Associate’s Breach of Duty of Confidentiality, Etc.

If a listed company, etc. learns that a business associate that has received the material information has, in violation of laws, regulations, or contract, divulged to another business associate a secret concerning the material information or effected a purchase and sale, etc. of listed securities, etc. of the listed company, etc. before the disclosure of the material information, it must disclose the material information promptly (FIEA, art. 27-36, para. 3). However, disclosure is not required if material information cannot be disclosed due to a compelling reason or in any other cases specified by Cabinet Office Ordinance (id., proviso; Material Information Ordinance, art. 9). This provision has been introduced because the confidentiality of material information cannot be maintained when a business associate, in breach of its duty of confidentiality, provides the information to a third party that does not have such duty.
(7) Method of Disclosure

A listed company, etc. seeking to disclose material information must disclose the material information using the internet or through other means, pursuant to the provisions of Cabinet Office Ordinance (FIEA, art. 27-36, para. 4; Material Information Ordinance, art. 10). This rule has been introduced from the perspective of ensuring the prompt disclosure by issuers and providing individual investors, etc. with easy access to the information.

(8) Law Enforcement by the Regulatory Authorities

When finding that material information that is required to be disclosed has not been disclosed, the Prime Minister may instruct a person that is found to be required to disclose the material information to disclose the material information or to take any other appropriate measure (FIEA, art. 27-38, para. 1). If a person who has been thus instructed fails to take the measure pertaining to the instruction without just cause, the Prime Minister may order that person to take the measure pertaining to the instruction (id., para. 2). It was considered to be appropriate to first encourage the issuer to promptly disclose the material information, and then give administrative instruction and order to the issuer in the case of its failure to take appropriate measures.

When finding it to be necessary and appropriate in the public interest or for the protection of investors, the Prime Minister may order a person that has disclosed material information, a person that is found to be required to disclose material information, or a witness, to submit reports or materials that should serve as a reference, and may have the relevant officials inspect that person’s books and documents or any other of articles they possess (FIEA, art. 27-38, para. 1). When finding it necessary with regard to the order to submit reports or materials or the inspection, the Prime Minister may make inquiries to public offices or public or private organizations and request them to report necessary matters (id., para. 2).

13 8 Accounting System Under the FIEA

(1) Significance of the FIEA Accounting System

Article 193 of the FIEA states that “the balance sheet, profit and loss statement and other statements of finance and accounting to be submitted under the provisions of this Act shall be prepared in conformity with the terms, forms and preparation methods which the Prime Minister prescribes in a Cabinet Office Ordinance in accordance with the manner generally accepted fair and proper.” The “Cabinet Office Ordinance” here refers to e.g., the Financial Statements Regulations. This provision is the fundamental provision governing accounting under the FIEA (hereinafter “FIEA accounting”).

There is a growing trend to reexamine the significance of accounting which constitutes the backbone of the information disclosure system, given that the legal objective of the FIEA is understood to extend to the achievement of fair formation of prices in financial instruments, etc. by fully exploiting the functions of the capital markets, and further given that new financial
instruments are developed every day.

From this perspective, the reason the FIEA contains provisions concerning accounting under the FIEA is because it is necessary to ensure the possibility of comparative evaluations with other securities, on capital markets in which various kinds of financial instruments exist on the same market, and to this end, it is necessary to use the same lens to view the assets and liabilities, etc. of issuers. The first objective of the FIEA accounting is to make it possible to apply a common measure to different financial products in the market.

The second objective is to clarify the “true value” of the object of the transaction which is the greatest value of the FIEA. “True value” here means that financial information which can lead to fair price formation (the objective of the FIEA) will be provided without fail. The “first general principle of financial accounting—the principle of truthfulness” is to the extent that it relates to the FIEA accounting precisely an expression of the legal objectives of the FIEA. In order to achieve this second objective, it is necessary to access each company’s improprieties and off-balance sheet treatment, etc.

It may appear that the objective of providing the market with a common scale of measurement and the objective of clarifying the true value could easily conflict, but these two objectives tend to converge around the overall objective of the FIEA of ensuring fair pricing and should not be understood as conflicting. Nevertheless, determining what sorts of rules should be the concrete rules is not necessarily an easy question, and therefore the FIEA avoids formulating standardized precepts for the accounting rules for the capital markets, while the financial statement regulations are to be prescribed in accordance with the manner generally accepted fair and proper.

(2) Uniform Content

Stemming from this significance of the FIEA accounting, the first characteristics of the rules that should be incorporated therein is that they must be able to constantly provide the market with changing information about the quality of the securities (company). If material information arises concerning finance in the capital markets, which have continuity, such information should be promptly provided to the capital markets; therefore, it is necessary for accounting methods to enable the same as well.

Accordingly, the first demand on the accounting system is that it can accurately record the daily transactions and be able to ascertain the daily net profit/loss position. From the objectives of the FIEA, this accounting system has its true significance not only in providing materials on the future earning capability of the relevant company that are beneficial to the investment decisions of investors, but also in enabling timely and proper disclosure of information in connection with finances.

Second, since the FIEA presumes the existence of a continuous secondary market, it is desirable to have an accounting system that guarantees the ability to compare different periods. In this sense, the principle of continuity is set forth as one of the most important principles for the FIEA accounting.
Audit System Under the FIEA

(1) Significance of the FIEA Audit System

Assuming that the significance of the FIEA accounting is to provide a common investment measure in the marketplace, to ascertain the true value of the object of the investment, and above all, to enable the timely disclosure of financial information based on a daily transactional record, then Article 193-2 of the FIEA, which requires an auditor’s certification from a certified public accountant or auditing firm with respect to the statements on finance and accounting that must be filed under the FIEA by the issuer of listed securities and other specified issuers, is understood as being an extension of these objectives.

In other words, the objective of the audit system is identified as being to verify that the accounting treatment and information disclosure is being made in conformity with the objectives of the FIEA accounting, and the objectives of the FIEA audit system (hereinafter “FIEA audit system”) are held to be first to provide a common measure enabling the formation of a comparative investment decision in the securities markets, and second to pursue the true value of the object of the investment.

Furthermore, having persons possessing a “common” qualification verify pursuant to “common standards” from the subject of the audit that the management is processing accounts in accordance with the FIEA accounting precepts makes it possible to accomplish this first objective, while having an “independent” person with a qualification look for issues such as illegitimate practices in connection with the accounting of each of the corporations makes it possible to accomplish the second objective.

Viewed against the first objective of the FIEA audit system, an FIEA audit means an audit using a single sophisticated and public interest oriented “measure” common throughout the securities markets. This FIEA audit is addressed towards the markets and is not the same as the accounting advice given to a company. It is, thus, essential to have “independence” and “commonality” in the form of a verification using certain “common” standards by persons possessing certain “common” qualifications who do not have a special interest in the company that is subject to the audit (independent).

These persons possessing common qualifications are certified public accountants and auditing firms, and the common standards are exemplified by the audit standards. The 2007 amendments to the Certified Public Accountant Act required measures for ensuring the appropriateness of business execution and the organization of business management systems such as the formulation and implementation of policies for the management of business quality, etc. from the viewpoint of ensuring the structuring and operation of an appropriate quality management system, etc. by accounting firms (Certified Public Accountant Act, art. 34-13), which has a significance of raising the business standards of accounting firms who possess the qualification of audits under the FIEA, and ensure the standardization as a “common” qualification.

In addition, the 2003 amendments to the Certified Public Accountant Act made certain
changes with the objective of enhancing the independence of certified public accountants and auditing firms. Such changes include that certified public accountants or auditing firms are prohibited from providing any audit certification services to Large Corporations (defined below) if the certified public accountant or auditing firm receives consideration on a continuous basis for the services unrelated to audit certification (as defined in Cabinet Office Ordinance) from a company subject to audits under the Commercial Code Special Exceptions Act, or a company subject to audits under the FIEA (hereinafter the “Large Corporations”) (This is referred to as the “prohibition against concurrent providing of non-audit certification services.”). In addition, a new system was introduced requiring a periodic replacement of certified public accountants or auditing firms that provide audit related services to the Large Corporations (a “rotation system”).

Nevertheless, with the frequent incidents of dressing up of accounts that continued to occur thereafter, it was necessary to beef up the auditing system, and consequently explicit statement is made in the 2007 amendment that certified public accountants and auditing firms shall carry out their activities from an independent perspective (Certified Public Accountants Act, art. 1-2), and furthermore, a partner in the accounting firm who is involved in the audit certification work is restricted from assuming the office of officer, etc. of the company under audit or its consolidated companies, etc. until the completion of the following accounting term (Certified Public Accountant Act, art. 34-14-2), and if a partner assumes the office of officer of the company under audit or its consolidated companies, etc., the accounting firm may not provide audit certification work for the company under audit or its consolidated companies, etc. until the following accounting term (Certified Public Accountant Act, art. 34-11, para. 1, item 3). Moreover, steps to enhance “independence” have been taken, including rotation of the chief accountant who is responsible for an audit of a listed company at a major auditing firm (continuing audit period of five years with intervals of five years) (Certified Public Accountants Act, art. 34-11-4; Certified Public Accountants Act Enforcement Order, art. 18 through art. 20; and Certified Public Accountant Act Enforcement Ordinance, art. 24).

As a means of achieving reliability of quarterly reports which have been introduced with the FIEA, a system of quarterly review has been enacted. In the same manner audits are also to be conducted of internal control reports which have been introduced with the FIEA (FIEA, art. 193-2, para. 2).

(2) Audit Opinion

Stemming from this intent of the FIEA audits, the audit opinion of a certified public accountant verifies whether the financial statements, etc. have been prepared in accordance with the accounting precepts under the FIEA that are necessary to form a comparable investment judgment and to clarify the true value of the target of the transaction. The audit opinion expresses an opinion and reports that the auditing standards and procedures that are necessary for this verification have been carried out. In this sense, the audit report of a certified public accountant under the FIEA first must confirm that the person preparing the report is qualified as a certified public accountant, second must describe what audit procedures were followed, and third must declare the opinion of the auditor concerning the audit results.
The Auditors Certificate Ordinance requires the certified public accountant or the accounting firm to disclose any special relationship with the audited company (Auditors Certificate Ordinance, art. 4, para. 1, item 1(f)). Next, the certified public accountant or the accounting firm must state an outline of the audit performed in the auditor’s report. In addition, the certified public accountant or auditing firm must include a statement as to the scope of the audit and the fact that the audit was undertaken pursuant to generally accepted auditing standards (Auditors Certificate Ordinance, art. 4, para. 1, item 1(d) and para. 5).

In response to the 2002 amendments to the auditing standards, the current audit report must state (i) that the auditing standards require the certified public accountant or accounting firm who performed the audits to obtain reasonable guarantee that the financial statements, etc. include no material false statements, (ii) that the audits were conducted based on sampling, (iii) that the audits have examined the statements in the financial statements, etc. as a whole, including the accounting standards adopted by the management, the method of application thereof and the evaluation of estimates performed by the management, and (iv) that the audits have provided reasonable grounds for expressing the opinion (Auditors Certificate Ordinance, art. 4, para. 5, item 3 through item 5, and item 8).

The Auditors Certificate Ordinance provides that the audit report must state an opinion as to whether the financial statements, etc. “properly present” the financial position, management performance, etc. of the company subject to audit (Auditors Certificate Ordinance, art. 4, para. 1, item 1(d)). “Properly present” here means an opinion that the financial statements, etc. are stated in conformity with the objectives of the FIEA, in other words, that they enable a comparison between securities in the capital markets and express the true value of the individual security. Since “proper” of course includes “legal,” it is not sufficient to simply conform with the standards of the “general principle of financial accounting” (this precondition is thought to contain a historically formed perception that self-regulatory rules have a higher standard than law and regulation as in Europe and North America).

Moreover, in a quarterly report, only limited procedures can be carried out in limited period of time, and consequently the statement of opinion by the auditor will express its conclusion in a negative assurance form concerning the suitability of the quarterly financial statements, etc. (the expression of a conclusion concerning whether it was not recognized in any material respect a matter that would cause the belief that a statement was not made in a proper manner), so that the statements of opinion can be divided into an “unrestricted conclusion,” “a limited conclusion stating matters that are excluded,” and a “negative conclusion” (Audit Certificate Ordinance, art. 4, para. 16).

In addition, the Auditors Certificate Ordinance does not provide a direct stipulation concerning an auditor’s reserving its opinion, while Accounting Standards No. 4, (1) (iv) provides that “if the auditor is unable to obtain reasonable basis for forming the auditor’s opinion because any material auditing standard could not conducted, the auditor shall not express its opinion.” Stemming from the above-mentioned intent of the FIEA audit provisions, a disclaimer not only expresses mistrust towards the management, it also indicates a serious situation—since the common scale to evaluate investment options is lost, and the preconditions for forming an
investment decision in the market are similarly lacking.

(3) **Duty to Report at the Time of Discovering Improprieties or Illegal Activity**

The 2007 amendments to the FIEA made simultaneously with the amendments to the Certified Public Accountant Act impose a duty to report on certified public accountants and auditing firms at the time they discover improprieties or illegal activity.

This duty has been imposed from the perspective of enhancing, e.g., the independence of auditors and the effectiveness of audits. It requires that if a certified public accountant or an auditing firm discovers a legal or regulatory violation on the part of a specified issuer, or another event that may have an impact on the propriety of documents in connection with financial accounting (a “legal or regulatory violation, etc.”) the certified public accountant or auditing firm must notify the specified issuer of the content thereof and that the issuing company, etc. must take corrective action. Moreover, if there is a risk of an impact on the achievement of the propriety of documents in connection with financial accounts, and appropriate action is not taken, the certified public accountant or auditing firm must notify the Prime Minister (FIEA, art. 193-3).

It is hoped that this will result in the issuing company taking appropriate action prior to notification being made to the Prime Minister.

13 10 **Internal Control Report System**

Having a system of internal control in place within the companies that provide the financial information which is presented to the capital markets, is of utmost importance in achieving the FIEA accounting and the FIEA auditing objectives, and ensuring the fair price formation by the full functioning of the capital markets functions.

Consequently, the FIEA stipulates that listed companies, etc. that are required to file annual securities reports must for each business year file with the Prime Minister a report which assesses the regimes that are necessary to achieve the compliance of documentation and other information in connection with financial accounting involving the corporate group of which such company is involved, as well as the company itself (an “internal control report”), together with the annual securities report (FIEA, art. 24-4-4).

This internal control report must be audited by a certified public accountant or an accounting firm, in order to ensure the objectivity of the evaluation of internal control by management, and to promote the implementation of internal control procedures by listed companies, etc. (FIEA, art. 193-2, para. 2). This system was developed using the U.S. Sarbanes-Oxley Act of 2002 as a reference, and applies to business years from April 1, 2008 (this section is referred to as the “J-SOX Act”).

Although this system of reporting on internal control under the FIEA is limited to “internal control with respect to financial reports,” it is necessary to have material information provided in a timely fashion to the capital markets in order to achieve fair price formation which is the objective
of the FIEA. And consequently, an internal control system must be created which will enable this to take place. From this perspective, the internal control system required by the FIEA is on a consolidated basis.

Although under the Companies Act it is the board of directors of a stock company that makes the decision to put in place an internal control system (Companies Act, art. 362, para. 4, item 6 and para. 5), a listed company, etc. which is governed by the internal control reporting system of the FIEA is required to make the decision in accordance with the internal control reporting system under the FIEA. In this sense, the internal control system that is for the purpose of achieving the objectives under the FIEA can be said to have a relationship of also contributing to governance under the Companies Act.

The Business Accounting Council has published its “On the Setting of the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (Council Opinions),” as well as its “Practice Standards for Management Assessment and Audit Concerning Internal Control Over Financial Reporting,” for the purpose of the internal control reporting system, which are considered as generally accepted standards for evaluation of internal control concerning financial reporting and generally accepted standards for audits on internal control concerning financial reporting (Internal Control Ordinance, art. 1, para. 1, para. 3 and para. 4).

There are several characteristics of this internal control reporting system. Firstly, audits on financial instruments and audits on internal control shall be conducted as a package by the same accounting firm. Secondly, the so-called direct reporting method where the certified public accountant/accounting firm directly evaluates internal control was not adopted. Accordingly, even if a material weakness is found, if it is properly disclosed in the internal control report, it will be represented as an “unqualified opinion.” Thirdly, standards concerning the defect of internal control was narrowed down to “internal control deficiency” and “material weakness to be disclosed” and if the internal control system is formulated from the perspective of preventing false statements that are created by a material weakness in internal control, and if a weakness of this nature is corrected by the end of the period, the internal control will be found to be effective. Furthermore, the standard for significance for this purpose is defined in values as approximately 5% of the consolidated profit before tax.

The contents that are to be stated in internal control reports and internal control audit report are prescribed separately by Cabinet Office Ordinance.

Under the 2014 amendment to the FIEA, a listed company, etc. whose amount of capital or any other scale of management does not reach the criteria specified by Cabinet Office Ordinance is exempted from the obligation to have its internal control report audited, for three years from the date of its new listing (FIEA, art. 193-2, para. 2, item 4; FIEAEO, art. 35-3; Internal Control Ordinance, art. 10-2). This is to reduce the burden on emerging and growing companies and facilitate their listing.
Disclosure of False Information and Civil Liability

(1) Civil Liability in the Primary Markets

With respect to public offerings and secondary distributions of certain securities, persons who have caused others to acquire such securities using a prospectus containing false statements of material facts or omitting material facts that must be stated or fact that is necessary to avoid misunderstanding, or using materials containing false indications or misleading indication with respect to material facts or lacks indication that is necessary to avoid misunderstanding, shall be liable for the damages incurred by such persons who have acquired the securities without knowledge of the said facts (FIEA, art. 17, main clause).

Nevertheless, a person who would normally be liable to compensate damages will not be liable if that person can prove that he/she did not know of, and was unable to know of even with reasonable care, the existence of such false statement, etc. (id., proviso).

The liability for false statement on the part of a person who has actually used a prospectus as the means for delivery of information directly to an investor is defined as a responsibility similar to that associated with ordinary unfair trading or fraud, and the provisions relating to the responsibility of persons filing securities registration statements apply to the responsibility of issuers who have prepared a false prospectus (FIEA, art. 18, para. 2).

The registrant of a securities registration statement containing false statements or the like is liable for the damages incurred by a person who has acquired the subject securities through a public offering or secondary distribution, but this liability will not be incurred if the acquirer was aware of the said false statements, etc. (FIEA, art. 18, para. 1). The amount of such liability for damages resulting from false statements in a securities registration statement is defined under law as the amount paid by the claimant to acquire the securities minus the market value of the securities at the time of the claim or amount received upon disposition of the subject securities if such securities have been disposed of prior to the time of the claim (FIEA, art. 19).

The right of claim for damages under the FIEA, Article 18, shall lapse if the injured party does not make a claim within a period of three years from the time that party becomes aware of the false statements or the time the claimant should have become aware of such false statements through the exercise of reasonable care. Moreover, such right of claim shall lapse after the passage of seven years from the time at which the registration of a public offering or secondary distribution became effective or the time at which the prospectus was delivered (FIEA, art. 20).

Responsibility for false statements in the securities registration statement is also assigned to the officers of the filing company, owners of the securities involved in a secondary distribution, the certified public accountants and accounting firms, and the financial instruments business operator or registered financial institution that entered into the wholesale underwriting contract (FIEA, art. 21).

(2) Civil Liability in the Secondary Markets

The officers, certified public accountants and accounting firms associated with the registrant
of annual securities reports, internal control reports, semiannual securities reports, quarterly
securities reports, extraordinary reports, and share buyback reports that contain false statements,
etc. are liable for the damages incurred by persons who have acquired or disposed of the securities
in the secondary market (FIEA, art. 24-4, art. 24-4-7, para. 4, art. 24-5, para. 5, art. 24-4-6, and
art. 24-6, para. 2). If a securities registration statement contains false statements or the like,
persons who have acquired or disposed of securities of the issuer who filed the securities
registration statement, by means other than a public offering or secondary distribution, shall have
the same right of claim for damages (FIEA, art. 22).

Under the amendments in 2004, the provisions above of the FIEA, Article 19, codifying the
amount of liability for damages resulting from false statements or the like in a securities
registration statement also became applicable to claims for damages against issuers resulting from
false statements or the like contained in disclosures made in the secondary markets (FIEA, art.
21-2, para. 1). In addition, the law as amended established provisions for presumption of the
amount of damages, in addition to the provisions of the FIEA, Article 19 (FIEA, art. 21-2, para.
3).

Under these provisions, if the fact of the false statement, etc. is publicly announced, the
amount of damages resulting from the false statement may be deemed to be the average market
value of the subject securities for a period of one month prior to the time of announcement (if no
market prices are available for this period, the estimated disposal value) reduced by the average
market value of the subject securities for a period of one month following the time of
announcement.

The presumption that the amount of damages is equal to the net of the value that is thought to
have been influenced by market abuse minus the value after eliminating this assumed market
abuse, and setting the respective calculation dates one month prior to and after calculation,
constitutes a concept of broad application, and may have practical significance against acts such
as market manipulation as well. Persons who may use this vehicle of presumption of damages are
limited to persons who both (i) acquired the subject securities within one year prior to the date of
the announcement of the fact of false statements, and (ii) hold the securities continuously on the
day of the announcement.

However, under the 2014 amendment, a company that has submitted a false disclosure
document in the secondary market is exempted from the liability for damages if it successfully
proves lack of negligence on its side (FIEA, art. 21-2, para. 2). As regulations to deter illegal
conduct have been tightened since 2004 through the introduction and reinforcement of the
administrative monetary penalty system and the introduction of the internal control report system,
it has become less important to impose absolute liability on the submitters of such false disclosure
documents beyond the level of the general rules of liability for damages.
Tender Offer System

Significance

A tender offer (or takeover bid (TOB)) refers to “an act of soliciting offers for purchase, etc. or sales, etc. of share certificates, etc. from many and unspecified persons through public notice, and making purchase, etc. of share certificates, etc. outside of financial instruments exchange markets” (FIEA, art. 27-2, para. 6).

Tender offers are used as a unilateral strategy in a corporate buyout (including a hostile takeover). A buyout with the consent of the management of the target company is an amicable takeover, while a buyout that is opposed by management is a hostile takeover, but a hostile takeover is not necessarily an abusive one that will undermine corporate value.

The proper conduct of a tender offer requires that shareholders and investors be given sufficient information and time to consider, as well as a fair opportunity to sell. When a buy-up of shares occurs off of a market, it becomes impossible to expect the fair price formation function to operate within the market, which consequently is believed to increase the risk of adverse consequences to shareholders and investors (of course there is also the opinion with respect to this issue that a distinction should not be made between on-market and off-market).

The FIEA consequently imposes a variety of regulations on tender offers.

Tender Offers by Person Other Than Issuer

(1) Extent of Application of Regulations

In principle, a purchase, etc. of share certificates, etc., for which the issuer thereof is required to file an annual securities report or of the issuer of specified listed securities by person other than such issuer, etc., and which is covered by any of (i) through (vi) below must be made by a tender offer (FIEA, art. 27-2, para. 1).

Because the trading market for professionals was established with the 2008 amendments, share certificates, etc. of issuers of specified listed securities (FIEA, art. 2, para. 33) has become subject to tender offer. The same applies to the share certificates, etc. of issuers of OTC-traded securities for professionals (specified OTC-traded securities) (FIELEO, art. 6, para. 2):

(i) to purchase share certificates, etc., from 11 or more persons off-market, within a 60 day period, and in which the shareholding ratio of the share certificates, etc. after the purchase will exceed five percent; (ii) to purchase share certificates, etc., from not more than 10 persons off-market, within a 60 day period, and in which the shareholding ratio of the share certificates, etc. after the purchase will exceed one-third; (iii) to purchase share certificates, etc., by way of
specified sales and purchase, etc. (such as ToSTNeT trades), and in which the shareholding ratio
of the share certificates, etc. after the purchase will exceed one-third; (iv) rapid purchase that
combine transactions such as purchase on and off-market (meaning acquisition of share
certificates, etc. in excess of 10 percent in three months, by way of purchase or acquisition of
newly issued shares, of which more than five percent will be by off-market transactions) and in
which the shareholding ratio of the share certificates, etc. after the purchase will exceed one-third;
(v) a purchase made within the tender offer period of another person, by a person who has a
shareholding ratio of more than one-third, and in which the said person will acquire in excess of a
further five percent; and (vi) such other cases as are prescribed by Cabinet Order.

The stipulation in (i) above has been imposed in order to prevent shareholders and investors
from selling off their shares when they are faced with a sudden offer from the purchaser, without
having been able to make a sufficient investment decision. The stipulation in (ii) above was made
to provide a fair opportunity to general shareholders and investors to sell their shares of stock at
the time of transfer of right of corporate control, when they would not have been provided this
opportunity to sell to the acquirer without this regulation (this can also be explained as an effort to
achieve a fair distribution of the premium on right of corporate control), and is referred to as the
one-third rule.

Category (iii) above was introduced with the 2005 amendments. Given that a public tender
offer is a transaction that is to be conducted off-market, treating an off-hours transaction of a
securities exchange as being the same as a market transaction would gut the tender offer
regulations since even though off-hours transactions are trades which are under the control of a
securities exchange, their substantive nature is that of a negotiated transaction. The 2005
amendments, therefore, defined sales and purchase, etc. in securities by means that the Prime
Minister prescribes as constituting sales and purchase, etc. in securities on the securities exchange
market (which under the FIEA is a financial instruments exchange market) by means other than
auction as being “specified sales and purchase, etc.,” and included this specified trading, etc.
under the regulation framework.

Categories (iv) and (v) were introduced with the 2006 amendments. Category (iv) was
enacted because transactions occurred which appeared to evade the one-third rule by combining
trades on and off market. Since the advent of category (iv) if for example a person who already
holds 24 percent of the share certificates has further acquired an additional six percent off-market
without making a tender offer, the acquisition of a further four percent on-market within the
following three months would be illegal. Category (v) was enacted in order to assure an equal
footing between purchasers, and in order to enable investors to give sufficient consideration to
competitive bids.

(2) **Registration System for Tender Offer**

A person who makes a purchase, etc. of share certificates, etc. through a tender offer must
make a public notice of the purposes of the tender offer, the purchase price, the number of share
certificates, etc. to be purchased, the purchase period, and other matters (FIEA, art. 27-3, para. 1).
A person who has given public notice of making a tender offer (a tender offeror) must on the date
on which the said public notice is made, file a tender offer registration statement with the Prime Minister stating the purposes of the tender offer, the purchase price, the number of share certificates, etc. to be purchased, the purchase period, and other matters (id., para. 2).

The 2006 amendments endeavor to enhance disclosure within tender offer registration statements, and require more extensive statements concerning matters such as the management policy and the behavior policy as a shareholder.

In some cases securities constitute the consideration for purchase in a tender offer. This type of tender offer is referred to as a swap offer. In a swap offer it is sometimes necessary to file a registration statement concerning the public offering or secondary distribution of the relevant securities at the same time as filing the tender offer registration statement (FIEA, art. 27-4).

Immediately after the filing of a tender offer registration statement, the tender offeror must send a copy thereof to the target company, etc. of the tender offer (FIEA, art. 27-3, para. 4).

Additional obligations are also imposed on the tender offeror, including that the offeror is required to deliver the tender offer circular to persons who intend to sell, etc. their share certificates, etc. (FIEA, art. 27-9), and after the completion of the tender offer period is required to file with the Prime Minister a report concerning the results of the tender offer (FIEA, art. 27-13).

The issuer of the share certificates, etc. in connection with the tender offer (the target entity) must within 10 business days from the date of announcement of the tender offer file with the Prime Minister an opinion report stating, inter alia its opinion in connection with the tender offer (e.g., whether it approves, opposes, is neutral or reserves expressing an opinion) and the reasons for the same, whether it will take defensive action against the purchase, and other matters (FIEA, art. 27-10, para. 1).

Although the tender offeror may set a tender offer period within a range that is at least 20 but not more than 60 business days (FIEA, art. 27-2, para. 2), if a tender offer period of less than 30 business days is stipulated, the target entity may demand in its opinion report that the tender offer period be extended to 30 business days (FIEA, art. 27-10, para. 2, item 2).

Within the opinion report, the target entity may also state questions to the tender offeror (FIEA, art. 27-10, para. 2, item 1), and a tender offeror to whom questions have been asked must within five business days submit a question response report (FIEA, art. 27-10, para. 11). Through these steps it is anticipated that the areas of conflict between the offeror and the management of the target company will be clarified, thereby enabling sufficient information to be provided that will contribute to the investment decisions by investors. Documents such as tender offer registration statements, etc. are made available for public inspection from the date that they are filed with the Prime Minister until five years have elapsed from the last day of the tender offer period (FIEA, art. 27-14).

With the 2008 amendments, if the Prime Minister issues an order to file amendment to registration statement, etc. and not make the tender offer registration with false statements, etc. be available for public inspection, the financial instruments exchanges/authorized financial instruments firms association receiving such notice are relieved from the obligation to provide the copies of such documents for public inspection (FIEA, art. 27-14, para. 5 through para. 7).

Moreover, regulations have been stipulated prescribing that liability to compensate damages
are to apply to a person who violates any of the regulations concerning tender offers, or who uses a tender offer circular containing a false statement, etc., or who makes a tender offer commencement notice containing a false statement, etc. (FIEA, art. 27-16 through art. 27-21). Furthermore, an administrative monetary penalty system against person not making a public notice for commencement of tender offer and a person making a public notice for commencement of public tender offer with false statements, etc. was newly established (FIEA, art. 172-5 and art. 172-6).

(3) Conduct Regulations

Since the equality of information between the offeror and the applicant in a tender offer cannot be guaranteed, and since the offeror unilaterally presents the offer price, it is difficult for the applicant to determine the fairness of the transaction.

For this reason, the FIEA does not simply relegate this function to information disclosure concerning the tender offer, but it imposes many conduct restrictions in an attempt to ensure fair transaction terms.

The terms of the price of a tender offer must be equal (FIEA, art. 27-2, para. 3). Although raising the tender offer price during the tender offer period is permitted, in principle, the tender offer price cannot be lowered (FIEA, art. 27-6, para. 1, item 1). In exceptional circumstances, the price may be lowered (ibid., parenthetical statement in the same item) if the tender offeror has stipulated as a condition in the tender offer commencement announcement or the tender offer registration statement that the price may be reduced if the target entity has made a stock split or an allocation of shares without contribution, etc. during the public tender offer term. Moreover, although the offering period may not be truncated it may be extended (FIEA, art. 27-6, para. 1 item 3 and para. 2).

In principle, an offeror who makes a tender offer is prohibited from making a separate purchase of the relevant securities through any means other than the tender offer, and thorough steps are to be taken to achieve equal treatment among investors (FIEA, art. 27-5). Furthermore, tendering shareholders who made application to sell their shares are allowed to revoke such application (FIEA, art. 27-12). Thus, if a rival suitor presents an offer price higher than the price offered by the tender offeror, the tendering shareholder can revoke its earlier application and apply to the rival suitor with the higher offer price.

This allows the tender offer to take on the role as a sort of auction market, which is hoped will lead to the formation of a quasi-secondary market price for the target securities. M&A (mergers and acquisitions) in the U.S. frequently use this kind of method. The revocation rights on the part of tendering shareholders are not simply a cooling-off system to protect investors.

Although, in principle, a tender offeror cannot revoke its tender offer (FIEA, art. 27-11), a tender offer may be revoked if the tender offeror has stipulated as a condition in the tender offer commencement announcement or the tender offer registration statement that the tender offer may be withdrawn in the event that a significant change in the business or assets of the target entity of the tender offer or its subsidiary, or other circumstance occurs that constitutes a significant impediment to achieving the objectives of the tender offer (such as the launching of defensive
action against the tender offer). The tender offer may also be withdrawn in the event that a material change in the tender offeror occurs, such as bankruptcy.

If tender offer is oversubscribed, the offeror must purchase the share certificates of tendering shareholders in proportion to the number of share certificates each tendered (FIEA, art. 27-13, para. 5). This is for the purpose of treating investors equally. The 2006 amendments further require that if the shareholding ratio of the share certificates, etc. after the purchase will exceed two-thirds, the tender offeror must purchase all of the shares of share offered. This requirement has been added from the perspective of protecting shareholders in the event of a case such as when de-listing will occur after the purchase (introduction of partial requirement to purchase all shares offered; FIEA, art. 27-13, para. 4).

14 3 Public Tender Offers by Issuer

Even if a listed company makes a tender offer for its own shares, it must similarly follow the aforementioned tender offer procedures. Accordingly, the procedures under the FIEA incorporate by reference a large part of the provisions concerning non-issuer public tender offers described in 14.2 above (FIEA, art. 27-22-2). However, in the case of tender offer by issuer, when taking into account (i) acquisition of control of the company, etc. is not directly relevant, and (ii) the company that possesses the material information is itself making the tender offer, the FIEA contains the following special provisions:

(1) The provisions concerning the filing of a report on statement of opinion of the target company do not apply (FIEA, art. 27-22-2, para. 2); and

(2) When unpublished material facts exist prior to the filing of the tender offer registration statement, or when material facts arise during the tender offer period, the announcement thereof is required (FIEA, art. 27-22-3);

(3) A more explicit statement is made of the liability to pay compensation for damages in the event of a violation of the duty of public announcement as set forth in (2) (FIEA, art. 27-22-4).

15 Disclosure System of Status of Possession of Large Volume of Share Certificates, Etc. (5% Rule)

15 1 Significance

A person who holds share certificates, etc. of a listed company, etc. and whose holding ratio of share certificates, etc. exceeds 5% (a “large volume holder”), must within 5 days from the date
on which such person became a large volume holder file a report with the Prime Minister stating that person’s holding ratio of share certificates, etc., the funds used to acquire the share certificates, etc., the purposes of holding and such other matters as prescribed by Cabinet Office Ordinance (a “report of possession of large volume”) (FIEA, art. 27-23, para. 1). This is known as the report system of large volume possession or simply the 5% rule.

The 5% rule itself has characteristics as a market structure regulation, requiring the disclosure of “clustered” information (occurrences, transfers, increase/decrease, and extinguishment) in an imperfect market. It is hoped that Japanese takeover techniques, by introducing this, against the sudden appearance of an undesirable cornering of shares, would come to be transactions based on tender offer which is highly transparent corporate acquisition rule premised on the transparent 5% rule.

Cornering the share certificates, etc. of an issuer to gain management control, etc. is not automatically illegal under the FIEA, unless, of course, such cornering constitutes an unfair transaction such as market manipulation, insider trading, etc. However, stock prices often fluctuate wildly on news of such cornering or substitution, etc. and general investors without sufficient market information can incur unforeseen losses. In addition, cornering a large amount of share certificates, etc. constitutes important investment information since it can signal an influence on the management of the target.

From this perspective, the FIEA contains detailed provisions on the disclosure concerning the status of possession of large volume of share certificates, etc. (FIEA, art. 27-23 through art. 27-30). Thus, by transmitting timely and proper information concerning the large volume acquisition and holding of share certificates, etc., these rules seek to increase the fairness and transparency of Japan’s stock markets and protect investors.

### Outline of the 5% Rule

#### (1) Target Securities

The securities to be covered by a report of possession of large volume would be securities issued by a corporation that is the issuer of listed share certificates, etc.

The target securities include (i) share certificates (excluding those without voting rights); (ii) share option certificates and bonds with share options (other than those which grant solely rights to acquire only shares without voting rights); (iii) certificates or securities issued by a foreign person which have the characteristics enumerated in (i) and (ii); (iv) investment securities, etc. and investment equity subscription right certificates, etc.; (v) beneficiary certificates of securities in trust of which the entrusted securities are the securities set forth in (i) to (iv); and (vi) those that are prescribed by Cabinet Order as representing rights in connection with relevant securities (FIEA, art. 27-23, para. 1; FIEAEO, art. 14-4, art. 14-4-2 and art. 14-5-2).

Since the large volume possession disclosure system seeks to regulate those who have an influence on the right of corporate control through large volume possession, non-voting share, etc.
is exempted from these provisions. Treasury shares have also been exempted as a result of the 2014 amendment (FIEA, art. 27-23, para. 4).

(2) Large Volume Holders

Persons who have a duty to file reports of possession of large volume shall be those holders of the target securities (share certificates, etc.) whose ownership ratio thereof exceeds five percent (large volume holders) (FIEA, art. 27-23, para. 1). A holder here means a person who owns the share certificates, etc. in its own name or that of another person (including a person, etc. who has the right to demand delivery of share certificates, etc. pursuant to an agreement of sale, etc.), as well as persons who have the authority to exercise voting rights, etc. pursuant to a monetary trust agreement, etc. and who have an objective of controlling the business activities of the issuer, as well as a person who has the necessary authority to invest in share certificates, etc. pursuant to a discretionary investment contract (id., para. 3).

(3) Holding Ratio of Share Certificates, Etc.

In principle, the holding ratio of share certificates, etc. shall be the number of share certificates, etc. held by the holder plus the number of share certificates held by joint holders, divided by the total number of shares issued (FIEA, art. 27-23, para. 4). It should be noted that the number of treasury shares is included in the number used as the denominator in calculating the holding ratio of share certificates, etc.

A joint holder is any other holder of share certificates, etc. with whom a holder of share certificates, etc. agrees to cooperate in the acquisition or assignment of share certificates, etc. or in the exercise of voting rights (id., para. 5). Moreover, persons with whom a relationship such as spousal or parent-child exists shall be deemed as joint holders (id., para. 6).

(4) Report of Possession of Large Volume

A large volume holder must file a report of possession of large volume within five days (not including Sundays and other holidays as prescribed by Cabinet Order) from the date on which the said person became a large volume holder (FIEA, art. 27-23, para. 1).

The report of possession of large volume must state a summary of the large volume holder and the joint holders, the purposes of holding, details of the share certificates, etc. held, the status of acquisition and/or disposition during the last 60 days and information concerning the acquisition funds, etc. (Possession of Large Volume Ordinance Form 1). A report of possession of large volume is to be filed with the Prime Minister (or in actual practice to a person such as the Director-General of the Kanto Local Finance Bureau), and must be filed through EDINET. Moreover, a copy of the report of possession of large volume must be sent to the issuer of the share certificates, etc. (FIEA, art. 27-27). However, under the 2014 amendment, a large volume holder is not required to send a copy of the said report to the issuer of share certificates if the report has been filed through EDINET (FIEA, art. 27-30-6, para. 3).

The report of possession of large volume will be made available for public inspection for five years (FIEA, art. 27-28, para. 1).
(5) Change Report

If, *inter alia*, an increase or decrease of at least one percent has occurred in the holding ratio of share certificates, etc. of a person who is to file a report of possession of large volume, after the said person has become a large volume holder, that person must file a change report within five days (not including Sundays and other holidays as prescribed by Cabinet Order) from the date that the event occurred (FIEA, art. 27-25, para. 1).

If a change report is to be filed on account of a change in the holding ratio of share certificates, etc. caused by an assignment of a large volume of share certificates, etc. within a short period of time, entries concerning the counterparty to the assignment and the consideration for the same must be made in the change report (FIEA, art. 27-25, para. 2; FIEAEO, art. 14-8, para. 1). However, with respect to a person specified by Cabinet Order as a person to whom an insignificant number of share certificates, etc. has been assigned (i.e., where the total number of share certificates, etc. that a person has acquired within the last 60 days accounts for less than 1% of all share certificates, etc.), only the matters concerning the consideration for the acquisition are required to be stated (FIEA, art. 27-25, para. 2; FIEAEO, art. 14-8, para. 2).

The amendments in 2013 made it unnecessary to submit any additional change report if a change report stating that the holding ratio of share certificates, etc. is five percent or less has already been submitted (FIEA, art. 27-25, *proviso*).

(6) Reports Subject to Special Provisions

Since entities such as securities companies, investment management companies, banks, trust banks and insurance companies engage in large volume trading of share certificates, etc. on a daily basis, they would have a very onerous clerical burden if the regulations concerning report of possession of large volume were to apply to them simply as discussed above. Consequently, the FIEA enacted a system for reporting under exceptional treatment in order to reduce the burden on this type of entity within reasonable limits, but in recent years increasing questions have been raised as to whether investment funds are abusing this exception, and consequently, the system of exceptional treatment was extensively revised with the 2006 amendments.

Essentially, the deadline for filing of the report under special provisions, which in principle had been within 15 days every three months, was shortened to within five days (not including Sundays and other holidays as prescribed by Cabinet Order) every two weeks. In addition, the situations which are ineligible for use of the reporting under the special provisions have expanded from “when the purpose of holding is to control the business activities of the company,” to “when the purpose of holding the company is to make an act as prescribed in by Cabinet Order as causing a material change or having a material effect (an ‘act of a material proposal, etc.’) on the business activities of the issuer” (FIEA, art. 27-26).

Moreover, there is no change from the prior situation in which the regulation allowing reporting under special provisions cannot be used if the holding ratio of share certificates, etc. exceeds 10 percent.
(7) Public Inspection of Report of Possession of Large Volumes, Etc.

Reports of possession of large volume or change reports are provided for public inspection for five years (FIEA, art. 27-28, para. 1).

With the 2008 amendments, if the Prime Minister issues an order for filing of amendment reports and determines the report of possession of large volume, etc. with false statements, etc. not to be provided to public inspection, the financial instruments exchange/authorized financial instruments firms association receiving such notice shall be relieved from the obligation to provide copies of such documents for public inspection (FIEA, art. 27-28, para. 4 through para. 6).

(8) Administrative Monetary Penalty

With the 2008 amendments, the failure to file reports of possession of large volume, etc. has become subject to an administrative monetary penalty, and the amount of administrative monetary penalty has been prescribed as one-one hundred thousandth of the total market value of the issuer of share certificates, etc. concerning the report of possession of large volume, etc. to be filed (FIEA, art. 172-7).

Furthermore, the Prime Minister has the authority to hear reports from and inspect the filer, etc. of reports of possession of large volume, and as the failure to file reports of possession of large volume have become subject to the administrative monetary penalty system, not only persons who have filed the report but persons who are required to file the report have also become subject to the hearing and inspection authority (FIEA, art. 27-30).

(9) Criminal Penalties

Failure to file a report of possession of large volume or a misrepresentation on such report is punishable by imprisonment of not more than five years and/or a penal fine of not more than JPY5 million (FIEA, art. 197-2, item 5 and item 6). In addition, penal sanction applies not only to the person who committed the offense, but also to his or her company (FIEA, art. 207, para. 1, item 2).

16 Market Supervision and Oversight

16 1 General

(1) Financial Regulatory Authorities in Japan

As of the present time regulation of financial institutions in Japan is carried out by the Financial Services Agency, which is an external agency of the Cabinet Office. Formerly, the (prior) Ministry of Finance served this role, but in 1998 the Financial Supervisory Agency and
Financial Reconstruction Commission were created as agencies to inspect and supervise financial institutions and to monitor securities trading, etc. In 2000, the Financial Supervisory Agency was reorganized as the Financial Services Agency under the Financial Reconstruction Commission, and succeeded to the role of the Ministry of Finance. Thereafter in 2001, a reorganization of central government agencies was implemented, and under the present structure, the Financial Services Agency positioned as an external agency under the Cabinet Office.

The following presents an organization chart of financial regulation in Japan as it currently stands.

![Organization Chart](image)

(From the FSA Website)

(2) **Delegation of Authority**

The FIEA grants various legal and regulatory authorities of administrative institutions under the FIEA to the Prime Minister. Since the Prime Minister delegates these authorities to the Commissioner of the Financial Services Agency (FIEA, art. 194-7, para. 1), when reading the text it is necessary to be careful to replace the Prime Minister with the Commissioner of the Financial Services Agency.

Moreover, the Commissioner of the Financial Services Agency further delegates some of the authorities that are delegated by the Prime Minister, to the Securities and Exchange Surveillance Commission (FIEA, art. 194-7, para. 2).

**16 2 **Securities and Exchange Surveillance Commission

As set forth above, the Securities and Exchange Surveillance Commission (SESC) is delegated with certain authorities by the Commissioner of the Financial Services Agency. The SESC mainly conducts daily monitoring of the markets and inspection of business operators, inspection of annual securities reports, etc., administrative monetary penalty investigations, and investigations of criminal cases.

The delegated authorities specifically include the following (FIEA, art. 194-7, para. 2):
(i) The authority to order, *inter alia*, a financial instruments business operator, a financial instruments intermediary service provider, a credit rating agency, a financial instruments exchange, etc., or a counterparty to a transaction thereof, a subcontractor, related company, or foreign financial instruments business operator, etc., to submit documentation, et al., as well as to conduct inspections (FIEA, art. 56-2, para. 1, para. 3 and para. 4, art. 60-11, art. 66-22, art. 66-45, para. 1, art. 75, art. 151, and art. 155-9);

(ii) Collecting reports and making onsite inspections in connection with cases in which administrative monetary penalties may be assessed for reasons such as spreading rumors, market manipulation, or insider trading (FIEA, art. 177);

(iii) Report and documentation submission orders to persons submitting public documents, etc., persons related to tender offers, persons related to reports of possession of large volume, persons providing specific information, etc., persons disclosing material information, etc., financial instruments business operators, etc., subsidiary companies, etc. of special financial instruments business operators, designated parent companies, etc., major shareholders of designated parent companies, authorized transaction-at-exchange operators, etc., persons reporting specially permitted services, etc., financial instruments intermediary service providers, etc., credit rating agencies, etc., high-speed traders, authorized associations, etc., certified associations, etc., investor protection funds, etc., persons submitting a notification of holdings in subject voting rights of an exchange, major shareholders of a stock company-type financial instruments exchange, persons submitting a notification of holdings in subject voting rights of the holding company of a stock company-type financial instruments exchange, major shareholders of a holding company of a stock company-type financial instruments exchange, the holding company of a stock company-type financial instruments exchange or its subsidiary, a financial instruments exchange, etc., a foreign financial instruments exchange, etc., persons submitting a notification of holdings in subject voting rights concerning a domestic clearing organization, major shareholders of a domestic clearing organization, financial instruments clearing organizations, etc., foreign clearing organizations, etc., a securities finance company, etc., designated dispute resolution organizations, trade repositories, etc., specified financial indicator calculation agents, etc., certified public accountants or auditing firms (FIEA, art. 26, art. 27-22, art. 27-30, art. 27-35, art. 27-37, art. 56-2, para. 1 through para. 4, art. 57-10, para. 1, art. 57-23, art. 57-26, para. 2, art. 60-11, art. 63-6, art. 66-22, art. 66-45, para. 1, art. 66-67, arpt. 75, art. 79-4, art. 79-77, art. 103-4, art. 106-6, art. 106-16, art. 106-20, art. 106-27, art. 151, art. 155-9, art. 156-5-4, art. 156-5-8, art. 156-15, art. 156-20-12, art. 156-34, art. 156-58, art. 156-80, art. 156-89, art. 193-2, para. 6; SELEO, art. 38);

(iv) The authorities of the Commissioner of the Financial Services Agency regarding the petition for order for prohibition or suspension by the court (FIEA, art. 192, para. 1) have also been delegated to the SESC (FIEA, art. 194-7, para. 4, item 2). In addition, by the 2010 amendments, the authority to petition for an order for prohibition or suspension by the court and the authority to take certain measures necessary for the
investigation of such petition may be delegated by the SESC to the directors-general of each local finance bureau (FIEA, art. 194-7, para. 7). Furthermore, by the same amendments, from the viewpoint of ensuring the effectiveness of orders for prohibition or suspension by the court, a penalty (fine of JPY300 million or less) may be levied against juridical persons violating the prohibition or suspension order by the court (FIEA, art. 207, para. 1, item 3). Under the amendments in 2011, the court having jurisdiction over the place where the violation has been committed or will be committed is included in the scope of courts having jurisdiction over a petition for a prohibition order or order of suspension (FIEA, art. 192, para. 3). Further as a result of the amendments in 2015, the court may now issue an order for prohibition or suspension of the sale and solicitation when the execution of operations in connection with specially permitted services for qualified institutional investors is extremely improper and is actually causing serious damage to the interests of investors, and there is urgent necessity to prevent the spread of damage among investors (FIEA, art. 192, para. 1).

### 16.3 Administrative Monetary Penalties

Given the substantial public interest involved with the large number of transactions concentrated at a single location and the impact that the resulting price formation can have on the national economy, the legal system for capital markets must simultaneously evolve in a timely fashion in both rule making and enforcement. There are also many instances where there is a need for such provisions to be able to respond dynamically to situations such as with market oversight, management of listings and accounting rules.

Even if it is difficult to regulate what could be regarded as a living animal, the rules must be effective given their importance to the public interest. Leaving such matters in the hands of only criminal procedures and traditional administrative procedures will allow many market abuses to go unchecked and result in the distortion of fair market prices, which are important indicators for the national economy. The securities markets, with little ability to resist being caught up in a bubble, would thus become the source of a great many problems for society.

Accordingly, first, the regulatory authorities must respond immediately if it appears that a market abuse may occur. Second, if such market abuse has already occurred, it is first necessary to seize from the perpetrator the gains resulting from any prohibited conduct. Third, a system of sanctions must be in place to prevent “market abuses from occurring in the first place.”

The system of administrative monetary penalties introduced by the 2004 amendments to the SEL came into being as the result of these unique concepts in market regulation. The administrative monetary penalties are imposed by the Prime Minister based on certain procedures upon the occurrence of certain types of unfair trading, and require the payment into the national treasury of an amount decided according to the particular offense involved (FIEA, art. 172). However, unlike civil penalties that impose fines which are “multiples of the amount of improper
profit gained,” the amount of these fines go no further than a portion of such gains.

Originally, the application of the system of administrative monetary penalties was limited to the four prohibited types of conduct consisting of (i) violation of the duty of disclosure involving issues by making a false representation, etc. in a securities registration statement, (ii) violation of the prohibition against spreading rumors or using fraudulent means, (iii) violation of the prohibition against market manipulation, and (iv) violation of the prohibition against insider trading. With the 2005 SEL amendments, however, administrative monetary penalties have also come to apply to violation of continuous disclosure obligations such as annual securities reports, semiannual reports and extraordinary reports, etc.

In addition, with the 2007 amendments to the Certified Public Accountants Act they have also come to apply to false or inappropriate certifications by a certified public accountant or an auditing firm (Certified Public Accountants Act, art. 31-2 and art. 34-21-2), and the FSA has clarified the standards for dispositions in the “Basic Concept for Disciplinary Actions, Etc. Against Certified Public Accountants and Accounting Firms.”

Tribunal proceedings have also been enacted as the procedure in order to impose administrative monetary penalty (FIEA, art. 178 through art. 185-17; Certified Public Accountants Act, art. 34-40 through art. 34-62).

The administrative monetary penalty system was reviewed with the 2008 amendments based on the past records, etc. since its introduction and to achieve a more effective prevention of acts of violation. Specifically, administrative monetary penalty standards were raised, the scope of application of administrative monetary penalties was reviewed, addition system of administrative monetary penalties and reduction system of administrative monetary penalties were introduced, statute of limitation was extended, and trial proceedings were reviewed.

These amendments have broadened the application of administrative monetary penalties to false statements in tender offer registration statements and failure to file thereof, false statements in reports of possession of large volume and failure to file thereof, fictitious trades and wash trades among market manipulation, stabilization operations among market manipulation, failure to file shelf registration documents and failure to file continuous disclosure documents.

In addition, if a person that has become subject to an administrative monetary penalty during the past five years has once again made a violation, the administrative monetary penalty has become stricter such as adding 50% to the amount of administrative monetary penalty or extending the statute of limitations from three years to five years. Furthermore, the so-called leniency system where the amount of administrative monetary penalty will be reduced by 50% if reporting of certain acts of violation (insider trading in trading of treasury shares, false statements in offering or continuous disclosure documents, failure to file reports of possession of large volume) was made prior to investigation by the authorities.

The amendments in 2011 introduced a new system for amending the facts alleged as the basis for commencement of the trial procedure for administrative monetary penalties. Under the conventional system, even when the trial examiners, in the course of examining evidence, became convinced of a fact that was inconsistent with the facts subject to the trial, it was unclear how they would rectify such inconsistency in the trial procedure, due to the absence of provisions.
concerning the permissibility to amend the facts subject to the trial or the method of amendment. The amendments in 2011 clarified these matters, expressly stipulating that the designated officer may amend the facts alleged as the basis for commencement of the trial procedure, the applicable laws and regulations, the amount of administrative monetary penalties, etc. as long as such amendment does not harm the interests of respondent (FIEA, art. 181, para. 4; Administrative Monetary Penalty Ordinance, art. 23-2).

Furthermore, pursuant to the amendments in 2012, in cases where an issuer, etc. submits, provides or publishes false disclosure documents, etc., a person who has conducted an act that makes such submission, etc. easier or an act that abets such submission shall be subject to an administrative monetary penalty in an amount equivalent to the amount, etc. paid as a consideration for such acts (FIEA, art. 172-12). Moreover, if a person other than a financial instruments business operator, etc. conducts unfair trading based on the account of others, such person shall be subject to an administrative monetary penalty in an amount equivalent to the amount of consideration of the remuneration therefor (FIEA, art. 173 through 175).

The amendments in 2013 authorized the Prime Minister to order the production of articles in an inspection regarding imposition of an administrative monetary penalty and to make inquiries to public offices or public or private organizations and request them to submit reports when necessary for such inspection (FIEA, art. 26, para. 2, art. 27-22, para. 3, art. 27-22-2, para. 2, art. 27-30, para. 3, art. 27-35, para. 2, art. 177, and art. 187, para. 2).

16 4 Disclosure of Names, Etc. of Persons Who Violated Laws and Regulations

When the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, he/she may, pursuant to the provisions of Cabinet Office Ordinance, make public the name of a person who has violated law or regulation as well as other matters necessary for preventing the occurrence or spread of damage from such violation or for ensuring fairness in transactions (FIEA, art. 192-2).
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Introduction

The Financial Instruments and Exchange Act (hereinafter referred to as the “FIEA”) is not the only law which sales representatives must take into consideration upon soliciting and selling financial instruments to customers. Laws such as the Act on Sales, Etc. of Financial Instruments[^1], the Consumer Contract Act[^2], the Act on the Protection of Personal Information[^3] and the Act on the Prevention of Transfers of Profits from Criminal Activity[^4] are closely related to the solicitation and sale of financial instruments.

Sales representatives conducting the solicitation and sale of financial instruments must fully understand and comply with these related laws.

[^1]: Act No. 101 of May 31, 2000
[^2]: Act No. 61 of May 12, 2000
[^3]: Act No. 57 of May 30, 2003
[^4]: Act No. 22 of March 31, 2007
(iii) Ensuring the appropriateness of solicitation by financial instruments providers, etc.

The objective of the FISA is to aim for the protection of customers and contributing to the sound development of the national economy by providing for (i), (ii) and (iii) above.

Customers shall purchase financial instruments under the principle of self-responsibility; however, in reality, there is a difference between the knowledge and experience of customers and financial instruments providers, and a gap in the information held (asymmetry of information). In view of such circumstances, the FISA was established to organize the premises for customers to subjectively select risk while being aware of their self-responsibility.

Currently, other laws such as the FIEA aim to protect customers regarding trades in financial instruments, but the focus of the FISA is to expedite and lessen the burden regarding suits concerning the sale of financial instruments by the civil compensation liability and shifting burden of proof, thereby aiming to prevent disputes in advance.

### Coverage and Scope of Application

The obligation to explain under the FISA is borne by a person conducting the “sale, etc. of financial instruments” in the course of business. The “sale, etc. of financial instruments” refers to deposit contracts, acts of causing the acquisition of securities, market and OTC derivatives transactions or the brokerage thereof or the acting as agent for or the intermediation thereof (each item under id., art. 2, para. 1 and para. 2).

Specifically, the “sale, etc. of financial instruments” include the act of brokering entrusted trades in share certificates from customers, the sale of investment trusts to customers, the act of entering into specified deposit, etc. contracts such as derivatives deposits with customers and the act of soliciting specified insurance contracts such as variable annuity and variable insurance for example.

A person conducting the sale, etc. of financial instruments in the course of business is considered to be a “financial instruments provider, etc.” Financial instruments business operators, etc. (including registered financial institutions) bear the responsibilities provided for in the FISA such as the obligation to explain important matters to customers as “financial instruments providers, etc.” if they conduct the sale, etc. of such financial instruments as business.

### Obligation to Explain

If a financial instruments provider, etc. conducts the sale, etc. of financial instruments as business, it must explain important matters to the customer prior to the sale of the financial instrument (FISA, art. 3, para. 1).

The explanation of important matters may be conducted by delivering a document, but it
must be in the manner and extent necessary for the customer to understand in light of the
customer’s knowledge, experience, financial standing and purpose for entering into the contract
concerning the sale of the financial instrument (id., para. 2).

Key matters among those listed as important matters to be explained prior to the sale are as
follows:

(1) If there is a possibility that the principal may be lost or a loss exceeding the
initial principal may arise directly due to fluctuations in interest rates, price of
currencies, market rates or other indices (market risk) (FISA, art. 3, para. 1, item 1 and item 2):
   ・The effect that the principal may be lost or a loss exceeding the initial
   principal may occur;
   ・The said indices; and
   ・Important parts of the transaction scheme concerning the sale of the said
   financial instrument;
(2) If there is a possibility that the principal may be lost or a loss exceeding the
initial principal may arise directly due to the change of status of the business
or assets of the provider of the said financial instrument or other persons
(credit risk) (id., item 3 and item 4):
   ・The effect that the principal may be lost or a loss exceeding the initial
   principal may occur;
   ・The said person; and
   ・Important parts of the transaction scheme concerning the sale of the said
   financial instrument;
(3) If there is a restriction on the period for exercising rights or the cooling-off
period, the said effect.

The obligation to explain important matters above does not apply to “specified customers”
(basically the same as “professional investors” under the FIEA, (art. 2, para. 31)) prescribed by
Cabinet Order as having professional knowledge and experience regarding the sale, etc. of
financial instruments (FISA, art. 3, para. 7, item 1). General investors who have changed to
professional investors are also treated as specified customers.

In addition, if the customer manifests its intent not to require explanation on the important
matters, the financial instruments provider, etc. is exempt from the obligation to explain important
matters, except where the sale of financial instruments is a commodity-related market derivatives
transaction prescribed in Article 2, Paragraph 8, Item 1 of the FIEA or brokerage thereof (FISA,
art. 3, para. 7, item 2). However, it shall be noted that the financial instruments provider, etc. is
not exempt from the obligation to explain under the FIEA (FIEA, art. 40, item 1; Cabinet Office
Ordinance Concerning Financial Instruments Business, Etc. (hereinafter “FIBCOO”), art. 117,
para. 1, item 1) even in such case.
The FISA makes it clear that the failure of a financial instruments provider, etc. to give explanation of certain important matters or the violation of the prohibition of the provision of conclusive evaluations upon the sale, etc. of financial instruments shall be subject to compensation liability arising from tort, and as special provisions regarding tort under the Civil Code, shifted the burden of proof of the damages as well as presumes the amount of damages.

The following are the modifications made to the Civil Code as special provisions of the Civil Code:

(1) **Strict Liability for Breach of Obligation to Explain**

Under the Civil Code, the existence of willful intent or negligence is required for tortuous acts, but under the FISA, the existence of willful intent or negligence is not considered with respect to the breach of obligation to explain important matters, and is considered strict liability (FISA, art. 5).

(2) **Shifting of Burden of Proof by Presumption of Causality and Amount of Damages**

Under the Civil Code, the party asserting the damages must prove the causality between the tort and the occurrence of the damages as well as the amount of damages, but under the FISA, the burden of proof with respect to causality and the amount of damages has been shifted to financial instruments providers.

Specifically, the FISA presumes the amount of damages as the “amount of loss in the principal,” and the amount of loss in the principal is prescribed to be the amount calculated in accordance with the following formula (FISA, art. 6):

\[
\text{Amount of loss in the principal} = (\text{Total amount of the money paid by and to be paid by the customer}) - (\text{total amount of money obtained by and to be obtained by the customer} + \text{total amount of the disposition value other than money obtained by the customer when goods or rights are sold or otherwise disposed of by the customer, etc.})
\]

This Article is a special provision to the Civil Code, but it is considered possible to claim compensation for damages by tort or pursue default liability under the Civil Code without using the presumption provisions, etc. above.
Obligation to Formulate and Publish Solicitation Policies

Article 8 of the FISA provides that “financial instruments providers, etc. must endeavor to ensure the appropriateness of solicitations concerning the sale, etc. of financial instruments in the course of trade.” It also sets ensuring general appropriateness concerning the sale, etc. of financial instruments as a voluntary obligation as well as requiring financial instruments providers, etc. to formulate and publish solicitation policies setting for certain matters (id., art. 9).

Matters to be stated in the solicitation policy are as follows:

1. Matters to be considered in light of the knowledge, experience, financial standing of the person to be solicited and the purpose of entering into a contract regarding the sale of the financial instrument;
2. Matters to be considered with respect to the person to be solicited regarding the manner and time slot of solicitation; and
3. In addition to (1) and (2) above, other matters concerning the ensuring of the appropriateness of solicitations.

The publication of the solicitation policy shall be (i) by posting or providing for inspection where easily seeable at the principal office or main office of the financial instruments provider, etc., (ii) by posting or providing for inspection where easily seeable at the business office or office where the sale, etc. of financial instruments is conducted, or (iii) by publishing on its website.

Financial instruments providers, etc. in breach of the obligation to formulate and publish the solicitation policy are subject to a penalty of JPY500,000 or less (id., art. 10).

Relation with the FIEA

The FIEA also provides for the suitability rule and the obligation to explain (FIEA, art. 40, item 1; FIBCOO, art. 117, para. 1, item 1), and it seems that they overlap with the obligation to explain under the FISA.

However, although the consequence of the violation of the suitability rule or the obligation to give substantial explanation under the FIEA is the administrative action or criminal penalty against the financial instruments business operator, etc. in breach of such obligations, under the FISA, there are no penalties other than the obligation to formulate and publish the solicitation policy, and they do not directly lead to administrative actions against the financial instruments provider, etc. but cause effects under private law (compensation liability, presumption of causality and amount of damages).

In line with the enforcement of the FIEA in 2007, the FISA has been amended to add the provision to prohibit the provision of conclusive evaluations, expand target instruments and...
transactions, introduce the idea of “specified customer” close to professional investors, include the suitability rule as the manner of performance of the obligation to explain and add the “important parts of the scheme of transactions concerning the sale of financial instruments” as the subject of the obligation to make it consistent with the FIEA.

### Court Precedents

A court precedent acknowledging compensation liability pursuant to the FISA is the case concerning the sale of corporate bonds of Mycal Corp. (delisted from the TSE 1st Section on December 15, 2001).

This is a precedent that upheld the compensation liability of the securities company that sold unsecured bonds issued by Mycal to the customer that purchased the same due to the breach of obligation to explain important matters under the FISA (Tokyo District Court April 9, 2003; Hanrei Jiho Vol. 1876, page 76). In this case, the court found that the securities company failed to fulfill the obligation to explain because the salesperson only read aloud to the customer, on the phone, the document containing the explanation of the credit risk of domestic bonds, at a time when the salesperson was not actually soliciting the customer to conduct bonds transactions, and thus hearing the explanation given in such manner, the customer could not have understood the risk of the loss of principal. Subsequently, lower courts held securities companies liable for damages under the FISA, based on the finding of their breach of the obligation to explain important matters upon selling structured bonds (Tokyo District Court November 30, 2010; Hanrei Jiho Vol. 2104, page 62; Tokyo District Court November 12, 2012; Hanrei Jiho Vol. 2188, page 75 etc.). However, in response to the appeal against the Tokyo District Court decision rendered on November 30, 2010 (Tokyo High Court, May 30, 2012), the high court ruled that the plaintiff was categorized as a “specified customer” and that as a result the securities company did not have the obligation to explain important matters under the FISA to the plaintiff.

### Customer’s Manifestation of Intent for “No Need to Explain”

A financial instruments provider, etc. is exempt from the obligation to explain important matters (FISA, art. 3) even if the customer is not a specified customer “if the customer manifests his or her intent not to require explanation on important matters” (id., para. 7), but under the FIEA, the financial instruments provider, etc. are not exempt from the substantial obligation to explain (FIBCOO, art. 117, para. 1, item 1) to customers who are not professional investors even if the customer manifests his or her intent “not to require explanation.”

However, even under the FIEA, the explanation shall be made “in light of the knowledge, experience, financial status and objective of investment” of the customer, so simplifying the
explanation should be considered possible to a certain extent if the customer manifesting its intent “not to require explanation” has sufficient knowledge and experience, etc. or is purchasing additional units of financial instruments he/she has purchased before. In the Tokyo High Court ruling as of May 30, 2012 mentioned above, the court found that the plaintiff had manifested the intention not to require an explanation on the important matters.

If a customer manifests his or her intent “not to require explanation” under the FISA, it shall be documented to prevent later disputes, but if it is considered that the soliciting party has forced the customer to sign and seal such document, the manifestation of intent shall be deemed invalid and the financial instruments provider, etc. shall not be exempt from the obligation to explain, so it is important that the circumstances, etc. under which the customer requested not to receive explanation are recorded in the meeting and negotiation records, etc. with the customer.

2 Consumer Contract Act

The Consumer Contract Act, from the perspective of consumer protection, provides for the rescission and nullification of contracts concluded between business operators and consumers by way of unfair practices employed by the business operators. It applies to business operators selling financial instruments, etc. to customers who are individuals.

2 Outline and Purpose

The Consumer Contract Act provides for the consumer’s right of rescission upon acts that mislead consumers or confuse customers and the nullification of unfair contract clauses from the viewpoint of consumer protection. The Act is positioned as special provisions regarding the defect in the manifestation of intent under the Civil Code.

In view of the difference of the quality and quantity of information and powers of negotiation between customers and business operators, the Consumer Contract Act grants the right under the private law to rescind contracts or assert the nullification of contract provisions for the protection of the consumers’ interests to enable the restoration of the consumers’ interests and indirectly causing business operators to conduct appropriate solicitation and the use of fair contract provisions.

Upon selling financial instruments to consumers, it shall be noted that the Consumer Contract Act applies in addition to the FIEA and the FISA.

The amendment to the Consumer Contract Act, which came into effect on June 3, 2017, has expanded the scope of consumers contracts that consumers are allowed to rescind (e.g., a
consumer contract for a transaction of an excessive volume), as well as the scope of important matters, and introduced a new provision to nullify the contractual clauses under which consumers shall waive their right of cancellation.

 Coverage and Scope of Application

The Consumer Contract Act applies to “consumer contracts” (contracts entered into between consumers and business operators (Consumer Contract Act, art. 2, para. 3). For this purpose, “consumers” mean individuals other than “those who are parties to the contract as business or for business” (Consumer Contract Act, art. 2, para. 1). “Business” is the same type of act conducted repeatedly and continuously with a certain purpose, and it is not necessary to be for-profit.

The definition of consumer contracts is very wide, and contracts regarding the sale, etc. of financial instruments subject to the FISA are included in consumer contracts so long as they are entered into between consumers and business operators.

In addition, the Consumer Contract Act applies to the act of solicitation by not only the direct party to the contract but also persons being entrusted with intermediation or granted the right of representation from the counterparty to the contract (Consumer Contract Act, art. 5, para. 1 and para. 2). For example, when an Association Member sells investment trusts or variable annuity, it is not the direct counterparty of the customer, but the Consumer Contract Act applies to such case.

The Consumer Contract Act is positioned as special provisions regarding the provisions of the Civil Code regarding defects in the manifestation of intent, and applies in priority to the Civil Code and the Commercial Code, but if there are any special provisions in other laws, those provisions prevail (Consumer Contract Act, art. 11). For example, the Interest Rate Restriction Act is considered as “special provisions.”

 Rescission of Contract Pursuant to the Consumer Contract Act

(1) Subject Contracts
A consumer may rescind a contract pursuant to the Consumer Contract Act if the business operator falls under any of the following upon solicitation of the execution of a consumer contract and the consumer manifested its intent to apply to or accept such consumer contract:

(i) Untrue Representation of Important Matters
To represent that which is not true as to an important matter to the customer, and thereby cause the consumer to misunderstand that the contents of the representation are true (Consumer Contract Act, art. 4, para. 1, item 1).

For this purpose, “which is not true” means that the contents of the representation
is objectively not true or correct, and includes cases not only by willful intent but also when the business operator was unaware that the matter was untrue. Accordingly, no proof that the business operator was aware that the contents was untrue or had the intent of deceiving the consumer is required.

However, statements regarding subjective assessment which cannot be determined by the objective fact whether it was not true (such as “this is a good buy”) are construed not to be an untrue representation. In any event, sales representatives shall fully understand the content of the instrument and be careful about their language and behavior upon soliciting customers to avoid making statements about the product that can be thought of as untrue.

(ii) Provision of Conclusive Evaluations

To provide conclusive evaluations of future prices, amounts of money that a consumer shall receive in the future or such other uncertain items that change in the future with respect to goods, rights, services and other subjects of a consumer contract, and thereby causing the consumer to misunderstand that the contents of the conclusive evaluations provided is certain (Consumer Contract Act, art. 4, para. 1, item 2).

It shall be noted that the willful intent of the business operator is not required as was in the untrue representation in (i) above.

(iii) Willful Failure to Represent Disadvantageous Facts

To represent the consumer the advantages as to important matters or matters related to the said important matters but intentionally fails to represent disadvantageous facts (limited to those facts that consumers would normally consider to be non-existent by such representation), and thereby cause the consumer to misunderstand that such fact does not exist (Consumer Contract Act, art. 4, para. 2).

(iv) Business Operator’s Failure to Leave

To fail to leave a place where the consumer resides or does business in defiance of the consumer’s request to the business operator to leave such place, and thereby cause distress to the consumer (Consumer Contract Act, art. 4, para. 3, item 1).

(v) Obstruction of Leave

Not to allow a consumer to leave a place where the consumer is solicited to enter into the consumer contract by the business operator in defiance of the consumer’s request to leave the place, and thereby cause distress to the customer (Consumer Contract Act, art. 4, para. 3, item 2).

(vi) Transaction of Excessive Volume

To solicit a consumer while knowing that the volume, number of times, or period (hereinafter “volume, etc.”) of goods, rights, services or other objects of the consumer contract considerably exceeds the normal volume, etc. for the consumer (meaning the volume, etc. that is normally assumed as the volume, etc. of objects of the consumer contract in light of the details and the conditions of transaction of the objects of the consumer
contract, while also taking into account the living conditions of the consumer at the time of being solicited by the business operator to conclude the consumer contract and the consumer’s awareness thereof), and thereby cause the consumer to manifest the intention to offer or accept the consumer contract (Consumer Contract Act, art. 4, para. 4, first sentence).

(vii) Transaction of Excessive Volume under Contract of the Same Type

To solicit a consumer while knowing that the consumer has already concluded a consumer contract for the same type of objects as the objects under the consumer contract subject to the solicitation (hereinafter referred to as a “contract of the same type” in this paragraph), and that the sum of the volume, etc. of the objects under the contract of the same type and the volume, etc. of the objects under the contract subject to the solicitation considerably exceeds the normal volume, etc. for the consumer, and thereby cause the consumer to manifest the intention to offer or accept the consumer contract (Consumer Contract Act, art. 4, para. 4, second sentence).

(2) Manner of Exercise of Right of Rescission; Exercise Period

There are no special provisions under the Consumer Contract Act with respect to the manner of exercise of the right of rescission by consumers, and the consumer shall notify the counterparty his or her intent to rescind the manifestation of intent pursuant to Article 123 of the Civil Code. Assertion is not necessarily required to be made at the court. The manifestation of intent of rescission is limited to the consumer manifesting such intent or his or her agent or successor (Civil Code, art. 120, para. 2).

The right of rescission pursuant to the Consumer Contract Act shall extinguish if not exercised within one year of the time when it could have been ratified, or after five (5) years from the execution of the consumer contract (Consumer Contract Act, art. 7).

(3) Effect of Rescission

If a consumer exercises the right of rescission, the contract will become null retroactively (Civil Code, art. 121). If a consumer received performance of an obligation under the consumer contract and did not know, at the time of receiving performance, that he/she may rescind the manifestation of intention, the consumer has an obligation to reimburse only to the extent that he/she is actually enriched as a result of the consumer contract (Consumer Contract Act, art. 6-2).

Specifically, if a consumer exercises the right of rescission with respect to an investment trust solicited by a financial instruments business operator and acquired by the customer by reason of untrue representation in the solicitation act, the entire amount delivered by the customer to the financial instruments business operator at the time of acquisition of the investment trust will be returned to the customer, and procedures to receive the return of beneficiary rights of the investment trust from the customer (specifically, making instructions for transfer through the financial instruments business operator that is the account management organization) will be taken.
The rescission may not be asserted to a conscientious third party (Consumer Contract Act, art. 4, para. 6).

Nullification of Contract Pursuant to the Consumer Contract Act

In view of the difference in the quality and quantity of information and powers of negotiation between business operators and consumers in consumer contracts, it is not appropriate to conclude a contract including clauses that harm the interests of consumers one-sidedly. Article 10 of the Consumer Contract Act nullifies such clauses.

Contractual clauses that shall be nullified under the Consumer Contract Act are: (i) clauses exempting business operators from the compensation liability for damages not attributable to the consumer (Consumer Contract Act, art. 8), (ii) clauses causing consumers to waive their right of cancellation (right of cancellation arising due to the default by the business operator or latent defect in the objects of the contract; Consumer Contract Act, art. 8-2); (iii) clauses predetermining the amount of compensation for damages paid by consumers (Consumer Contract Act, art. 9) and (iii) clauses harming the interests of consumers one-sidedly (id., art. 10).

Among these provisions of the Consumer Contract Act, Article 10 is a general provision, and the amended version thereof mentions, as an example, “clauses which deem a consumer to have manifested the intention to offer or accept a new consumer contract by reason of the consumer’s inaction.” However, what clause actually falls under this Article should be determined on a case-by-case basis.

Among these, with respect to provisions falling under Article 9, the entire provision does not become null but only the excessive part becomes null according to the Article.

Relation with the FISA

Both the FISA and the Consumer Contract Act function as special provisions to the Civil Code, but the same act is considered to be subject to both Acts redundantly.

For example, with respect to the provision of conclusive evaluations, under the Consumer Contract Act, the misunderstanding of a consumer is required, but under the FISA, the provisions regarding compensation liability and the presumption of causality and amount of damages apply to the provision of conclusive evaluations even when consumers did not misunderstand. The customer may select to assert the provision advantageous to it.
The Act on Protection of Personal Information provides for the obligations concerning protection of personal information with which business operators should comply in accordance with the content of the information. It should be noted that even in the case of dealing with a corporate customer such as a company, the information concerning the company’s employee in charge falls within the scope of personal information, and improper handling of personal information is subject to penalties under the relevant guidelines as well as under this Act.

Outline and Purpose

Association Members who fall under business operators handling personal information must comply with the obligations of business operators handling personal information as prescribed by the Act on Protection of Personal Information (hereinafter referred to as the “PPIA”) in accordance with the PPIA and the “Guidelines for the Protection of Personal Information in the Financial Field” (hereinafter referred to as the “Guidelines for the Financial Field”), “Practical Guidance on Safety Management Measures for the Guidelines on the Protection of Personal Information in the Financial Field” (hereinafter referred to as the “Safety Management Practical Guidelines”). The Personal Information Protection Commission was established as of January 1, 2016, to put in place a system of centralized supervision of personal information handling business operators by the Commission. It should be noted that the amendment to the PPIA, which came into effect on May 30, 2017, has additionally included information containing an individual identification code (information relating to a living individual whereby a specific individual can be identified) in the scope of personal information. The amendment has also introduced a wide range of changes, including: a new provision concerning anonymously processed information, a new provision concerning special care-required personal information, additional obligations such as an obligation to make a notification concerning the opt-out procedure, a new obligation to confirm and record matters regarding the provision of personal data to a third party or receipt of personal data provided by a third party (third-party provision), and new rules concerning the provision of personal data to a third party in a foreign country. The Personal Information Protection Commission has published the “Guidelines for the Act on the Protection of Personal Information (Volume on General Rules)” and other sets of guidelines and Q&A materials. In practically handling personal information, it is important to make reference to these guidelines and materials.
Coverage and Scope of Application

The PPIA covers “Personal Information,” “Personal Data,” “Retained Personal Data,” “Special Care-Required Personal Information,” and “Anonymously Processed Information.” In addition, the PPIA specifies a person’s fingerprints, palm prints, iris patterns, individual number (My Number), basic pension number, and the like as an individual identification code which independently allows a specific person to be identified, and includes information containing an individual identification code in the scope of personal information (PPIA, art. 2, para. 2; PPIA Enforcement Order, art. 1).

The PPIA requires strict handling on such occasions as acquiring or using Special Care-Required Personal Information or providing it to a third party (PPIA, art. 2, para. 3, PPIA Enforcement Order, art. 2). In addition to the regulations under PPIA, Financial instruments business operators who are business operators handling personal information are placed under special regulations, such as regulations concerning “Sensitive Information.”

Obligations Regarding “Personal Information”

“Personal Information” refers to information about a living individual which can identify the specific individual by name, date of birth or other description contained in such information.

Information that cannot identify a specific individual but will allow easy reference to other information and will thereby enable the identification of the specific individual is also considered personal information.

Obligations regarding personal information under the PPIA include the specification of the purpose of utilization (PPIA, art. 15), restriction by the purpose of utilization (PPIA, art. 16), proper acquisition (PPIA, art. 17) and notice of the purpose of utilization at the time of acquisition (PPIA, art. 18).

(1) Specification of the Purpose of Utilization (PPIA, art. 15)

A business operator handling personal information must specify the purpose of utilization of personal information as much as possible when handling personal information (PPIA, art. 15, para. 1). The Guidelines for the Financial Field provides that it is desirable to specify the purpose of utilization after presenting the financial instruments or services that will be provided (Guidelines for the Financial Field, art. 2, para. 1).

In addition, when changing the purpose of utilization specified without the consent of the person, the purpose of utilization shall not be changed beyond the scope which is reasonably considered that the purpose of utilization after the change is related to that before the change (PPIA, art. 15, para. 2).
(2) Restriction by the Purpose of Utilization (PPIA, art. 16)

A business operator handling personal information must not handle personal information about a person, without obtaining the prior consent of the person, beyond the scope necessary for the achievement of the purpose of utilization specified (PPIA, art. 16, para. 1).

However, such restrictions do not apply to certain cases such as cases in which the handling of personal information is based on laws and regulations, or necessary for the protection of the life, body, or property of an individual, etc. and where it is difficult to obtain the consent of the individual (PPIA, art. 16, para. 3).

(3) Notification of the Purpose of Utilization at the Time of Acquisition, Etc. (PPIA, art. 18)

When having acquired personal information stated in a contract or other document, etc. in connection with the conclusion of a contract or otherwise acquired personal information stated in a document directly from the person, the business operator handling personal information shall expressly indicate the purpose of utilization in advance (PPIA, art. 18, para. 2). In addition, if it shall acquire personal information by other means, it shall promptly notify the person of the purpose of utilization or publicly announce the purpose of utilization except in cases which the purpose of utilization has already been publicly announced (PPIA, art. 18, para. 1).

Normally, the obligations under this Article shall be sufficiently met by publishing the purpose of utilization on the website.

3 4 Obligations Regarding “Personal Data”

“Personal Data” refers to personal information constituting a personal information database, etc. with respect to personal data, obligations regarding the assurance, etc. of accuracy of data (PPIA, art. 19), security control measures (PPIA, art. 20), supervision of employees (PPIA, art. 21), supervision of trustees (PPIA, art. 22) and the restriction of provision to a third party (PPIA, art. 23) are provided.

(1) Security Control Measures (PPIA, art. 20), Supervision of Employees (PPIA, art. 21), Supervision of Trustees (PPIA, art. 22)

A business operator handling personal information shall take necessary and proper measures for the prevention of leakage, loss or damage, and for other security control of the personal data it handles (hereinafter referred to as “security control measures”).

As security control measures, the Security Control Practical Guidelines provide in detail with respect to the preparation of basic policies and handling regulations, etc. concerning the security control of personal data, organizational, personnel and technical security control measures concerning the preparation of a system for implementation concerning security control measures of personal data, supervision of employees and supervision of trustees.

For example, with respect to the supervision of an entrusted party, the Security Control
Practical Guidelines provide that the (i) authority of the entrusting party concerning supervision, audit and requesting of reports from the entrusted party, (ii) prohibition of leakage, fraudulent use, falsification and utilization outside the purposes by the entrusted party, (iii) conditions for re-entrustment and (iv) liability of the trustee upon occurrence of cases of leakage, etc. in the entrustment contract (Security Control Practical Guidelines 5-3).

(2) Restriction of Provision to a Third Party (PPIA, art. 23)

A business operator handling personal information must not provide personal data to a third party without obtaining the prior consent of the Person; provided, however, such restrictions do not apply in certain cases such as cases in which the provision of personal data is based on laws and regulations, or necessary for the protection of the life, body, or property of an individual, etc. (PPIA, art. 23, para. 1).

There are other exceptions to the restrictions under this Article. In cases where a business operator handling personal information entrusts the handling of personal data within the scope necessary for the achievement of the purpose of utilization, or cases where personal data is provided as a result of the succession of business in a merger or otherwise, a person who receives the personal data shall not be considered to be a “third party” (PPIA, art. 23, para. 5, item 1 and item 2). The same applies in cases where personal data is used jointly and where the items of personal data used jointly, the scope of the joint users, the purpose for which the personal data is used by the joint user and the name of the person responsible for the management of personal data are notified to the Person in advance or put in a readily accessible condition for the Person (e.g., published on a website) (generally referred to as the joint use system; PPIA, art. 23, para. 5, item 3). In these cases, the provision of personal data to the recipient does not constitute the provision to a third party and therefore it is allowable without the Person’s prior consent.

In addition, when a business operator handling personal information has discontinued the provision of personal data identifying a Person to a third party at the request of the Person and notifies the following matters to the Person in advance or puts the same in a readily accessible condition for the Person, provide such personal data to a third party. This is known as an “opt-out”:

- That the purpose of utilization is the provision to a third party;
- The items of personal data provided to a third party;
- The method of provision to a third party;
- That the provision of personal data identifying the Person shall be discontinued at the request of the Person; and
- The method of receiving the Person’s request.

The PPIA does not allow an opt-out regarding special care-required personal information. Furthermore, “measures to inform the Person in advance of the matters concerning the provision of his/her personal data to a third party or measures to put these matters into a state where the Person can easily know them” are to be implemented by giving the Person time necessary to demand cessation of the provision of the personal data to a third party and by employing an appropriate and reasonable method that ensures that the Person can become aware of the relevant
matters (PPIA Enforcement Ordinance, art. 7). In addition, the business operator that implements the opt-out procedure must in advance notify the Personal Information Protection Commission of this fact, which then discloses the fact to the public on its website (PPIA, art. 23, para. 3 and para. 4).

Except in cases that fall under the items of Article 23, Paragraph 1 or the items of Paragraph 5 of the said Article, a personal information handling business operator, when providing personal data to a third party or receiving personal data provided by a third party, must prepare and preserve records concerning such provision or receipt of personal data to a third party that includes information such as the date of provision or receipt of the personal data, the name of the third party, and other matters (PPIA, art. 25, para. 1 and para. 2).

<table>
<thead>
<tr>
<th>Column: Obligations to Confirm and Record Matters Related to Third-Party Provision</th>
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<tbody>
<tr>
<td>The amendment to the PPIA introduced new obligations to confirm and record matters related to the third-party provision of an individual’s personal data. Special attention should be paid to the obligation to record, because different matters are required to be recorded according to the respective types of cases shown below (PPIA, art. 25, para. 1 and para. 2).</td>
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<Matters to be recorded when providing personal data to a third party>|
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<thead>
<tr>
<th>Date of provision</th>
<th>Name, etc. of the third party</th>
<th>Name, etc. of the individual</th>
<th>Items of personal data</th>
<th>Individual’s consent</th>
</tr>
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<tbody>
<tr>
<td>(i) Providing personal data to a third party with the individual’s consent</td>
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<tr>
<td>(ii) Providing personal data to a third party through the opt-out procedure</td>
<td>Required</td>
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<Matters to be recorded when receiving personal data provided by a third party>|
<table>
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<tr>
<th>Date of receipt</th>
<th>Name, etc. of the third party</th>
<th>Circumstances of acquisition</th>
<th>Name, etc. of the individual</th>
<th>Items of personal data</th>
<th>Disclosure by the Commission</th>
<th>Individual’s consent</th>
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<tr>
<td>(i) Receiving personal data provided by a third party with the individual’s consent</td>
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<td>(iii) Receiving personal data provided by a third party that is a private person, etc., (not a personal information handling business operator)</td>
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In addition to the cases prescribed in the items of Article 23, Paragraph 1 or Paragraph 5 of the PPIA, keeping records of these matters is not required in cases where the individual provides his/her personal data (e.g. an individual posts information on a social media website operated by a business operator, thereby making the individual’s personal data automatically available to a large number of unspecified persons) or a personal information handling business operator provides an individual’s personal data on his/her behalf (e.g. in response to an individual’s order of money transfer to another individual’s account, the sending bank provides the information regarding the transfer to the receiving bank at which the recipient...
holds the account) (Guidelines for the Protection of Personal Information (Obligations to Confirm and Record Matters at the Time of Third-Party Provision of Personal Data), 2-2-1-1). If the individual gives consent to the provision of his/her personal data, a contract or any other document in which the relevant matters are stated may substitute for a record of these matters (PPIA Enforcement Ordinance, art. 12, para. 3 and art. 16, para. 3).

3 5 Obligations Regarding “Retained Personal Data”

“Retained Personal Data” refers to such personal data over which a business operator handling personal information has the authority to disclose, correct, add or delete the content, discontinue its utilization, erase and to discontinue the provision to a third party, excluding data which is specified by Cabinet Order as harming public interests or other interests if its presence or absence is known, and data which will be erased within six months (PPIA, art. 2, para. 7; PPIA Enforcement Order, art. 5).

With respect to “Retained Personal Data,” obligations regarding the public announcement of matters concerning retained personal data, etc. (PPIA, art. 27), disclosure at the request of the person (PPIA, art. 28), correction at the request of the Person (PPIA, art. 29), discontinuance of the utilization, etc. at the request of the Person (PPIA, art. 30), explanation of reasons at the request of the Person (PPIA, art. 31) are provided.

Personal information concerning anti-social forces fall under Article 4, Item 2 of the Enforcement Order for the PPIA (information that may enhance or invoke illegal or unfair acts if the existence or absence thereof becomes known) if they may enhance or invoke illegal or unfair acts such as unfair requests, etc. in cases where the possession thereof by the business operator becomes known, and is considered to be excluded from retained personal data pursuant to Article 2, Paragraph 7 of the PPIA. Accordingly, such personal information is not subject to the obligations under this Article, and it is considered that the name of the business operator handling such personal information, the purpose of utilization and procedures, etc. for disclosure, etc. does not need to be published, etc.

3 6 Obligations Regarding “Special Care-Required Personal Information” and “Sensitive Information”

“Special Care-Required Personal Information” refers to personal information comprising a Person’s “race,” “creed,” “social status,” “medical history,” “criminal record,” “fact of having suffered damage by a crime,” or “other descriptions etc. prescribed by Cabinet Order as those for which the handling requires special care so as not to cause unfair discrimination, prejudicial treatment or other disadvantages to the Person” (PPIA, art. 2, para. 3).
Descriptions, etc. prescribed by Cabinet Order include the following: a fact that the Person has a certain type of physical or psychological disability; the results of health checkups; a fact that the Person has received guidance for improvement of health conditions, medical examination or prescription of drugs from physicians or other medical care professionals; a fact that the Person, as a suspect or accused person, has been subject to arrest, search, seizure, detention, public prosecution, or any other procedure in a criminal case; and a fact that the Person has been subject to investigation, probation, hearing, protective measures, or any other procedure in a juvenile protection case under the Juvenile Act (PPIA Enforcement Order, art. 2).

In principal, acquisition of Special Care-Required Personal Information requires the Person’s consent, except in special cases such as where acquisition is based on laws and regulations or where acquisition is necessary to protect a human life, body or fortune, and it is difficult to obtain the Person’s consent (PPIA, art. 17, para. 2). It is prohibited to provide Special Care-Required Personal Information to a third party through the opt-out procedure; the Person’s consent is required for such provision to a third party except in cases prescribed in the items of Articles 23, Paragraphs 1 and 5 of the PPIA.

“Sensitive Information” is defined as including “Special Care-Required Personal Information” and information on an individual’s affiliation to a labor union, family origin, registered domicile, health care record, and sexual life (excluding information on any of these matters that falls within the category of Special Care-Required Personal Information)” (excluding: information disclosed by the individual, or by a certain scope of entities such as a State organ, a local public entity, a broadcasting organization, a newspaper company, a news agency, or any other news media; and information that is obvious from the appearance of the individual and can be acquired by visual inspection or visual recording).

Association Members that fall within the category of personal information handling business operators in the financial field are prohibited from acquiring or using sensitive information or providing it to a third party except in cases where such activities are based on laws and regulations or are necessary to protect the life, body or property of a person (Guidelines for the Financial Field, art. 5). Attention should be paid to the fact that the Guidelines for the Financial Field do not allow them to acquire or use Sensitive Information or provide it to a third party even with the consent of the individual concerned.

### 3 7 Corporation Information, Public Information, and Other Information

Information of corporations is not subject to the PPIA and the Guidelines for the Financial Field, but it shall be noted that information identifying the representative of the corporation or individual in charge of the transaction is considered personal information.

In addition, the PPIA does not distinguish public and non-public information, so it must be noted that the Act does not only protect non-public information. Accordingly, public information is considered personal information so long as it falls under the definition of personal information.
Financial instruments business operators are required to ensure the proper management of information regarding individual customers (FIBCOO, art. 123, para. 1, item 6 and item 7). The FSA’s supervisory guidelines indicate that information relating to customers (including juridical persons) constitutes the basis of financial instruments transactions and therefore it is extremely important to ensure its appropriate management, thus requiring the establishment of an appropriate control environment for the management of customer information (Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., III-2-4). It should be noted that from the perspective of preventing insider trading and any other unfair acts, the guidelines require financial instruments business operators to establish systems to adequately manage corporation-related information (FIBCOO, art. 1, para. 4, item 14 and art. 123, para. 1, item 5), which is also included in the scope of supervisory viewpoints.

**3 My Number Act**

On January 1, 2016, the Act on the Use of Numbers to Identify a Specific Individual in the Administrative Procedure (generally called the “My Number Act”) came into effect and the My Number (social security and tax number) system was put into practice. This system is designed to manage information on individuals efficiently in terms of social security, taxation and disaster control and make it possible to link pieces of information retained by multiple bodies on each individual together by means of the number assigned to the individual and thereby ascertain that these pieces of information pertain to that individual. It is expected to serve as social infrastructure to improve administrative efficiency, enhance public convenience and realize a fairer and just society.

From October 1, 2015, each individual with a resident record has been notified of a 12-digit “individual number” (“My Number”) and each corporation has been notified of a 13-digit “corporate number.” While individual numbers are not disclosed and the acquisition, use and management thereof are subject to strict restrictions, corporate numbers are made public, with no restriction on the scope of use or user.

Business operators who are “persons in charge of affairs related to individual numbers” (Association Members normally fall within this category of persons in relation to payment of salaries to their employees) will be required to enter individual numbers of their employees in documents that they are obligated to file in the taxable period that commences on or after January 1, 2016 (initially, these documents will be limited to those concerning taxation, social security and disaster control, such as a withholding certificate and payment report to be issued for employment income). To fulfill this obligation, business operators need to be informed by the employees of their individual numbers. In order to receive information on employees’ individual numbers, business operators will be required to notify the employees or give public notice of the purpose of use of the individual numbers, and they will also be required to confirm the employees’ identity by a prescribed procedure whenever they receive the said information (art. 16).
Individual numbers must be strictly managed and must not be used for purposes other than statutory purposes. The measures necessary for appropriate management of individual numbers, such as prevention of divulgation, loss, or damage of individual numbers, are required to be taken (art. 12). “Specific personal information,” which contains individual numbers, is likely to be used for name-based aggregation of information and therefore it is subject to strict protective measures as provided in the Act on Protection of Personal Information. Accordingly, the My Number Act restricts the provision of specific personal information (art. 19) and prohibits any person from collecting or keeping specific personal information for purposes other than statutory purposes (art. 20).

If a person who is currently or was formerly engaged in the affairs involving individual numbers, for the purpose of acquiring a wrongful gain for him/herself or for a third party, provides or misappropriates an individual number that the person has learnt in the course of his/her duties, the person shall be punished by imprisonment with work for not more than three years or a fine of not more than JPY 1.5 million, or both. If such person, without justifiable grounds, provides a third party with a specific personal information file in which any individual’s confidential matters that the person handles in his/her duties are recorded, the person shall be punished by imprisonment with work for not more than four years or a fine of not more than JPY 2 million, or both.

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4 Act on Prevention of Transfer of Criminal Proceeds

The Act on Prevention of Transfer of Criminal Proceeds (hereinafter referred to as the “CPTPA”) has been established for the prevention of legitimization of money obtained through criminal activities (money laundering) and financing of terrorists. In principle, when financial instruments business operators conclude contracts upon the first sale of financial instruments, etc., they should conduct identity verification upon transaction with regard to certain matters concerning customers, and if they find suspicious transactions, they should report without notifying the counterparty to the transaction and other parties concerned. The amendment to the CPTPA, which came into effect as of October 1, 2016, requires financial instruments business operators to take the following measures: clarify the method for determining suspicious transactions; implement strict identity verification upon transactions with foreign PEPs (politically exposed persons); introduce a stricter method for verifying the identity of substantial controllers of corporate customers; provide education and training for their employees; establish rules for the implementation of the procedures for verification upon conducting transactions; appoint persons responsible for supervising and managing an audit and other operations necessary for the proper implementation of such procedures.
Outline and Purpose

The CPTPA is a law which aims to prevent the transfer of criminal proceeds to preclude money laundering as well as to ensure the appropriate enforcement of international treaties, etc. concerning the prevention of terrorism financing, and, thereby, to ensure the safety and peace of national life and to contribute to the sound development of economic activities.

Accordingly, when Association Members engage in certain types of transactions, they are subject to the (i) obligation to conduct identity verification upon transaction, (ii) obligation to prepare and retain verification records, (iii) obligation to prepare and retain transaction records, etc. and (iv) obligation to notify suspicious transactions. In addition to the CPTPA, the “Foreign Exchange and Foreign Trade Act (Act No. 228 of December 1, 1949)” (hereinafter referred to as the “FEA”) imposes customer identification obligations (FEA, art. 22-2).

Obligation to Conduct Identity Verification upon Transaction

An Association Member must conduct identity verification upon transaction with regard to identification data of a customer when it enters into the first contract whereby the customer is to acquire securities (CPTPA, art. 4, para. 1; CPTPA Enforcement Order, art. 7, para. 1, item 1(i)). The name of this procedure was changed from “customer identification” to “identity verification upon transaction” after the amendment to the CPTPA came into force on April 1, 2013.

Association Members must verify: (i) identification data of the customer (the name, address and date of birth in the case of an individual except for certain foreign nationals, and the name and location of the head office or main office in the case of a corporation); (ii) the purpose of conducting the transaction; (iii) occupation (in the case of an individual customer) or business description (in the case of a corporate customer); and (iv) if the customer, etc. is a corporation and there is a substantial controller thereof (a person who is in a relationship that allows such person to have substantial control of the corporation, as specified by Article 11, Paragraph 2 of CPTPA Enforcement Ordinance), the identification data of the said person. These matters should be verified by means such as receiving presentation or delivery of identification documents (CPTPA, art. 4, para. 1).

If Association Members engage in any of the following transactions, which are recognized as high-risk transactions, they should conduct strict identity verification upon transaction: (i) a transaction with a party who is suspected of pretending to be the customer, etc.; (ii) a transaction with a customer, etc. who is suspected of having given false information concerning the matters for identity verification; (iii) a transaction with a person who resides or is located in Iran or North Korea, or a transaction which involves the transfer of property to a person who resides or is located in Iran or North Korea; (iv) a transaction with the Head of a foreign state, and a person specified in Article 15 of the CPTPA Enforcement Ordinance as those entrusted with prominent...
public functions at a foreign government, central bank or any other similar organization or a person who previously held any of these posts; (v) a transaction with a family member (the spouse (in legal or common-law marriage; the same applies in (v)), a parent, child or sibling, or a parent or child of the spouse) of any of the persons mentioned in (iv); and (vi) a transaction with a corporation under substantial control of any of the persons mentioned in (iv) or (v) (CPTPA, art. 4, para. 2; CPTPA Enforcement Order, art. 12; CPTPA Enforcement Ordinance, art. 15). Among these, the transactions mentioned in (i) and (ii) require verification of identification data by a method different from the method applied when conducting the initial verification. Furthermore, if the transaction involves the transfer of property of a value exceeding two million yen, the status of the assets and income of the customer, etc. should also be verified (CPTPA Enforcement Order, art. 11).

Identification documents include, in the case of an individual, a driver’s license, resident card, certificate of special permanent residence, individual number card, various types of health insurance card, and national pension book (each item of the CPTPA Enforcement Ordinance, art. 7).

It must be noted that in principle, the identification documents must be effective as of the date of presentation of delivery for certificates with expiration dates, or prepared within six months of the date of presentation or delivery for certificates without expiration dates (CPTPA Enforcement Ordinance, art. 7, main paragraph).

Where an agent shall conduct a transaction, identity verification upon transaction must be conducted with regard to the agent in addition to the Person. Similarly, when an accounting staff of a company opens a deposit account on behalf of the company, identity verification upon transaction with regard to the accounting staff is also required (CPTPA, art. 4, para. 4).

If identity verification upon transaction with regard to the customer who is the prospective counterparty to a transaction has already been conducted, and verification records regarding the customer are retained, there is no need to conduct additional identity verification upon transaction if it is confirmed that the customer is the same person as the person recorded in the verification records by receiving the presentation, etc. of documents, etc. which indicate that the customer is the same person as the person recorded in the verification records, or hearing matters, etc. that could only be known by the customer (there is no need to even conduct such confirmation procedures if the business operator knows the customer in person or it is otherwise apparent that the customer is the same person as the person recorded in the verification records) (CPTPA, art. 4, para. 3; CPTPA Enforcement Order, art. 13, para. 1, main paragraph).

However, for high-risk transactions, identity verification upon transaction must be conducted additionally even if identity verification upon transaction was already conducted.

Obligation to Prepare and Retain Verification Records

After conducting identity verification upon transaction, an Association Member must
immediately prepare verification records and retain the same for seven years from the date of
termination of the transaction under the contract or the date of termination of the transaction for
which identity verification upon transaction has been completed, whichever comes later (CPTPA,
art. 6; CPTPA Enforcement Ordinance, art. 21).

The verification record shall include the name of the person conducting the identity
verification upon transaction, the person preparing the verification records, the date of
presentation of the identification documents, etc., the type of transactions regarding which the
identity verification upon transaction was conducted and the method of verification, etc. (CPTPA
Enforcement Ordinance, art. 20).

4 4 Obligation to Prepare and Retain Transaction Records, Etc.

After conducting a transaction pertaining to the specified service with a customer, an
Association Member must immediately prepare transaction records and retain the same for seven
years from the date on which such transaction was conducted (CPTPA, art. 7).

However, there is no need to retain transaction records under certain cases such as
transactions without the transfer of property, or transactions with the transfer of property for
which the value thereof is JPY10,000 or less (CPTPA Enforcement Order, art. 15, para. 1).

4 5 Obligation to Report Suspicious Transactions

An Association Member must examine whether the property received from a customer is
suspected to have been criminal proceeds, or whether a customer is suspected to have been
disguising facts with respect to the acquisition or disposition of criminal proceeds or hiding
criminal proceeds. If such suspicion is found, the Association Member must promptly submit a
report of suspicious transactions to the Financial Services Agency (CPTPA, art. 8).

The matters to be reported are: (i) name and location of the reporter, (ii) date and place of the
suspicious transaction, (iii) description of business, (iv) contents of the property concerning the
transaction, (v) name and address of the customer or representative, etc. and (vi) reason for
submitting the report (CPTPA Enforcement Order, art. 16, para. 2).

Whether a transaction falls within the category of suspicious transaction must be determined
by taking into consideration the result of the identity verification upon transaction, the details and
other circumstances of the transaction, and the annual report on the risk of transfer of criminal
proceeds (CPTPA, art. 3, para. 3), focusing on the prescribed matters to be verified and employing
the prescribed methods of verification (CPTPA Enforcement Order, art. 26 and art. 27).

For this purpose, “criminal proceeds” not only include criminal proceeds directly
acquired through crimes, but also property acquired as consideration for criminal proceeds and property acquired based on the retention or disposition of criminal proceeds. For example, the interest on deposits of criminal proceeds or proceeds acquired through the sale of stolen goods is included in “criminal proceeds.”

In addition, whether a transaction is “suspicious” shall be determined by the officers or employees of the Association Member in comprehensive consideration of the form of the transaction, customer attributes and circumstances upon the transaction, etc. on the premise of general knowledge and experience in the financial industry. However, there is no need to recognize the existence of a specific crime, but only the suspicion of some crime which invokes the suspicion that the property is “proceeds from crime” is considered to be sufficient.

An Association Member shall not divulge the fact that a report on suspicious transactions will be or has been made to the customer pertaining to such suspicious transaction or persons related to the said customer (CPTPA, art. 8, para. 3).

4. Obligation to Develop Necessary Systems

In order to appropriately take measures such as identity verification upon transaction, preservation of transaction records, etc. and reporting of suspicious transactions, an Association Member is required to (i) take measures to keep information up-to-date concerning the matters for identity verification upon transaction, and is also required to endeavor to: (ii) implement education and training for its employees; (iii) establish rules for the implementation of the procedures for verification upon conducting transactions; (iv) appoint a manager responsible for the necessary procedures; (v) prepare documents that are required to be prepared by specified business operators and make changes thereto if necessary; (vi) collect, organize and analyze information required for measures such as identity verification upon transaction; (vii) conduct continuous scrutiny of verification records and transaction records; (viii) require a manager’s approval for conducting a high-risk transaction; (ix) collect, organize and analyze information on high-risk transactions, and prepare and preserve documents regarding the analysis results; (x) employ personnel equipped with necessary capabilities; and (xi) conduct an audit regarding identity verification upon transaction, etc. (CPTPA, art. 11; CPTPA Enforcement Ordinance, art. 32; the activities mentioned in (vi) and (vii) should be carried out by taking into account the content of the documents prepared by specified business operators).

Column: FATF Recommendations and the CPTPA

The FATF (Financial Action Task Force), an inter-governmental body established by the agreement at the Arch Summit in 1989, has published “Forty recommendations” and “Nine special recommendations,” and the government of each country shall promote their
anti-money laundering measures in accordance therewith. The FATF also conducts mutual
evaluation on the status of compliance with these recommendations.

However, the results of the third mutual evaluation of Japan published in October 2008
presented harsh assessment on Japan’s response to the FATF recommendations as being
“non-compliant” on customer management mainly due to insufficiency in the legislative
response. Accordingly, the Metropolitan Police Department has established a council by
intellectuals to deliberate on the direction in the future and proceeded with the deliberation.
On July 20, 2010, the Metropolitan Police Department issued the “Report of the Council
Regarding the Manner of Customer Management by Operators as Anti-Money Laundering
Measures.”

This report shows the results of the deliberation that transactions with a high risk of
money laundering shall be obligated under laws and regulations, and shall be responded by
legislation although the manner of the provisions of such laws and regulations will require
ingenuity. Following this, the law for amendment of the CPTPA was enacted, and was
promulgated as of April 28, 2011, and put into effect as of April 1, 2013.

Yet, the FATF pointed out that the situation in Japan was still below the required level,
although some improvements had been made. On June 12, 2013, the Council Regarding
Anti-Money Laundering Measures was launched, and experts carried on discussions with an
eye toward implementing system reforms to achieve the level of customer management as
required by the FATF. As a result of this discussion process, the Council released a report on
July 17, 2014. Following this report, the amendment to the CPTPA was promulgated on
November 27, 2014, and put into effect in full on October 1, 2016.

Thus, the FATF recommendations are closely related to the amendments to the CPTPA
that have been made several times thus far. Association Members should continue to pay
attention to amendments to be made to the CPTPA in the future. With the FATF’s fourth
mutual evaluation of Japan being scheduled in 2019, it is hoped that Association Members
will take effective anti-money laundering measures. On February 6, 2018, the FSA published
the “Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism,” in
which it clarified the “required actions” and “expected actions” to be taken by financial
institutions in order to ensure that the measures to prevent money laundering and combat the
financing of terrorism through the risk-based approach will effectively function. The FSA has
stated that it will conduct monitoring in accordance with these Guidelines, while pointing out
that financial institutions should also pay attention to other regulatory documents, including
the supervisory guidelines, the “Points to Note regarding the Criminal Proceeds Act” and the
“List of Reference Cases of Suspicious Transactions.”
Chapter 4  Articles of Association and Various Rules of the Association

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Overview of the Japan Securities Dealers Association

The Japan Securities Dealers Association (hereinafter the “JSDA”) is the juridical person (authorized financial instruments firms association) that has received authorization from the Prime Minister under Article 67-2, Paragraph 2 of the Financial Instruments and Exchange Act (hereinafter the “FIEA”), and is organized from persons that are registered with the Prime Minister under FIEA, Article 29 and carry on a type I financial instruments business under FIEA, Article 28, Paragraph 1, and financial institutions registered with the Prime Minister under FIEA, Article 33-2 (hereinafter referred to as “registered financial institutions”).

Types of Association Members

There are three categories of Association Members. These are:

(1) **Regular Members**: Among the financial instruments business operators, those who conduct the type I financial instruments business (Note 1) (excluding the business related to OTC financial futures transactions, etc. and transactions set forth in FIEA, Article 2, Paragraph 22, Item 4 (limited to transactions pertaining to a currency), (Note 2) or intermediary, brokerage or agency service thereof) (excluding those who only conduct the business set forth in (2)(a) or (b))

(2) **Specified Business Members**: Among financial instruments business operators, those who conduct only either of the following in the type I financial instruments business:

(a) Business related to specified OTC derivatives transactions, etc.; (Note 3)

or

(b) Type I small amount electronic offering handling business prescribed in FIEA, Article 29-4-2, Paragraph 10. (Note 4)

(3) **Special Members**: Registered financial institutions

(Notes) 1. From among financial instruments businesses, meaning those conducting any of the following acts in the course of trade: (i) with regard to securities with high market liquidity, (a) sale and purchase, market derivatives transactions or foreign market derivatives transactions, (b) intermediary, brokerage or agency service for sale and purchase, market derivatives transactions or foreign market derivatives transactions, (c) intermediary, brokerage or agency service for entrustment of sale and purchase, market derivatives transactions or foreign market derivatives transactions, (d) brokerage for clearing of securities, etc., (e) secondary distributions, and (f) handling of public offerings, secondary distributions or
The purposes of the JSDA are to ensure fair and smooth sale and purchase or other transactions of securities, etc. conducted by Association Members and sound development of the financial instruments business and thereby contribute to investor protection (Articles of Association, art. 6).

Main Functions of the Japan Securities Dealers Association

To achieve the above-mentioned purposes, the JSDA engages in the following functions:
2 1 Self-Regulatory Functions

(1) Enactment and Implementation of Self-Regulatory Rules

By enacting and enforcing the various self-regulatory rules to which the Association Members are subject, together with seeking to make financial instruments trading more fair and efficient, the JSDA strives for the protection of investors.

(2) Implementation of Inspections and Monitoring

The JSDA periodically conducts inspections of the Association Members to verify the status of their compliance with the laws and regulations, self-regulatory rules, etc. that apply to their business activities as well as the coordination of their internal administration systems, etc. Further, the JSDA monitors the status of management as well as the separate management of customer assets on the part of Regular Members.

(3) Issuance of Disciplinary Measures

The JSDA instigates strict disciplinary measures against Association Members or their officers and employees who violate the laws and regulations, self-regulatory rules, etc. in an attempt to prevent recurrences.

(4) Implementation of Qualification Examinations and Qualification Renewal Training and Registration of Sales Representatives

In view of the public nature of the Association Members as an intermediary in financial and capital markets and the importance of its social mission, the JSDA implements the Sales Representatives Qualification Examination and the Internal Administrator Qualification Examination, and Sales Representatives Qualification Renewal Training in addition to performing the administrative tasks related to the registration of sales representatives under a delegation of authority from the Prime Minister.

(5) Implementation of Educational Training

The JSDA holds training based on self-regulatory rules and other various educational training programs and provides support such as dispatching of lecturers to internal training seminars held by its Association Members, etc. to improve the quality of officers and employees of Association Members.

(6) Disputes/Consultations, Mediation Concerning Financial Instruments Transactions

The JSDA performs the “mediation” prescribed in the FIEA to respond to complaints or requests for consultations from customers concerning Association Member or financial instrument intermediary service providers and to help resolve disputes between customers and Association Members concerning financial instrument transactions.

The JSDA outsources the dispute consultation and mediation activities to the Financial...
Instruments Mediation Assistance Center (FINMAC).

(7) **Implementation of Activities as an Authorized Personal Information Protection Organization**

The JSDA implements activities to secure the adequate handling of personal information of Association Members as an authorized personal information protection organization under the “Act on the Protection of Personal Information.”

(8) **Improvement and Expansion of the Bond Markets**

The JSDA constantly endeavors to improve the bond OTC market such as enacting and reviewing the systems and practices in the OTC bond transactions in order to make the trading in bond, etc. fair and efficient.

(9) **Reform of Systems for Transactions of Listed Securities, Etc. Outside the Financial Instruments Exchange Market and Implementation of Such Systems**

The JSDA reforms necessary systems for transactions of listed share certificates, etc. outside the financial instruments exchange market, in order to make the system regarding the off-exchange trades of listed share certificates, etc. fair and efficient as well as to secure the protection of investors.

The JSDA engages in providing useful information to its Association Members and investors, by compiling and publicizing the data on the status of off-exchange trades as reported by its Regular Members, as well as publicizing the information on quotations and contracted trades by way of the proprietary trading system (PTS) relating to listed share certificates, etc.

(10) **Development of Systems Related to Unlisted Securities, Etc.**

With a view to ensuring proper management of business and protection of investors in relation to equity-based crowdfunding, shareholders community, and Phoenix issue systems, the JSDA develops necessary systems concerning investment solicitation of unlisted securities, etc. such as establishing rules to be observed by Regular Members, etc.

The JSDA also engages in providing useful information to its Association Members and investors, by compiling and publicizing the data on the status of use of these systems as reported by its Regular Members, etc.

2 Functions to Encourage Sound Development of the Financial Instruments Business and Financial Instruments Markets

(1) **Research and Study of the Finance and Capital Markets; Expression of a Formal Opinion**

In order to build a market highly trusted by investors and to contribute to Japan’s economic growth and development, the JSDA carries out studies with respect to system issues, tax issues,
etc. concerning the financial instruments business and the financial instruments market as well as presents its opinion to the government and other related parties for their realization.

(2) Development of Common Infrastructure for the Securities Market
The JSDA focuses on the development of a common infrastructure such as systems, etc. for the securities market to improve the credibility and revitalize the securities market.

(3) Announcement of Statistic Materials, Etc. Concerning the Stock Market and the Bond Market
The JSDA collects and sums up various information concerning the stock market and the bond market, and provides materials, etc. that are useful for its Association Members and investors. It also announces over-the-counter trading reference prices for bonds and over-the-counter price quotations for corporate bonds targeting individual investors every business day.

(4) Activities of Promoting Knowledge and Education in Financial Instruments, Etc.
In order to raise awareness of and enlighten the public concerning knowledge of financial instruments, etc., and for the publicity on the part of all levels of people, the JSDA focuses on the development of programs to promote knowledge and education both in the academic world as well as for the general public.

(5) Public Awareness Activities
The JSDA also engages in public awareness activities for announcing system reforms and new systems that are important to investors and its Association Members, and for responding to important challenges to the securities industry as a whole appropriately.

(6) Sharing of Opinions with Related Organizations, Etc. and Mediating Opinions
The JSDA promotes various measures for the communication and mediation of opinions between Association Members or with related organizations.

(7) Assistance Regarding Elimination of Anti-Social Forces
The JSDA provides assistance to the efforts of its Association Members, etc. in order to eliminate anti-social forces from financial instruments transactions and financial instruments markets.

(8) Assistance Regarding Business Continuity of the Securities Markets as a Whole
The JSDA manages and operates an information service website specialized in business continuity plans (BCP) in order to collect and provide information for its Association Members and securities markets of securities exchanges with regard to the common infrastructure organizations from which they can seek help in the event of disasters.
International Functions/International Relations

In response to the globalization of the financial instruments and capital markets, the JSDA participates in international conferences such as the International Council of Securities Associations (ICSA), the Asia Securities Forum (ASF) and International Organization of Securities Commissions (IOSCO) to exchange information with related overseas organizations and foster international exchange, as well as promotes the Japan market to foreign countries, responds to inquiries from overseas, collects information, etc.

Organs of the Japan Securities Dealers Association

(1) Central Organs

The body with ultimate decision-making authority is the General Assembly, while the Board of Governors is the body with responsibility for decision-making and oversight concerning matters specific to overall operations of the JSDA. The Self-Regulation Board, Securities Strategy Board, Code of Conduct Committee, and Finance and Securities Education Support Committee are established under the Board of Governors and functioning as the bodies responsible for decision-making concerning self-regulatory functions, securities strategy functions, functions regarding the code of conduct, and functions for promoting knowledge and education in financial instruments and securities, respectively. The General Affairs Committee, established by a delegation of authority from the Board of Governors, functions as the deliberative body for general affairs matters such as budgeting or settlement and organization management, etc. of the JSDA.

(2) Local Organs

There are nine district offices nationwide. The district office performs work, etc. related to the Securities Strategy Board (Tokyo, Osaka, Nagoya, Hokkaido, Tohoku, Hokuriku, Chugoku, Shikoku, and Kyushu).
(3) Affiliated Bodies

There is also an Incident Confirmation Committee, a Complaint Review Council, and a Sales Representatives Examination Committee.

4 Various Rules of the Japan Securities Dealers Association

The establishment of business rules for Association Members is the most important aspect of the self-regulatory measures of the JSDA.

For this reason, the JSDA is given the authority to establish the Self-Regulatory Rules, the Uniform Business Practice Rules, the Disputes Mediation Rules, the Association Management Rules and other rules under Article 8 in the Articles of Association of the JSDA.

From among these, the Self-Regulatory Rules is prescribed to promote fair practices regarding securities trades and other transactions conducted by Association Members (to prevent Association Members from conducting improper profit taking acts and) to promote the duty of good faith in transactions.

As described below, rules are established for investment solicitation and customer management by Association Members, acceptance, etc. of deposit of securities and reports to customers, internal administrator system, matters concerning an application for confirmation of incidents, matters to ensure compliance by financial instruments intermediary service providers, services standards of employees, qualification of sales representatives and registration,
representation of advertisements, etc. and provision of premiums, etc., protection of personal information, over-the-counter securities, equity-based crowdfunding, shareholders community, Phoenix Issues, trading of listed share certificates outside a financial instruments exchange, underwriting of securities, announcement of over-the-counter trading reference prices for bonds and the trading price, foreign securities transactions, CFD transactions and so forth.

On the other hand, the Uniform Business Practice Rules are prescribed to unify the practice for the trades and other transactions, etc. in securities by Association Members and acts related thereto to increase the efficiency of processing transactions and to eliminate disputes arising from ambiguity or disunity thereof.

In addition, the Dispute Mediation Rules are prescribed to solve the customers’ complaints regarding the business operations conducted by Association Members, to mediate the resolution of disputes between customers and Association Members concerning sale and purchase and other transactions, etc. in securities, and to resolve disputes between Association Members.

# 4

Customer Management and Internal Administration, Etc. by Association Members

1 Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members

The purpose of these Rules is to ensure appropriate solicitation and management of customers, etc. by Association Members for the sale and purchase or other transactions of securities, etc. (art. 1)

The provisions of these Rules are thus greatly important since they have a direct relationship to the daily responsibilities of the sales representative. Therefore, these Rules, along with the Rules Concerning Employees of Association Members, form the fundamental standards by which sales representatives carry out their duties.

(1) Fundamental Attitude Toward Executing Functions

Association Members must, in carrying out its business, always put the best interests of the investors before everything else in business activities, giving top priority to securing the confidence of the investors and complying with the FIEA and other laws and regulations, and they must endeavor to solicit investments that meet customers’ intentions and actual situation, by fully understanding the customers’ investment experience, purpose of investment, financial condition, etc. (art. 3, para. 1 and para. 2).

When conducting sale of securities, etc. (including securities, securities-related derivatives transactions, etc. and specified OTC derivatives transactions, etc.; hereinafter the same shall apply in these Rules) that are new for an Association Member (including new securities-related derivatives transactions, etc. and new specified OTC derivatives transactions, etc.; hereinafter the same shall apply in these Rules), the Association Member shall fully understand the characteristics and risks of such securities, etc. and must not sell them if it is impossible to assume
that there will be any customer who is suitable for trading such securities (art. 3, para. 3).

Association Members must also endeavor to adequately explain and have the customer understand the essential matters of sale and purchase or other transactions of securities, etc. (art. 3, para. 4).

The reason for this rule is that the sound development of the capital market depends on financial instruments business operators maintaining the trust of the general investors in the broad sense.

Hence, this fundamental attitude has been stipulated here as one of the rules to be followed by Association Members, and the rules prescribe that Association Members must conduct their solicitation activities in compliance with the principle of suitability, so as to protect investors, and the duty of financial instruments business operators to provide an explanation concerning the transaction.

It goes without saying that these provisions should be the fundamental attitude of sales representatives when carrying out their work responsibilities.

(2) Thorough Enforcement of the Principle of Self-Responsibility

The principle of self-responsibility is that investments are to be made by the customer based on the customer’s own judgment and own responsibility, so Association Members should not engage in excessive or overly aggressive solicitation. In order to cultivate a healthy attitude toward investments on the part of customers, “Association Members shall, in soliciting investment, make customers understand that investment in securities should be made based on the customer’s own judgment and own responsibility” (art. 4), and it is also necessary for customers to have a clear understanding of this principle.

(3) Maintenance, Etc., of Customer Cards

In order to promote appropriate customer management, Association Members must be equipped with customer cards stating the following information regarding customers who conduct sale and purchase or other transactions, etc. of securities (excluding professional investors) (art. 5, para. 1):

(i) Name or appellation;
(ii) Address or domicile, and mailing address;
(iii) Date of birth (limited to cases where the customer is a natural person; the same in (iv) below);
(iv) Occupation;
(v) Purpose of investment;
(vi) Asset condition;
(vii) Experience of investments;
(viii) Type of transaction;
(ix) Motive behind becoming the customer of an Association Member; and
(x) Other matters deemed necessary by each Association Member.

Since personal information such as the customer’s asset condition, etc. appears on the customer card, the customer card must be kept strictly confidential. Association Members must not leak to others any secret about a customer which has come to its knowledge through the customer card, etc. (art. 5, para. 2).

(4) Solicitation Commencement Standards

When soliciting sale (limited to solicitation made by visit or telephone to customers who do not request the solicitation of such sale, and those made at the headquarters or other sales or business office of an Association Member to customers who do not request the solicitation of such sale) of products set forth in each of the following items (i) through (iv) to a customer (limited to individuals and excluding professional investors), the Association Member shall establish the solicitation commencement standards for each sale set forth in each of the following items (i) through (iv), and shall not solicit customers who do not meet such standards (art. 5-2):

(i) Sale of complex structured bonds similar to OTC derivatives transactions;
(ii) Sale of complex investment trusts similar to OTC derivatives transactions;
(iii) Sale of leveraged investment trusts; and
(iv) Sales of corporate bonds subject to rules as prescribed in Article 2, Item 2 of the Rules Concerning Dealing, etc. of Private Placement, etc. of Corporate Bonds (limited to the cases that meet the dealing, etc. of private placement, etc. as prescribed in Item 3 of said Article).

The “complex structured bonds similar to OTC derivatives transactions” refer to structured bonds whose redemption or interest conditions are determined by the derivatives transaction prescribed in Article 2, Paragraph 20 of the FIEA or commodity derivatives transactions prescribed in Article 2, Paragraph 15 of the Commodity Derivatives Act, or by a method that has an effect similar to those of the above two, and that fall under either of the following; provided, however, that if the bonds are government securities, or if the bonds meet either of the following criteria due to the deterioration of the credit condition of the issuer of such bond or, in the case such bond has a structure to reflect the credit condition of a single entity, such bonds shall be excluded (art. 2, item 7):

(a) The redemption price can be less than the face value (excluding those structured in such manner that the fluctuation rate of the redemption price is consistent with the value that is calculated by multiplying the change rate of a specific indicator or price (hereinafter referred to as the “Base Indicator” in these Rules) throughout the period from issuance to redemption by a pre-defined value (limited to one time or minus one time), or there is a condition
that the redemption is made with other securities by the automatic exercise of derivatives transactions;
(b) Interest is not determined at the time of issuance, and the currency used for redemption payment and that used for purchase payment are different (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of the interest indicator);
(c) Interest is not determined at the time of issuance, and the currency used for interest payment and that used for purchase payment are different (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of the interest indicator); or
(d) Interest becomes zero or very close to zero depending on the conditions (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of interest indicator).

“Complex investment trust similar to OTC derivatives transactions” refers to an investment trust that will have the same nature of product or effect as that of a complex structured bond similar to OTC derivatives transactions by managing it with such structured bonds (art. 2, item 8).

“Leveraged investment trust” refers to an investment trust that is managed to match the change rate of net asset value per unit of the investment trust assets of such investment trust to the value that is calculated by multiplying the change rate of the Base Indicator by a pre-defined factor (limited to two times or minus two times) (excluding those listed in an exchange financial instruments market or a foreign financial instruments market or those to be listed in these markets, and those fall under the category of complex investment trust similar to OTC derivatives transactions) (art. 2, item 9).

(5) Sales by Solicitation to Aged Customers

Where an Association Member sells securities, etc. to aged customers (limited to individuals; excluding professional investors) by solicitation, the Association Member must establish internal rules that include the definition of aged customers, the securities, etc. subject to sale, an explanation method, delivery method, etc. in light of its business type, size, customer distribution and customer attributes, social conditions, and other conditions, and strive to make proper investment solicitation (art. 5-3).

(6) Transaction Commencement Standards

Association Members must always give sufficient consideration to carrying out transactions in the way most suitable for the investor’s investment objectives and actual status. And particular care must be exercised in carrying out the following enumerated transactions, etc. that are of nature of being high risk/high return which present both the possibility of achieving large gains but also present the possibility of losing the entire amount invested. Consequently, respective standards for commencing these transactions must be established, and Association Members shall enter into a contract for the said transaction, etc. with customers who meet the said standards (art. 5-3).
(i) Margin transactions;
(ii) Sale and purchase or other transactions in share option certificates (including securities or certificates issued by a foreign country or foreign entity that have a nature of share option certificates; and excluding share option certificates in connection with allotment of share options without contribution as prescribed in Article 277 of the Companies Act that are listed or to be listed in a financial instruments exchange market; hereinafter the same shall apply in these Rules) (excluding sales other than the margin transactions in the customer’s account);
(iii) Sale and purchase or other transactions in investment equity subscription right certificates (including foreign investment securities that are similar to investment equity subscription right certificates; and excluding investment equity subscription right certificates that are related to the allotment of investment equity subscription rights without contribution prescribed in Article 88-13 of the Act on Investment Trusts and Investment Corporations and are currently listed or scheduled to be listed in a financial instruments exchange market; hereinafter the same shall apply in these Rules) (excluding sale other than the margin transactions in the customer account);
(iv) Securities-related derivatives transactions, etc.;
(v) Specified OTC derivative transactions, etc.;
(vi) Sale and purchases or other transactions in OTC handled securities (OTC handled securities set forth in the “Rules Concerning OTC Securities,” Article 2, Item 4) (excluding sales other than margin transactions in the customer’s account);
(vii) Transactions related to the equity-based crowdfunding business prescribed in Article 2, Item 2 of the “Rules Concerning Equity-Based Crowdfunding Business,” etc.;
(viii) Transactions of shareholders community issues prescribed in Article 2, Item 5 of the “Rules Concerning Shareholders Community”; and
(ix) Other transactions deemed necessary by each Association Member (excluding the sales other than margin transactions on the customer’s account).

These transaction commencement standards must be established with respect to the investment experience of the customer, the assets of the customer under custody for safekeeping, and other matters deemed necessary by each Association Member (art. 6, para. 2).
Delivery, Etc. of Alert Documents

When an Association Member enters into a contract with a customer (excluding professional investors; hereinafter the same shall apply in (7)) on the sale of the securities, etc. that are set forth below, it shall deliver an alert document to the customer in advance; provided, however, that this provision shall not apply if the Association Member has delivered an alert document relating to the sale of securities, etc. that are similar to those to be sold this time within one year before executing a contract of sale of securities, etc. set forth below, or if the customer agrees not to receive the prospectus pursuant to the provision of Article 15, Paragraph 2, Item 2 of the FIEA (art. 6-2, para. 1):

(i) Securities-related derivatives transactions, etc. (excluding transactions that are prescribed in Article 116, Paragraph 1, Item 3, (a) or (b) of the Cabinet Office Ordinance Concerning Financial Instruments Business, etc. (hereinafter referred to as “FIBCOO”);
(ii) Specified OTC derivatives transactions, etc.;
(iii) Complex structured bonds similar to OTC derivatives transactions; and
(iv) Complex investment trust similar to OTC derivatives transactions.

The alert document prescribed Article 6-2, Paragraph 1 must clearly and correctly indicate the following matters (art. 6-2, para. 2):

(i) The fact that the “no solicitation without a request” rule applies, if applicable;
(ii) Alert regarding associated risks;
(iii) The fact that a customer can use a complaint processing and dispute resolution framework provided by a designated dispute resolution organization (the designated dispute resolution organization prescribed in Article 156-38, Paragraph 1 of the FIEA) that conducts the dispute resolution business (the dispute resolution business prescribed in Article 156-38, Paragraph 11 of the FIEA) relating to the sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 4, and the contact information of such designated dispute resolution organization; and
(iv) The fact that a customer can use a complaint processing and dispute resolution framework provided by a designated dispute resolution organization (excluding the designated dispute resolution organizations prescribed in item (iii)) that conducts the dispute resolution business relating to the sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 4 or a specified nonprofit corporation “Financial Instruments Mediation Assistance Center (FINMAC)” to which the JSDA delegates the complaint and dispute resolution business as prescribed in Article 78-2, Paragraph 1 of the Articles of Association, and the contact information on such organizations (limited only to the case where there is no designated dispute resolution
When entering into a contract on sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 4 with a customer, an Association Member must explain the matters set forth in Article 6-2, Paragraph 2, Items 1 through 4 in advance in a manner and to an extent necessary to enable the customer to understand such matters in light of the knowledge, experience, and assets of the customer and the customer’s purpose for entering into the contract (art. 6-2, para. 3).

If an Association Member enters into a contract of sale of securities within one year from the date of delivery of an alert document (including the date when the alert document is deemed to have been delivered under Article 6-2, Paragraph 4) for securities that are similar to the securities to be sold this time (limited to those set forth in Article 6-2, Paragraph 1, Item 1, Item 3 and Item 4 (for those set forth in Item 1, excluding the OTC derivatives transactions, etc. prescribed in Article 3, Item 5 of the Articles of Association)), the alert document shall be regarded to be delivered on such date of conclusion of the contract, and the provision in proviso of Article 6-2, Paragraph 1 shall apply (art. 6-2, para 4).

(8) Confirmation in Accepting an Order for Margin Transactions

Each time an Association Member accepts an order from its customer for margin transactions, it must confirm matters including whether the customer intends to conduct standardized margin transactions or general margin transactions, etc. (art. 7).

(9) Requisition of the Confirmation Document from the Customer

When an Association Member enters into a contract with a customer (excluding professional investors; hereinafter the same shall apply in (9)) for sales and purchases or other transactions in share option certificates, investment equity subscription right certificates or covered warrants (excluding sale of securities other than margin transactions in the customer account) or for securities-related derivatives transactions, etc. or specified OTC derivatives transactions, etc. for the first time, it shall collect a confirmation document regarding such transactions, etc. from the customer in order for the customer to understand the risks involved in the financial instruments transaction, fees, and other details described in the documents related to such a contract that are set forth in the provisions of Article 117, Paragraph 1, Item 1 (a) through (d) of the FIBCOO (hereinafter referred to as “Documents to Be Delivered Prior to Conclusion of Contract”) as well as to confirm that the transaction is made according to the customer’s own judgment and responsibility (art. 8, para. 1).
When an Association Member enters into a contract with a customer for sale of OTC derivatives transactions, etc. (the OTC derivatives transactions, etc. prescribed in Article 3, Item 5 of the Articles of Association, and limited to securities-related derivatives transactions (excluding transactions that fall under all the requirements in Article 3, Items 1-(a), (c), and (d) of “Rules Concerning CFD Transactions” and transactions prescribed in Article 116, Paragraph 1, Item 3-(a) or (b) of the FIBCOO) and specified OTC derivatives transactions, etc.), it shall obtain a confirmation document on such OTC derivatives transactions from the customer for the purpose of ensuring that the customer understands the matters set forth below and conducts the OTC derivatives transactions, etc. on its own judgment and responsibility (art. 8, para. 2):

(i) Details of important matters set forth in Article 3, Paragraph 4;
(ii) The contract is tradable by the customer in consideration of the loss amount that can be acceptable by the customer and the assumed loss amount based on the amount of possible loss from the contract (including the termination clearance fee (expected amount) due to any early cancellation), and the effect of such loss amount on the customer’s business management or assets;
(iii) The contract can work as an effective hedge tool for continuing the customer’s business operation until the transaction is closed in consideration of the business condition and the competitiveness in the market (limited to the case that such contract with the customer (excluding retail customers) is for hedging purposes);
(iv) The contract does not make the forecasting of the customer’s business more difficult (limited to the case where such contract with the customer (excluding retail customers) is for hedging purposes);
(v) If the customer does not accept the solicitations of OTC derivatives transactions, etc., such non-acceptance will not affect loan transactions with the customer in the future (only for the case where the Association Member conducts a loan transaction with such customer (excluding retail customers)).

When an Association Member enters into a contract on sale of complex structured bonds similar to OTC derivatives transactions, or complex investment trust similar to OTC derivatives transactions, it shall obtain a confirmation document on such sale from the customer for the purpose of ensuring that the customer understands the matters set forth below and purchases such product based on its own judgment and responsibility (art. 8, para. 3):

(i) Details of important matters set forth in Article 3, Paragraph 4;
(ii) The contract is tradable by the customer in consideration of the loss amount that can be acceptable by the customer and the assumed loss amount based on the amount of possible loss from the contract (including the sale proceeds at the time of early sale (expected amount)), and the effect of such amount of loss on the customer’s business management or assets;
(iii) If the customer does not accept the solicitation of complex structured bonds similar to OTC derivatives transactions, or a complex investment trust similar to OTC derivatives transactions, such non-acceptance will not affect loan transactions with the customer in the future (only for the case where the Association Member conducts a loan transaction with such customer (excluding retail customers)).

When an Association Member intends to conclude a contract related to securities-related derivative transactions, etc. that are binary option transactions, etc. (binary option transactions, etc. as prescribed in Article 2, Item 7 of the “Rules Concerning Binary Option Transactions”) with a customer, the Association Member shall collect the confirmation letter prescribed in Article 12 of the Rules Concerning Binary Option Transactions in lieu of the confirmation document prescribed in Article 8, Paragraphs 1 and 2 (art. 8, para. 4).

(10) Exceptions to Confirmation, Etc. of Intent

In the event that a Special Member conducts financial instruments intermediary service as a registered financial institution (acts set forth in the provisions of Article 33, Paragraph 2, Item 3 (c) and Item 4 (b) of the FIEA (excluding those related to the rights set forth in each Item of Article 2, Paragraph 2 of the FIEA that are regarded as the securities pursuant to the provisions of the said Paragraph); hereinafter the same shall apply in these Rules), if either a Regular Member or a Special Member confirms the customer intention regarding margin transactions (standardized margin transactions or general margin transactions, etc.) described in (8) above or collects the confirmation document described in (9) above (hereinafter referred to as “Confirmation of Intentions, etc.” in these Rules), other Association Member concerned may not prepare the Confirmation of the Intentions, etc. (art. 9).

(11) Prevention of Confusion with Deposits, Etc.

When a Special Member handles securities as set forth in the provisions of Article 33, Paragraph 2, Items 1 through 4 of the FIEA (excluding government bonds securities, etc. (the securities set forth in Article 2, Paragraph 1, Items 1 and 2 of the FIEA, and the securities set forth in the same Paragraph, Item 3 and Item 5 (limited to those for which the redemption of the principal and interest payment are guaranteed by the government); hereinafter the same shall apply in these Rules) and securities index consisting of government bond securities only) as the registered financial institutions business, it must provide the customers (excluding professional investors; the same shall apply hereinafter in (11)) with explanations of the matters set forth in (i) to (vi) below to prevent the customer from mistaking the securities for deposits, etc. by an appropriate method such as distributing documents or other means, depending on the business methods and based on the knowledge, experience and asset condition of the customer (art. 10, para. 1 and para. 2):

(Note) “Registered financial institution business” refers to, among the acts prescribed in...
Article 33-2 of the FIEA, the acts set forth in Item 1 (excluding those relating to the rights set forth in the items of Article 2, Paragraph 2 of the FIEA which shall be deemed to be securities pursuant to the provisions of the said Paragraph), Item 2 (excluding those relating to the rights set forth in the items of Article 2, Paragraph 2 of the FIEA which shall be deemed to be securities pursuant to the provisions of the said Paragraph), or Item 3 (limited to those relating to specified OTC derivatives transactions), or securities, etc. management business (Articles of Association, art. 5, item 3).

(i) It is not a deposit (or not an insurance policy in the case of an insurance company);
(ii) It is not covered by the insurance payment prescribed in the provisions of Article 53 of the Deposit Insurance Law (or not subject to the contracts for compensation prescribed in the provisions of Article 270-3, Paragraph 2, Item 1 of the Insurance Business Law in the case of an insurance company);
(iii) It is not covered by the payment to general investors pursuant to Article 79-56 of the FIEA under the Investors Protection Fund prescribed in the provisions of Article 79-21 of the FIEA (limited to cases where a Special Member keeps the securities for custody);
(iv) Repayment of the principal is not guaranteed
(v) Party to the contract; and
(vi) Other matters that are useful to prevent customers from mistaking it for deposits, etc.

When a Special Member handles the securities as set forth in Article 10, Paragraph 1 in its business office or office, the Special Member must handle them at a specific counter, and display the matters set forth in Items (i) through (iii) above at such a counter so that the customers can easily see them (art. 10, para. 3).

(12) Prudent Utilization of Margin Transactions, Share Option Certificates Transactions, Investment Equity Subscription Right Certificates Transactions, and Derivatives Transactions, Etc.

An Association Member shall operate its business in a prudent manner depending on the scale and actual business of each company in the execution of a contract for margin transactions, sales and purchases or other transactions in share option certificates or investment equity subscription rights certificates, securities-related derivatives transactions, etc., and specified OTC derivatives transactions, etc. and always restrain itself from pursuing such transactions to an excessive level (art. 11, para. 1).

Furthermore, an Association Member shall endeavor to adequately understand the open interest, profit and loss, customer margin, assets under custody of the securities-related derivatives
transactions, etc. and the specified OTC derivatives transactions, etc. of the customers, as well as to manage the evaluation of the profits or losses of customers who repeatedly conduct such transactions, etc. in a comprehensive manner (art. 11, para. 2).

Multiple trades in the area of high-risk, high-return derivatives transactions by customers require an Association Member’s special attention and care regarding the evaluation of the profits or losses of customers beyond that required for independent or single contract.

(13) Prevention of Excessive Solicitation, Etc.

(i) Prohibition from Recommendation in a Concentrated Manner Which Represents a Subjective or Arbitrary Supply of Information

An Association Member must be prohibited from recommending to its customers the securities of specific issues or the option related to the sale and purchase of such securities in a concentrated manner, which represents a subjective or arbitrary supply of information (art. 12, para. 1).

(ii) Self-Restraint in Soliciting Margin Transactions in Restricted Issues, Etc.

An Association Member shall refrain from soliciting for margin transactions with respect to the issues set forth in each of item (a) or (b) below for which a financial instruments exchange or a securities finance company has taken the measures stated therein (art. 12, para. 2):

(a) Issues with respect to which a financial instruments exchange has restricted or prohibited margin transactions; or
(b) Issues with respect to which a securities finance company has restricted or suspended an application for the use of lending stocks, etc.

An Association Member must, when it accepts an order for a margin transaction from a customer with respect to the issues listed in either item (a) or (b) above, or the issues for which measures listed in any of items (a) through (c) below have been taken by a financial instruments exchange or a securities finance company, explain to the customer the fact that such measures are in effect and the contents thereof (art. 12, para. 3):

(a) Issues designated by a financial instruments exchange as issues subject to daily publication of margin transaction balances;
(b) Issues with respect to which the financial instruments exchange has increased the rate of margin for margin transactions (including restrictions on the use of securities in substitution for margin, etc.); or
(c) Issues with respect to which a securities finance company a notice for alert with respect to the use of lending stock, etc.
(iii) Self-Restraint, Etc. in Soliciting Securities Option Transactions

An Association Member shall refrain from soliciting for securities option transactions with respect to these issues for which a financial instruments exchange has taken measures of restriction or prohibition of the securities option transactions (art. 12, para. 4).

Also, an Association Member must, when it accepts an order for an securities option transaction from a customer with respect to the issues set forth in Article 12, Paragraph 4 or the issues set forth in any of items (a) or (b) below for which the measures stated therein have been taken by a financial instruments exchange, explain to the customer about the fact that these measures are in effect and the contents thereof (art. 12, para. 5):

(a) Issues with respect to which a financial instruments exchange has alerted caution with respect to the open interest related to securities option transactions; and
(b) Issues with respect to which a financial instruments exchange, relating to securities option transactions, has taken measures for advancing the date on which the margin is offered, increasing the rate of such margin (including the restrictions on the use of securities in substitution for margin, etc.) or accepting a deposit prior to the settlement date of the purchase price.

(14) Prohibition Against Soliciting Investments in Over-the-Counter Securities

An Association Member must not solicit customers to invest in Over-the-Counter securities (OTC securities prescribed in the provisions of Article 2, Item 1 of the Rules Concerning Over-the-Counter Securities) other than the cases under the provision of the Rules Concerning Over-the-Counter Securities (art. 12-2).

(15) Prohibition on the Acceptance of Orders for Transactions Under a Fictitious Name or Name-Lending

Where an order for sale and purchase or other transactions of securities, etc. is placed by a customer, any Association Member must not accept such an order knowing that the transaction is being made under a false name (art. 13, para. 1). Financial institutions including Association Members are required to conduct identity verification of a customer upon transaction under the “Act on Prevention of Transfer of Criminal Proceeds” (hereinafter referred to as the “Criminal Proceeds Transfer Prevention Act”) (See 4-2 (2) (ii) Prohibition Against “Acceptance of So-called Transactions under Fictitious Name” of this Chapter for details).

Furthermore, when a customer applies for a name transfer of stocks, any Regular Member must not lend its name (art. 13, para. 2).
(16) Establishment of Internal Administration System to Prevent Transfer of Criminal Proceeds

An Association Member shall appoint a person responsible for the notification of doubtful transactions pursuant to the provisions of Article 8, Paragraph 1 of the Criminal Proceeds Transfer Prevention Act, and shall endeavor to establish an internal administration system designed to prevent transfer of criminal proceeds and fund provision to terrorist organizations (art. 14).

(17) Maintenance, Etc. of Insider Registration Cards

An Association Member must ask any customer that makes a sale and purchase, etc. of the specified securities, etc. of a listed company, etc. prescribed in FIEA, Article 166 for the first time to submit a form declaring that the customer is categorized into any of the persons set forth in Article 15, Paragraph 1, Items 1 through 10 (hereinafter referred to as an “officer, etc. of a listed company, etc.” in these Rules), and based on the declaration, it must prepare an insider registration card before making such a sale and purchase, etc. of the specified securities of a listed company, etc., by stating the following matters therein (art. 15, para. 1 and para. 2):

(i) Name or appellation;
(ii) Address or domicile, and a mailing address;
(iii) Date of birth (limited to the case where the customer is a natural person);
(iv) Company name, title, and section; and
(v) Name and issue code of the listed company, etc. in which the customer falls under the officer, etc. of the listed company, etc.

Further, an Association Member must make a promise with a customer to notify without delay to the Association Member when there is any change in whether the customer falls under the officer, etc. of the listed company, etc. or not. And when an Association Member receives the notice of a change, it must revise the insider registration card without delay (art. 15, para. 3 and para. 4).

An Association Member must develop a system to control and manage insider trading by establishing internal rules on the prevention of insider trading and other means (art. 15, para. 7).

(18) Reconciliation with J-IRISS

An Association Member must reconcile the name, date of birth, and address of a customer who conducts sale and purchase, etc. of the specified securities, etc. of a listed company, etc. prescribed in FIEA, Article 166 (excluding legal entities) that are included in a customer card, with the data in J-IRISS (a reconciliation system of the JSDA) at least once a year, and, based on the result of the reconciliation, it must confirm whether or not the customer falls under the category of officer, etc. of a listed company, etc., and prepare the insider registration card without delay (art. 15-2, para. 1 and para. 2).

If an Association Member receives information from J-IRISS as a result of the reconciliation prescribed in Article 15-2, Paragraph 1, it shall not use such information for any purpose other
than the preparation of insider registration card (art. 15-2, para. 3).

(19) Establishment of System for Management of Discretionary Trading

An Association Member must—in order not to lack in investor protection, hamper fair transactions and undermine trust in the Association Member—establish an adequate system for the management of sale and purchase or other transactions of securities, etc. that are effected on the basis of the contracts set forth in Article 123, Paragraph 1, Item 13 of the FIBCOO (hereinafter referred to as “Discretionary Trading” in these Rules) (art. 16).

(20) Ensuring the Safety of Transactions

An Association Member must, in accepting an order from a new customer or a customer for a large-lot transaction, endeavor to ensure the safety of the transaction by such means as having the customer concerned deposit the whole or a part of the money for purchasing securities or securities for sale with the Association Member concerned in advance (art. 17).

(21) Proper Management of Transactions Pertaining to Customer Orders

An Association Member must, when it conducts sale and purchase or other transactions of securities, etc., clearly distinguish the transactions ordered by customers from the transactions executed on its own account, and, in sale and purchase or other transactions of securities, etc., must properly manage the transactions ordered by customers by immediately preparing, keeping and maintaining order slips with respect to the customers’ orders and by inputting numbers, etc. designed to distinguish them from transactions conducted on its own account via a terminal (art. 18, para. 1 and para. 2).

Furthermore, an Association Member must establish internal rules, which prescribe the proper operation and management of a time-recording machine, elimination of improper operation of computers, etc. in order to contribute to the proper management of the transactions ordered by customers as prescribed in Article 18, Paragraphs 1 and 2 (art. 18, para. 3).

(22) Best Execution Duty

An Association Member must develop a system that is sufficient to properly fulfill the best execution duty prescribed in the provisions of Article 40-2 of the FIEA (art. 19).

(23) Provision of Facilities to Customers, Including Guarantees by Regular Members

A Regular Member must conduct proper management of the provision of facilities to customers, such as guarantees and mediation, etc. (including all acts, irrespective of the form, by which a Regular Member or its officer or employee takes part in the customer’s borrowing of money or securities) incidental to the customer’s borrowing of money or securities in relation to sale and purchase or other transactions of securities, etc. so that the facilities are not excessive in light of the value of the transaction conducted by the customer and other factors (art. 20).
(24) Prohibition of Provision of Facilities to Customers, Including Loan Extensions by Special Members

When a Special Member conducts or solicits the conduct of a transaction related to the registered financial institution business to a customer (including professional investors), it must not promise to provide any special benefits in connection with loans or guarantees to the customer (art. 21).

(25) Prohibition, Etc. of Special Members’ Automatic Credit Extension

A Special Member shall not make an automatic credit extension to customers for the purpose of covering losses or putting up an initial margin or additional margin for the transactions related to the registered financial institution business and must take the measures set forth in item (i) or (ii) below. In addition, a Special Member must not extend any loan that will clearly be used for putting up the initial margin or additional margin (art. 22, para. 1):

(i) A Special Member shall newly set up an exclusive account for securities futures transactions, etc. in JGBs, etc. (transactions set forth in Article 2, Paragraph 21, Item 1 of the FIEA in connection with the securities as set forth in the provisions of Article 2 of the FIEA, or actions set forth in the provision of Article 2, Paragraph 8, Item (2) or (3) in connection with the transactions mentioned above; hereinafter the same shall apply in these Rules) (hereinafter referred to as “Account for Bond Futures Transactions” in these Rules), and shall be prohibited from extending an overdraft to that account; and
(ii) Any Special Member shall not make an automatic transfer from a person’s account with an overdraft to the same person’s Account for Bond Futures Transactions.

A Special Member must, in order to confirm the customer’s intention with respect to the deposit of money in relation to securities futures transactions, etc. in JGBs, etc. appoint in advance a person in charge of the customer concerned in relation to the processing of money deposited into Account for Bond Futures Transactions, and shall have the customer concerned or a treasurer of the customer registered. Each time any money is put into the account, the Special Member shall obtain the customer’s prior approval by telephone, etc. (art. 22, para. 2).

When a Special Member conducts transactions related to the financial instruments intermediary service as a registered financial institution and the outstanding amount in the transaction account opened for the Special Member by the customer is not sufficient, it must not conduct the transactions related to the financial instruments intermediary service by the registered financial institution by making an automatic credit extension or by promising to do so (art. 22, para. 3).

(26) Complete Management of Information on Non-Disclosed Loans, Etc.

When a Special Member conducts the financial instruments intermediary service as a
registered financial institution, it must develop internal rules to manage and control the information on nondisclosed loans (that is prescribed in the provisions of Article 1, Paragraph 4, Item 13 of the FIBCOO) of the customer who is an issuer of the securities and to prevent any unfair transactions associated with such information as well as to thoroughly disseminate them for complete understanding among the officers and employees (including all the staff members who are in charge of such business if the accounting consultant is a corporation; hereinafter the same shall apply in these Rules) for the purpose of full compliance (art. 23).

(27) Notification of Profits and Losses from Investment Trusts, Etc.

An Association Member must notify a customer of any profits and losses (total return) from an investment trust, etc. which it takes custody of as entrusted by the customer or which it manages via entries or records in a book-entry account registry, as provided for in the appended table (art. 23-2).

(28) Establishment of a System for Management of Customers

An Association Member must establish internal rules concerning customer due diligence, transaction commencement standards, the prevention of excessive solicitation, and the establishment of a control system for discretionary trading, etc. for the purpose of ensuring the adequate management of customers in sale and purchase or other transactions of securities, etc., and ensures that its officers and employees comply with such rules (art. 24, para. 1).

Furthermore, an Association Member must develop a system to manage customers pursuant to the internal rules, and endeavor to accurately understand the conditions of any sale and purchase or other transactions of securities, etc. conducted by the customers and the business activities conducted by its officers and employees (art. 24, para. 2).

(29) Establishment of a System for Management of Insider Trading

An Association Member must endeavor to establish the system for management of insider trading by such means as establishing internal rules concerning the management of unpublished information relating to issuing companies which have been acquired in regard to the business operations by its officers and employees, management of customers, and management of the sale and purchase of securities, etc. with a view to preventing insider transactions (art. 25).

(30) Proper Management of Transactions Under Trust Accounts

An Association Member must accurately understand the situation of customers’ transactions utilizing accounts based on trust contracts (including the contracts of specified pecuniary trusts and contracts of specified non-pecuniary trusts), and endeavor to manage them appropriately (art. 26).

(31) Establishment, Etc. of Internal Inspection Rules

An Association Member must establish internal rules with respect to the internal inspection and audits concerning observance of the FIEA and other laws and regulations, investment
solicitations and customer management, etc., and shall also endeavor to establish the internal administration system and operate it properly (art. 27).

(32) Establishment of an Organization to Deal with Customer Complaints and Disputes
An Association Member must endeavor to establish an internal administration system by prescribing the departments, etc. to deal with customer complaints and disputes with customers and to deal with them properly (art. 28).

(33) Documents Delivery Using Electromagnetic Methods
In substitution for the delivery, etc. of the alert document prescribed in Article 6-2, under the provisions of Articles 2 and 3 of the “Rules Concerning Handling of Documents Delivery, etc. through Electromagnetic Methods” (hereinafter referred to as the “Rules Concerning Electromagnetic Documents Delivery, etc.”), an Association Member may use methods employing electronic information processing systems or other information technologies to provide the information on the matters that should be included in the alert document. In such a case, the Association Member shall be regarded as having submitted, etc. such alert document (art. 29, para. 1).

If an Association Member needs to collect a confirmation document as prescribed in the provisions of Article 8, it may receive the information on the matters that should be described in such a confirmation document by a method using electromagnetic organization or other means using information and telecommunications technologies pursuant to the “Rules Concerning Electromagnetic Documents Delivery, etc.” instead of obtaining such documents physically, and in such a case, the Association Member is considered to have collected the said confirmation document (art. 29, para. 2).

2 Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members
The purpose of Rules Concerning the Establishment of a Confidential Corporate Information Management System by Association Members (hereinafter referred to as the “Rules”) is to establish a management system, etc. of confidential corporate information by Association Members by prescribing necessary measures such as internal rules, for the purpose of preventing an unfair transaction using confidential corporate information that is acquired by Association Members during the course of the business (art. 1).

(1) Identification of Management Section of Confidential Corporate Information
An Association Member must designate the Management Section* (art. 3).

* The term “Management Section” as used in the Rules means a section that comprehensively manages the Confidential Corporate Information (or a responsible person if the Confidential Corporate Information is managed in each business outlet or office) (art. 2, item 2).
(2) **Establishment of Internal Rules**

An Association Member must establish internal rules for the management of Confidential Corporate Information that prescribe matters set forth in each of item (i) through (vii) below, for the purpose of preventing conduct of an unfair transaction using such information (art. 4):

- (i) Matters concerning the procedures at the time of acquiring the Confidential Corporate Information;
- (ii) Matters concerning the information management procedures for a person, etc. who acquired the Confidential Corporate Information;
- (iii) Matters concerning the identification of the Management Section and its information management procedures;
- (iv) Matters concerning the communication procedures of Confidential Corporate Information;
- (v) Matters concerning the extinction or deletion procedures of Confidential Corporate Information;
- (vi) Matters concerning prohibited actions; and
- (vii) Other matters the Association Member deems necessary.

(3) **Procedures at the Time of Acquiring the Confidential Corporate Information**

An Association Member must establish procedures that are necessary to manage the Confidential Corporate Information such that officers and employees who acquire the Confidential Corporate Information immediately report such acquisition to the Management Section (art. 5).

(4) **Management of Confidential Corporate Information**

An Association Member must manage the Corporate Section* so that the Confidential Corporate Information is not communicated to other sections that do not need such information for their business, such as through physically isolating the Corporate Section from other sections, managing the documents that describe the Confidential Corporate Information or information that could be the Confidential Corporate Information in an isolated environment from other sections, or managing such electronic files that contain the Confidential Corporate Information or information that could be the Confidential Corporate Information in a way that people cannot view them easily (art. 6).

* The term “Corporate Section” as used in the Rules means, among sections mainly conducting business (meaning the financial instruments business and incidental business or the registered financial institution business), sections with a high possibility of acquiring confidential corporate information mainly in their business activities (art. 2, item 3).
(5) Enhancement of Management Systems

An Association Member must conduct regular inspection or monitoring to check whether or not the Confidential Corporate Information is managed properly pursuant to the internal rules (art. 7).

(6) Concept of the Rules

The JSDA shall prescribe matters related to the operation, etc. of the Rules by Association Members in the Guideline for “Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members” (art. 8).

3 Rules Concerning Acceptance, Etc. of Deposit of Securities

The purpose of these Rules is to ensure appropriate management of customers by Association Members, by prescribing matters relating to acceptance by an Association Member of a deposit from a customer of securities, a report to a customer, and reconciliation of the balance of credits and liabilities (art. 1).

Deposit contracts are governed by Article 657 of the Civil Code. A deposit contract is an agreement under which one party promises to hold an item in custody for the other party, and the contract is established by accepting the item to be held.

(1) Restrictions on the Acceptance, Etc. of Deposits

The cases in which an Association Member can engage in the acceptance, etc. a deposit of securities (when a Special Member is concerned, referring to securities that are related to the registered securities business; when a Specified Business Member is concerned, referring to securities that are related to the specified business) from a customer are limited to the following cases (or only case (iv) applied to Specified Business Member) (art. 2):

(i) In case of a simple deposit contract

These are cases where the Association Member is entrusted with the custody of securities from customers and keep them in custody separately for each customer.

(ii) In case of a mandate contract

These are cases where the Association Member receives a mandate to act as standing agent with respect to such clerical functions for securities from customers.

(iii) In case of a commingled deposit contract (limited to a commingled deposit contract relating to bonds and investment trusts beneficiary certificates, transfer settlement to be conducted by the Japan Securities Depository Center Inc., a financial instrument exchange and a settlement house, and sale and purchase or other transactions in foreign securities and foreign certificates)

Commingled deposits refer to cases where all securities of the same issue deposited by multiple customers are commingled and held in custody. Upon the return of such securities, each customer receives an amount of securities from out of the pool corresponding to the amount he or she deposited (in this case, the deposited securities are the jointly owned by several persons, and this distinguishes commingled custody contracts from the securities...
(iv) **In case of the depositor being a pledgee**

Cases where the Association Member is a pledgee refer to cases where, for example, the Regular Member receives a deposit of securities from the customer in lieu of a cash margin in a margin transaction, or where the Regular Member holds securities from the customer as collateral for an advance of funds.

(v) **In case of the contract of deposit for consumption**

A deposit for consumption refers to custody arrangements under which the custodian agrees to consume the deposited securities, and replace them at a later date with items of the same type, quality and quantity (same issue name and same quantity).

(2) **Safe Custody Contracts**

(i) **Conclusion of the Safe Custody Contract**

In the case where a Regular Member or a Special Member accepts from a customer the deposit of securities under a simple deposit contract or a commingled deposit contract, the Regular Member must conclude with the said customer a contract concerning the deposit of securities (hereinafter referred to as “safe custody” in these Rules) under the terms and conditions of safe custody master agreement (in the case of a Special Member, meaning the custody rules in the business methods manual relating to the registered financial institution business; hereinafter the same shall apply in these Rules) (art. 3, para. 1).

The terms and conditions of safe custody master agreement are appropriate for the business practices, services and separate custody system of each Regular Member or Special Member. The following enumerated items must be provided for in the safe custody master agreement pursuant to the rules (with regard to the items which are not necessarily included in safe custody contract with a customer in the consideration of the business scope, etc. of the Regular Member (this would be the case, for example, with item C. below for a Regular Member who does not handle bonds at all) may be dispensed with) (art. 3, para. 2):

- The method and location of keeping securities to be held in custody;
- Matters agreed by the customer regarding commingled deposit;
- Treatment of bonds in the case of redemption by lot;
- Matters to be reported to a Regular Member or Special Member and procedures for reporting changes in those matters;
- Treatment in the account of securities in custody;
- Treatment of pledge;
- Treatment of notifications, etc. to the actual shareholders, etc.;
- Matters to be notified to the customer;
- Explanation of agency services, etc. for name transfer, etc.;
- Matters related to the receipt of redemption payments, etc. on the customer’s behalf;
- Handling of the restitution and return of securities held in custody or its
equivalent;
(l) Administration fee for safe custody;
(m) Matters related to the cancellation of safe custody contract;
(n) Matters related to exemptions; and
(o) Procedures for revising the safe custody master agreement.

With respect to the procedures for entering into the safe custody contract, the Regular Member or Special Member must receive an application for opening a safe custody account submitted by the customer (art. 3, para. 3), and have the customer report his/her name, date of birth and address, and register his/her seal, etc.

In the case where a Regular Member or Special Member has received from a customer an application for opening the safe custody account and accepted it, the Regular Member or Special Member must open the safe custody account and notify the said customer to that effect without delay (art. 3, para. 4).

In the case where a Regular Member or Special Member accepts from a customer under a commingled deposit contract the deposit of bonds which may be redeemed by lot, the Regular Member or Special Member must establish internal rules for handling of such bonds and obtain the prior consent from the customer (art. 4).

When the foregoing procedures are completed, and the custody account of the customer is opened, the Regular Member or Special Member must perform all receipts, custody and deliveries of the securities deposited by the said customer under a simple deposit contract or a commingled deposit contract within such account (art. 5).

(ii) Exception from Application of Safe Custody Contract

It is not necessary to enter into a safe custody contract with respect to the deposit of following securities (art. 6):

(a) Securities under a cumulative investment contract;
(b) Securities under a standing proxy contract; and
(c) Securities that are prescribed in Article 2, Paragraph 1, Item 15 of the FIEA, rights that are recognized as securities pursuant to the provisions of Article 2, Paragraph 2 of the FIEA and foreign securities that are prescribed in Article 2, Paragraph 1, Item 1 of “Rules Concerning Foreign Securities Transactions”.

(Note) Nowadays, with the increased progress of the dematerialization (digitization) of securities issued in Japan, a securities settlement system has been established where every process concerning securities, from issuance to redemption, can be dealt with under the book-entry transfer system.

This book-entry transfer system is based on the “Act on Transfer of Bonds, Shares, etc.” (hereinafter referred to as the “Book-Entry Transfer Act”). Securities
which shall be dealt with under the book-entry transfer system are required to be managed in accordance with the Book-Entry Transfer Act and the business regulations, etc. specified by the book-entry transfer institution (with respect to national government bonds, the Bank of Japan is designated as the book-entry transfer institution, and with respect to shares, general bonds and investment trusts, etc., the Japan Securities Depository Center, Inc.).

An Association Member that intends to serve as an account management institution must conclude a book-entry account management agreement based on the business regulations, etc. specified by the book-entry transfer institution, to clarify the rights and obligations between itself and the customer.

In other words, digitized securities (book-entry transfer national government bonds, book-entry transfer shares, book-entry corporate bonds, book-entry transfer beneficial interest in investment trust, etc.) shall be managed by the book-entry account registry kept by the Association Member that serves as the account management institution, and safe custody of such securities shall not be made.

(iii) Safe Custody Master Agreement

The safe custody master agreement clarify the relationship among the rights/obligations of the Regular Member or Special Member, acting as trustee, and the customer, who is the depositor, concerning the “custody” of securities, and contain detailed provisions governing the segregation and custody, etc. of the securities in custody.

The mandatory contractual matters (for Regular Members) that are listed in the aforementioned (i)(a) through (o) are constituted mainly by the following sample elements:

(Note) The details of the “safe custody master agreement” below are based on the reference forms of the JSDA (amended on October 5, 2015).

(a) Keeping of securities in custody: In general, this is to be determined by each Regular Member in conformity with the provisions concerning the separate custody prescribed in Article 43-2 of the FIEA as appropriate in view of the actual condition of each Regular Member. However, an overview of the custody methods that were commonly used is as follows:

• In general, securities in custody shall be kept by Regular Members;
• Securities in custody subject to the book-entry settlement of a financial instruments exchange will be commingled at the settlement corporation for such financial instruments exchange; and
• Bonds or the beneficiary certificates of investment trusts are sometimes commingled with the same issues held by other customers unless the customer requests otherwise.

(b) Matters requiring consent: As regards securities that are commingled, the depositor
will be treated as having consented to the following items:

i) The depositor will acquire joint ownership or quasi-joint ownership over securities of the same issue as the securities deposited according to the number or amount of the securities deposited; and

ii) When the depositor deposits new securities, or when securities already in custody are returned, no consultation will be made with the other customers who deposited securities of the same issue.

(c) Matters to be notified: The seal impression and the stated address, personal name, etc. in the custody account application form will be treated as the registered seal, address and personal name.

(d) Matters to be communicated to the customer of a Regular Member:

i) In cases of a change in the name of the registered holder or submission—the date thereof;

ii) In cases where the bonds in a commingled deposit account were selected for redemption by lot—the amount of the redemption;

iii) Final redemption date; and

iv) Reports for the reconciliation of balance; however, where the transaction balance statements (*) are periodically sent out, the reports under the transaction balance statement.

(Note) The statement may be omitted if the customer is a professional investor and if a system has been established that allows prompt answers to customer inquiries, the statement may be omitted. Further, notations in statements for balance reconciliation may be omitted in connection with some of the matters to be stated in the document to be delivered upon conclusion of contract, etc. concerning individual derivatives transaction.

* Transaction balance statements

While Documents to Be Delivered Prior to Conclusion of Contract (transaction statements) are documents for reporting contracts for securities transactions, etc., transaction balance statements are documents for reporting the status of delivery and settlements and the balance of securities or money based on the contract reports.

Rules for delivery: In principle, transaction balance statements are delivered periodically, at least once on the last day of each period set by dividing one year into periods of three months or shorter (“periodical statements”), or if customers make requests, on each occasion of the execution of a contract for financial instruments transaction or the delivery of securities or money (“transaction-based statements”).

Matters to be contained: Transaction balance statements must contain details
of the transactions conducted during each period, such as the securities (e.g., shares, bonds, investment trusts) traded, and the positions in margin transactions or futures/options transactions; and the records of acceptance and delivery of money and of securities in these transactions as well as the balances thereof at the end of the period. In the case of transaction-based statements (only in cases where the delivery of securities and money based on the contract for financial instruments transactions has been completed), transaction balance statements must also contain the following: the name of the customer; the date of delivery and the issue name of the securities; and the balance of the securities and money after the completion of the delivery of securities and money in relation to the sale and purchase or other transaction of securities or the derivatives transaction.

(e) Acting as agent with respect to the procedures for changes in the name of the registered holder, consolidation or split of shares, allotment of shares without contribution, exercise of share options under a bond with share option, representation with respect to repurchase demands to the issuing company of shares less than one unit, etc.: The Regular Member can act as agent upon the customer’s request.

(f) Receiving the redemption money: The Regular Member can receive the redemption money as agent and pay it when requested by the customer.

(g) Returning the securities in custody: The return of securities in custody is based on the procedures in place at each Regular Member.

(h) Procedures for amending the matters to be notified: Changes in the name, address, etc. of the customer are based on the procedures in place at each Regular Member.

(i) Fees: Fees may be set by each Regular Member as appropriate in accordance with its fee schedule.

(Note) The Regular Member and the customer can agree to the amount of custody account management fees, the standing proxy fees, the fee of the change in the name of registered holder, and the cumulative investment account management fees, etc. to be imposed and collected.

(j) Release from liability: Regular Members shall not be liable for any damages occurring in the following cases:

i) Cases where the securities in custody are returned, if the Regular Member determines that there is no difference between the seal impression affixed to the requisite documentation of the Regular Member and the registered seal;

ii) Cases where the securities in custody are not returned, if the Regular Member determines that there is a difference between the seal impression affixed to the requisite documentation of the Regular Member and the registered seal;

iii) When a change in the name of the registered holder or a submission of some kind is required, and notwithstanding the fact that the Regular Member sent out
notification thereof prior to the deadline, cases where no request for such procedures is received by the prescribed deadline;

iv) Cases where the securities in custody are originally defective or there are facts constituting the grounds for such defect; and

v) Cases where due to a natural disaster or other force majeure, the return of the securities in custody is delayed.

(3) **Standing Proxy Contract**

When a Regular Member is entrusted by a customer with administration relating to standing proxy service concerning securities, such as receiving and forwarding dividends, exercising voting rights, exercising or disposing of share options or other securities-related transactions, the Regular Member must collect from the customer a document proving the proxy (art. 7).

(4) **Contract of Deposit for Consumption**

When accepting from a customer, etc. the deposit of securities under the contract of deposit for consumption, a Regular Member or Special Member must prepare a document proving the said contract in duplicate and deliver one copy thereof to the said customer and retain the other copy (art. 8, para. 1).

However, in the case where a Regular Member or Special Member accepts from a customer the deposit of any share certificates, etc. under contract of deposit for consumption, the Regular Member or Special Member shall comply with “Rules Concerning Handling of Borrowing and Lending Transactions for Share Certificates, Etc.” (art. 8, para. 2).

(5) **Notice of Reconciliation and Document to be Delivered Upon Conclusion of Contract (In case of Regular Members)**

   (i) Reporting by Notice of Reconciliation

A Regular Member must report to a customer on the balance of credits and liabilities for the said customer by a notice of reconciliation in such category and at such frequency as prescribed in each item below.

However, this shall not apply to the case where the customer is one to whom a transaction balance statement, which is prescribed in FIBCOO, Article 98, Paragraph 1, Item 3 (a) is delivered regularly, and the transaction balance statement includes the matters to be set forth in a notice of reconciliation (art. 9, para. 1):

(a) Customers who conduct sale and purchase in securities

........................................................................................................Once a year or more

(b) Customers who conduct securities-related derivatives transactions or specified OTC derivatives transactions ................................Twice a year or more

(c) Customers with a positive balance of money or securities who have not conducted deliveries or transactions set forth in (a) and (b) above for one year or more ........................From time to time
(Note) Securities-related derivatives transactions mean the securities-related derivatives transactions prescribed in FIEA, Article 28, Paragraph 8, Item 6 (excluding those relating to the rights set forth in FIEA, Article 2, Paragraph 2 which are deemed to be securities under the said Paragraph; the same shall apply hereinafter).

Specified OTC derivatives transactions mean OTC derivatives transactions prescribed in FIEA, Article 2, Paragraph 22 (excluding those that fall under the FIEA Enforcement Order, Article 1-8-6, Paragraph 1, Item 2) which do not fall under any of the following: (i) transactions relating to the rights set forth in FIEA, Article 2, Paragraph 2 which are deemed to be securities under the said Paragraph; (ii) securities-related derivatives transactions; (iii) OTC financial futures transactions (meaning the OTC financial futures transactions prescribed in FIBCOO, Article 79, Paragraph 2, Item 2); or (iv) transactions prescribed in FIEA, Article 2, Paragraph 22, Item 4 (limited to transactions related to the financial indicators (limited to those referred to in Paragraph 24, Item 3 of the said Article) set forth in Paragraph 25, Item 1 or Item 4 of the said Article).

The matters to be stated on the notice of reconciliation are the latest balances of the following monies or securities (excluding those relating to the cashing of MMFs and medium-term government bond funds, etc.) (art. 9, para. 2):

i) Latest balance of advance money, loaned money, deposited money, or borrowed money;

ii) Latest balance of securities deposited under a simple deposit contract, a mandate contract, a commingled deposit contract or a contract of deposit for consumption and securities administered as records in a transfer account or registration, etc. (excluding those that are set forth in iii) below);

iii) Latest balance of money or securities as the object of pledge;

iv) Latest balance of outstanding account relating to margin transactions (this information may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to margin transactions.);

v) Latest balance of securities relating to “when-issued” transactions; and

vi) Latest balance of outstanding account relating to securities-related derivatives transactions and specified OTC derivatives transactions (the latest balance of outstanding account relating to securities-related derivatives transactions may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to securities-related derivatives transactions).

If a customer is a professional investor and a Regular Member has established a system which enables a prompt reply to the said customer, the Regular Member is allowed to omit a
report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to individual derivatives transactions, etc. (limited to such document delivered to a customer) or in a written contract in which terms on the relevant derivative transaction, etc. are stated (limited to such contract executed with a customer) may also be omitted in the notice of reconciliation (art. 9, para. 4 and para. 5).

Furthermore, even if there is no current balance of money or securities in the customer’s account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Regular Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10).

(ii) Preparation and Delivery of the Notice of Reconciliation

The notice of reconciliation shall be prepared in a Regular Member’s inspection, auditing, or administration department (art. 11, para. 1).

A Regular Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation to be delivered to a customer. With regard to the notice of reconciliation concerning the registered financial institutions’ acts of financial instrument intermediation of a Special Member, the Special Member may indicate the responsible person in the Special Member’s inspection, audit or administration department, in addition to the contact information listed on below, on the same notice of reconciliation (art. 11, para. 2):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of reconciliation, an inquiry shall be made directly to the responsible person in a Regular Member’s inspection, audit, or administration department without delay; and
(c) Contact information relating to the preceding item (b) above.

In addition, in the case where a Regular Member delivers the notice of reconciliation to a customer, the Regular Member shall mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and a Regular Member make the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4).

Further, in the case where a Regular Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through vi) above, the Regular Member’s inspection, audit, or administration department must accept such inquiry and make a reply without delay to the said customer about the balance. Also, in the case where the inquiry is related to the financial instruments intermediary service, the Regular Member shall, when
necessary, request a Special Member in charge of the financial instruments intermediary service on an entrustment basis or a financial instrument intermediary service provider to make a report and shall investigate (art. 12).

(iii) Delivery of the Document to be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Regular Member delivers a document to be delivered upon conclusion of a contract to a customer, the Regular Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and a Regular Member make the arrangement under the provisions of the rules prescribed by the JSDA (art. 13).

Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief manager or an employee authorized by the chief manager of a Regular Member has brought a document to be delivered when concluding a contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2).

(6) Notice of Reconciliation and Document to Be Delivered upon Conclusion of Contract

(In case of Special Members)

(i) Report by Notice of Reconciliation

A Special Member must report to a customer by a notice of reconciliation in such category and at such frequency as set forth in each of the following items.

However, this shall not apply to the case where the customer is the one to whom a transaction balance statement is delivered regularly or who is notified in the form of transaction book, and also the transaction balance statement or the transaction book includes the matters to be set forth on a notice of reconciliation (art. 17, para. 1):

(a) Customers who conduct securities-related market derivatives transactions, transactions in bonds with options, securities-related over-the-counter derivative transactions and specified OTC

.................................................................................................................................................Twice a year or more

(b) Customers who have a positive balance of securities concerning registered financial institution business (excluding customers who conduct the transactions listed in (a) above)

.................................................................................................................................................Once a year or more

(c) Customers who have a positive balance of money or securities concerning registered financial institution business and who have not conducted deliveries or transactions set forth in item (a) above for more than a year

.................................................................................................................................................From time to time
The matters to be stated on the notice of reconciliation are the balances of the following cash or securities relating to the registered financial institution business (art. 17, para. 2):

- i) Latest balance of advance money or deposited money;
- ii) Latest balance of securities deposited under a simple deposit contract, a mandate contract or a commingled deposit contract or securities administered as records in a transfer account or registration, etc. (excluding items iii) through vi));
- iii) Latest balance of margin and collateral securities for securities-related market derivatives transactions;
- iv) Latest balance of cash collateral or collateral securities for securities-related OTC derivatives transactions (limited to the ones relating only to the relevant transactions);
- v) Latest balance of margin and collateral securities for transactions in bonds with options;
- vi) Latest balances of cash collateral and collateral securities for specified OTC derivatives transactions (limited to the ones relating only to the relevant transactions) (these balances may be omitted if a document containing them has been delivered to the customer); and
- vii) Latest balance of outstanding account relating to transactions in bonds with options, securities-related market derivative transactions, securities-related OTC derivatives transactions, or specified OTC derivatives transactions (the latest balance of outstanding account relating to securities-related market derivatives transactions may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to securities-related derivatives transactions).

If a customer is professional investor and a Special Member has established a system which enables a prompt reply to the said customer, the Special Member is allowed to omit a report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to individual derivatives transactions, etc. (limited to such document delivered to a customer) or in a written contract in which terms on the relevant derivative transaction, etc. are stated (limited to such contract executed with a customer) may also be omitted in the notice of reconciliation (art. 17, para. 5 and para. 6).

Furthermore, even if there is no current balance of money or securities in the customer’s account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Special Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10 applied mutatis mutandis through art. 16).
(ii) Preparation and Delivery of the Notice of Reconciliation

The notice of reconciliation shall be prepared in a Special Member’s inspection, audit, or administration department (art. 11, para. 1 applied mutatis mutandis through art. 16).

A Special Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation (art. 11, para. 2 applied mutatis mutandis through art. 16):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of reconciliation, an inquiry shall be made directly to the responsible person in the Special Member’s inspection, audit, or administration department without delay; and
(c) Contact information relating to item (b) above.

In addition, in the case where a Special Member delivers the notice of reconciliation to a customer, the Special Member must mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Special Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4 applied mutatis mutandis through art. 16).

Further, in the case where a Special Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through vii) above, the Special Member’s inspection, audit, or administration department must accept such inquiry and make a reply without delay to the said customer about the balance. Also, in the case where the inquiry is related to the financial instruments intermediary service, a Special Member shall, when necessary, request the financial instruments intermediary service provider who conducts entrustment of financial instrument intermediary service to make a report and shall investigate (art. 12 applied mutatis mutandis through art. 16).

(iii) Delivery of the Document To Be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Special Member delivers a document to be delivered upon conclusion of a contract to a customer, the Special Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Special Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 13, para. 1 applied mutatis mutandis through art. 16).
Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief manager or an employee authorized by the chief manager of a Special Member has brought a document to be delivered upon conclusion of contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2 applied mutatis mutandis through art. 16).

(7) Notice of Reconciliation and Document to Be Delivered upon Conclusion of Contract
(In case of Specified Business Members)

(i) Report by Notice of Reconciliation

A Specified Business Member must report to a customer by a notice of reconciliation in the category and frequency set forth in each of the following items.

However, this shall not apply to the case where the customer is the one to whom a transaction balance statement is delivered regularly, and the transaction balance statement includes the matters to be set forth on a notice of reconciliation (art. 20, para. 1):

(a) Customers who conduct sale and purchase or other transactions of securities
...........................................................................................................Once a year or more

(b) Customers who conduct specified OTC derivatives transactions
...........................................................................................................Twice a year or more

(c) Customers who have a positive balance of securities concerning the business related to specified OTC derivatives transactions (excluding customers who conduct the transactions set forth in item (a) and item (b) above)
...........................................................................................................Once a year or more

(d) Customers who have a positive balance of money or securities concerning the specified business and who have not conducted deliveries or transactions set forth in item (a) or (b) above for more than a year
...........................................................................................................From time to time

The matters to be stated on the notice of reconciliation are the balances of the following monies or securities relating to the specified business (art. 20, para. 2):

i) Latest balance of advance money or deposited money;

ii) Latest balance of cash collateral or collateral securities for specified OTC derivatives transactions (limited to the ones relating only to the relevant transactions); and

iii) Latest balance of outstanding account relating to specified OTC derivatives transactions.

If a customer is professional investor and a Specified Business Member has established a system which enables a prompt reply to the said customer, the Specified Business Member is
allowed to omit a report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to the specified business (limited to such document delivered to a customer) or in a written contract in which terms concerning the specified OTC derivatives transactions, etc. out of the specified business are stated (limited to a written contract executed by and between the person engaged in the business relating to the specified OTC derivatives transactions, etc. and its customer) may also be omitted in the notice of reconciliation (art. 20, para. 3 and para. 4).

Furthermore, even if there is no current balance of money or securities in the customer’s account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Specified Business Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10 applied mutatis mutandis through art. 19).

(ii) Preparation and Delivery of the Notice of Reconciliation
The notice of reconciliation shall be prepared in a Specified Business Member’s inspection, audit or administration department (art. 11, para. 1 applied mutatis mutandis through art. 19).

A Specified Business Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation (art. 11, para. 2 applied mutatis mutandis through art. 19):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of reconciliation, an inquiry shall be made directly to the responsible person in the Specified Business Member’s inspection, audit or administration department without delay; and
(c) Contact information relating to item (b) above.

In addition, in the case where a Specified Business Member delivers the notice of reconciliation to a customer, the Specified Business Member must mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Specified Business Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4 applied mutatis mutandis through art. 19).

Further, in the case where a Specified Business Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through iii) above, the Specified Business Member’s inspection, audit or administration department must accept such inquiry and make a reply without delay to the said customer concerning the balance (art. 12 applied mutatis mutandis through art. 19).
(iii) Delivery of the Document to Be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Specified Business Member delivers a document to be delivered upon conclusion of a contract to a customer, the Specified Business Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Specified Business Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 13, para.1 applied mutatis mutandis through art. 19).

Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief manager or an employee authorized by the chief manager of a Specified Business Member has brought a document to be delivered upon conclusion of contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2 applied mutatis mutandis through art. 19).

4 Rules Concerning Internal Administrators, Etc. of Association Members

The purpose of these Rules is to prescribe the posting, qualifications, duties, etc. of officers and employees who engage in management in Association Members of the compliance with the FIEA and other laws and regulations, thereby strengthening the internal administration systems of Association Members and contributing to the performance of proper sales activities (art.1).

(1) Registration of Internal Administration Supervisor

An Association Member must appoint one person as Internal Administration Supervisor and have the person registered in the register of Internal Administration Supervisors kept at the JSDA (art. 2, para. 1). Further, when a change in the contents of the registration occurs, an Association Member must register such change (art. 2, para. 2).

(2) Qualifications for Internal Administration Supervisor

The Regular Member’s Internal Administration Supervisor must, in general, be a representative director or a representative executive officer registered who takes charge of internal administration (as for a Regular Member that is a foreign juridical person, the Internal Administration Supervisor shall be a person having the authority corresponding to that of the representative concerned in Japan who is engaged in daily business operations at the said branch office) (art. 3, para. 1).

The Internal Administration Supervisor must be a person who can give advice to the chief executive officer (the president and representative director in general) from the viewpoint of compliance with the FIEA and other laws, regulations and rules, and
accordingly, it is desirable for a person who ranks high in the corporate organization to assume the office of the chief executive officer of the internal administration division.

An Association Member must not appoint as the Internal Administration Supervisor a person who is treated as a Class-1 perpetrator of an inappropriate act by the JSDA (art. 3, para. 4), and must not appoint any of the following persons as the Internal Administration Supervisor during the period specified herein: (a) a person who is treated as a Class-2 perpetrator of an inappropriate act by the JSDA or a person who has been subject to the disciplinary action to revoke his/her Sales Representative registration, during a period of five years from the day the JSDA took such disciplinary action, etc.; or (b) a person who has been subject to the decision to prohibit appointing him/her as a Sales Manager or an Internal Administrator (hereinafter referred to as “prohibition of appointment as a Sales Manager, etc.” in these Rules), a person who has been subject to the decision to prohibit assigning him/her to duties of a Sales Representative, or a person who has been subject to the disciplinary action to suspend his/her duties of a Sales Representative, during the effective period of such prohibition or disciplinary action (art. 3, para. 5, para. 6 and para. 7). (Note)

(Note) An Association Member must not appoint as the Internal Administration Supervisor a person who was subject to any of the following disciplinary actions before April 1, 2014, under the Rules Concerning Internal Administrators, Etc. of Association Members or the Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members prior to the revision: (a) a person whose Sales Manager qualification, Internal Administrator qualification or Sales Representative qualification was revoked, during a period of five years from the day the JSDA took such disciplinary action; or (b) a person whose Sales Manager qualification, Internal Administrator qualification or a Sales Representative qualification was suspended, during the effective period of such disciplinary action.

(3) Duties of Internal Administration Supervisor
The Internal Administration Supervisor must comply with the FIEA and other relevant laws, regulations and various rules, and endeavor to establish the internal administration system by directing officers or employees to keep a business attitude toward complying with the FIEA and other laws, regulations, and various rules so that sales activities including solicitation for investments, etc. and management of customers may be properly carried out (art. 4, para. 1).

(4) Instructions to Internal Administration Supervisor
The President & Director, etc. must ensure that the Internal Administration Supervisor is able to perform his/her duties properly, and when receiving a report from the Internal Administration Supervisor in accordance with the provisions of Paragraph 4 of the preceding Article, give proper instructions to him/her (art. 5).
(5) Sharing of Duties
The Internal Administration Supervisor may, at his/her own responsibility, delegate a part of the duties to Internal Administration Assistant Supervisor in order to perform his/her duties (art. 6, para. 1).

(6) Recommendation of Replacement of Internal Administration Supervisor and Internal Administration Assistant Supervisor
When the Internal Administration Supervisor or Internal Administration Assistant Supervisor has not properly performed his or her duties (each Paragraph of art. 4; art. 6, para. 6) such as breaching law and regulations, having concealed or having taken no action against breach of laws and regulations, etc., or such breach having occurred due to the instruction by him or her, the JSDA may recommend the Association Member to replace its Internal Administration Supervisor or Internal Administration Assistant Supervisor (art. 9, para. 1 and para. 2).

(7) Allocation of Sales Manager and Internal Administrator
An Association Member shall define the headquarters and other business office or administration office (including departments/sections of the headquarters and other business office or administration office) that conduct sales activities such as investment solicitation, etc. and customer management of the Association Member, as a sales unit, and appoint and allocate the chief of such sales unit as the Sales Manager (art. 10, para. 1).

An Association Members must appoint and allocate a manager etc. of internal administration business as the Internal Administrator of such sales unit (art. 13, para. 1).

(8) Qualifications of Sales Manager and Internal Administrator
A Regular Member must not appoint any person as Sales Manager unless he/she has passed the Qualification Examination for Regular Member’s Internal Administrator (including the Qualification Examination for Regular Member’s Sales Manager pursuant to the “Rules on Qualification Examination for Sales Representative, etc.” prior to the revision in April 1, 2006) (art. 11, para. 2).

A Regular Member must not appoint any person as Internal Administrator unless such person has passed the Qualification Examination for Regular Member’s Internal Administrator (art. 14, para. 2).

An Association Member must not appoint as the Sales Manager or the Internal Administrator a person who is treated as a Class-1 perpetrator of an inappropriate act by the JSDA (art. 11, para. 6, art. 14, para. 6), and must not appoint any of the following persons as the Sales Manager or the Internal Administrator during the period specified herein: (a) a person who is treated as a Class-2 perpetrator of an inappropriate act by the JSDA or a person who has been subject to the disciplinary action to revoke his/her Sales Representative registration, during a period of five years from the day the JSDA took such a disciplinary action, etc.; or (b) a person who has been subject to the decision of prohibition of appointment as a Sales Manager, etc., a person who has been subject to the decision to prohibit assigning him/ her to duties of a Sales Representative, or a
person who has been subject to the disciplinary action to suspend his/her duties of a Sales Representative, during the effective period of such prohibition or disciplinary action (art. 11, para. 7 and para. 8, and art. 14, para. 7 and para. 8). (Note)

(Note) An Association Member must not appoint as the Sales Manager or the Internal Administrator a person who was subject to any of the following disciplinary actions before April 1, 2014, under the Rules Concerning Internal Administrators, etc. of Association Members or the Rules Concerning Qualification and Registration, etc. of Sales Representatives of Association Members prior to the revision: (a) a person whose Sales Manager qualification, Internal Administrator qualification or Sales Representative qualification was revoked, during a period of five years from the day the JSDA took such disciplinary action; or (b) a person whose Sales Manager qualification, Internal Administrator qualification or Sales Representative qualification was suspended, during the effective period of such disciplinary action.

(9) Duties of Sales Manager and Internal Administrator

The Sales Manager must comply with the FIEA and other laws, regulations, and various rules; and guide and supervise officers or employees belonging to each sales unit for which the Sales Manager is appointed as the Sales Manager to keep a business attitude toward complying with the FIEA and other laws, regulations, and various rules so that sales activities including a solicitation for investments and management of customers may be properly carried out (art. 12, para. 1).

Internal Administrator must comply with the FIEA and other laws, regulations, and various rules; and perform proper internal administration by such means as constantly supervising to see if sales activities at the sales unit for which the Internal Administrator is appointed as the Internal Administrator are properly carried out in accordance with the FIEA and other laws and regulations (art. 15, para. 1).

Sales Manager and Internal Administrator must, when there has occurred a serious case concerning sales activities including solicitation for investments and management of customers at the sales unit for which he or she is appointed as the Sales Manager or Internal Administrator, promptly report to the Internal Administration Supervisor and receive his/her instructions (art. 12, para. 2; art. 15, para. 2).

(10) Action Prohibiting Allocation of Sales Manager, Etc.

(i) Action

In cases where the Sales Manager or Internal Administrator personally breaches laws or regulations, or any of the officers or employees who belong to the Sales Manager’s or Internal Administrator’s sales unit breaches laws or regulations, and it is judged that the Sales Manager or Internal Administrator has not sufficiently performed his or her duties (art. 12 and art. 15), such as the Sales Manager or Internal Administrator having concealed or having taken no
action against such breach of laws and regulations, etc., or such breach having been caused by the instruction by the Sales Manager or Internal Administrator, the JSDA may make a decision to take action to prohibit the Association Member to which the said Sales Manager or Internal Administrator belonged at the time of such breach from appointing or allocating him/her as a Sales Manager or Internal Administrator for a period not exceeding five years (art. 17, para. 1 and art. 18, para. 1)\(^\text{(Note)}\).

(Note) When the JSDA treats the Sales Manager or Internal Administrator in question as a perpetrator of an inappropriate act, it does not make a decision to take action prohibiting allocation of Sales Manager, etc. because the qualification of the Sales Manager or Internal Administrator is to be revoked.

(ii) Procedures for Taking Action

In cases where the JSDA intends to take action prohibiting allocation of Sales Manager, etc., it shall implement the procedures for explanation in accordance with the “Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members,” and send a notice of the action decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the action shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members, art. 8, 27, and 28).

(iii) Filing of Complaints

An Association Member which is an addressee of a decision to take action prohibiting allocation of a Sales Manager, etc. and its employee, etc. who is subject to that decision may file a complaint on the decision with the JSDA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

The Sales Manager and the Internal Administrator are positions responsible for properly conducting control over the employees, etc. who belong to their sales unit, and the JSDA requires that Association Members appoint appropriate persons to be a Sales Manager and Internal Administrator by taking such actions regarding persons inappropriate for these positions.

5 Rules Concerning Application for Confirmation, Examination, Confirmation, Etc. of Incidents

Financial instruments business operators, etc. are prohibited from compensating losses with respect to securities trading transactions, etc. unless (i) the compensation was due to the incidents of the financial instruments business operator, etc. or its officers or employees and the financial instruments business operator, etc. has obtained in advance the confirmation of the Prime Minister...
(Director-General of the Local Finance Bureau), or (ii) it falls under the cases in which confirmation of incidents is not required as prescribed in the FIBCOO (FIEA, art. 39, para. 1 and para. 3; FIBCOO, art. 119, para. 1).

The cases in which confirmation of incidents is not required as prescribed by the FIBCOO include cases where the final judgment of the court has been awarded or cases such as “examination and confirmation by the committee established within the financial instruments firms association has been conducted.”

Among the cases in which confirmation of incidents is not required as prescribed by the FIBCOO, cases determined by the financial instruments business operator, etc. or determined by the committee established within the financial instruments firms association must be reported to the Director-General of the Local Finance Bureau (FIBCOO, art. 119, para. 3).

These Rules prescribe necessary procedures, etc. in order to report to the Director-General of the Local Finance Bureau in connection with obtaining a confirmation from the Prime Minister (Director-General of the Local Finance Bureau) as set forth in item (i) of the previous paragraph, and an examination and confirmation by the committee established with the JSDA, which are among the description made in 1. above.

In these Rules, “incidents” refer to incidents concerning the sales and purchase and other transactions, etc. specified in Article 3, Item 8 of the JSDA’s Articles of Association from among the incidents set forth in Article 39, Paragraph 3 of the FIEA, and “compensatory conduct” refers to the conducts set forth in Article 39, Paragraph 1, Items 2 and 3 of the FIEA (art. 2, items 1 and 2).

(1) Application for Examination and Confirmation by the Committee

(i) Application for Examination and Confirmation by the Committee

If an Association Member shall take compensatory conduct due to the incidents of the Association Member or its employees, etc. (limited to cases where the amount to be paid to the customer with respect to losses due to incidents are fixed between the Association Member and the customer, and the amount to be paid by the Association Member to the customer does not exceed JPY10 million; hereinafter the same in (1)), it must obtain the examination and confirmation of the committee in advance that the payment to the customer will be made to compensate losses due to incidents except for cases where an application for confirmation will be made or in cases prescribed by the FIBCOO (cases provided for in FIBCOO, art. 119, para. 1, items 1 through 8, item 10 or item 11) (art. 8, para. 1).

An Association Member applying for such examination and confirmation must submit an application for examination and confirmation of incidents (hereinafter referred to as “Application for Examination and Confirmation” in these Rules) to the incident confirmation committee (art. 8, para. 2).

(ii) Examination and Confirmation by the Committee

Upon receiving the Application for Examination and Confirmation from an Association Member pursuant to (i) above, the incident confirmation committee shall conduct an examination and confirm whether the payment to the customer as stated in the Application for
Examination and Confirmation will be made to compensate losses due to incidents (art. 9, para. 1).

(iii) Response to the Association Member

After the incident confirmation committee has conducted the examination and confirmation in (ii) above, it shall promptly respond the contents thereof to the Association Member that made the application (art. 10). In response to the results, the Association Member shall make payment to the customer.

(2) Reporting of Incidents

If an Association Member has taken compensatory conduct upon examination and confirmation by the incident confirmation committee in cases of compensatory conduct of JPY 100,000 or less, etc. as determined by the Association Member, it must report to the Director-General of the Local Finance Bureau (art. 12, para. 1).

This report must be made via the JSDA by submitting a report to the JSDA by the 20th of the month following the month in which the compensatory conduct was taken (art. 12, para. 2).

(3) Application for Confirmation

If an Association Member shall take compensatory conduct due to the incidents of the Association Member or its employees, etc. it must receive the confirmation of the competent Director-General of the Local Finance Bureau, etc. in advance that losses concerning the compensatory conduct was due to incidents except for cases where confirmation by the competent Director-General of the Local Finance Bureau, etc. is not required (art. 4, para. 1).

An Association Member applying for such confirmation must submit an application for confirmation of incidents (hereinafter referred to as “Application for Confirmation”) to the competent Director-General of the Local Finance Bureau, etc. via the JSDA (art. 4, para. 2 and para. 4).

The JSDA will examine whether the losses concerning the compensation as stated in the Application for Confirmation is due to incidents (art. 5, para. 1), and submit the Application for Confirmation to the competent Director-General of the Local Finance Bureau, etc. (art. 6).

The result of the confirmation by the competent Director-General of the Local Finance Bureau, etc. is notified to the Association Member via the JSDA (art. 7), and if the confirmation of the competent Director-General of the Local Finance Bureau, etc. is obtained, the Association Member shall provide financial benefit (payment of money, etc.) to the customer.

Rules Concerning Financial Instruments Intermediary Service Providers

The purpose of these Rules is, in connection with the entrustment of business relating to the financial instruments intermediary service of Association Members, to define matters, etc. that Association Members should ensure that financial instruments intermediary service providers comply with, and to ensure proper business management by the said financial instruments intermediary service providers through the instruction and supervision by Association Members, thereby contributing to the protection of investors (art. 1).
As used here, “financial instruments intermediary service provider” refers to those persons who carry out the financial instruments intermediary service set forth in FIEA, Article 2, Paragraph 11 (limited to such service relating to the acts set forth in Items 1 through 3 of the said Paragraph (with respect to the acts set forth in Item 2, excluding those pertaining to the transactions set forth in each item of FIEA Enforcement Order, Article 16-4, Paragraph 2)) among financial instruments intermediary service providers as set forth in Paragraph 12 of the said Article, whose entrusting financial instruments business operator, etc. (meaning the entrusting financial instruments business operators, etc., as set forth in FIEA, Article 66-2, Paragraph 1, Item 4) is an Association Member (art. 2, item 3; Articles of Association, art.3, item 9).

(1) **Thorough Compliance with Laws, Etc. by Financial Instruments Intermediary Service Provider**

An Association Member must ensure that a financial instruments intermediary service provider thoroughly understands and complies with the FIEA and other applicable laws and regulations, the Articles of Association, and other rules of the JSDA (hereinafter referred to as “laws, etc.”) (art. 3, para.1). In case where an Association Member becomes aware that a financial instruments intermediary service provider has taken an action that breaches the laws, etc., the Association Member must request the financial instruments intermediary service provider to correct such breach (art. 3, para. 2).

If it is found that a person who belongs to a financial instruments intermediary service provider and who seeks to be registered as a sales representative, or a financial instruments intermediary service provider who is an individual (hereinafter referred to as an “individual financial instruments intermediary service provider” in these Rules), has been subject to the decision of treatment as a Class-2 perpetrator of an inappropriate act under Article 12, Paragraph 1 of the Rules Concerning Employees of Association Members, the Association Member concerned shall have the financial instruments intermediary service provider provide training courses, etc. to such person or have the individual financial instruments intermediary service provider attend the training courses, etc. it provides regarding the prevention of violation of laws and regulations and the protection of investors (art.3-2).

(2) **Conclusion of a Business Delegation Agreement for Financial Instruments Intermediary Business**

In the case where the Association Member concludes a business entrustment agreement on the financial instruments intermediary service, it must provide for the following matters in the business entrustment agreement (art. 4):

i) A financial instruments intermediary service provider or its officers or employees must comply with the FIEA and other applicable laws and regulations;

ii) An Association Member shall instruct and supervise a financial instruments intermediary service provider to comply with the Articles of Association and
other rules of the JSDA, and the financial instruments intermediary service provider must comply with the instructions from the Association Member;

iii) In case where the JSDA either took a disciplinary action against an Association Member with respect to an individual financial instruments intermediary service provider or a sales representative of a financial instruments intermediary service provider, or an action prohibiting business of sales representative prescribed in Article 29, Paragraph 1, such individual financial instruments intermediary service provider or sales representative must obey such disciplinary action or action of prohibition;

iv) In the case where the JSDA requests a financial instruments intermediary service provider to participate in an interview or submit materials, the financial instruments intermediary service provider must comply with such request; and

v) An Association Member may inspect a financial instruments intermediary service provider, and the financial instruments intermediary service provider must undergo such inspection.

(3) Prohibition of Dual Registration as Sales Representative of Association Member

An Association Member must not entrust the business relating to the financial instruments intermediary service to an entity to which its own sales representative or sales representative of other Association Members belongs (art. 5, para. 1). In the case where the Association Member entrusts the business relating to the financial instruments intermediary service provider to the entity to which its sales representative or a sales representative of another Association Member belongs, the Association Member must clearly provide in the relevant agreement that the registration of such sales representative must be cancelled before the completion of registration as a financial instruments intermediary service provider, and that the business entrustment cannot commence until the registration of such sales representative is cancelled (art. 5, para. 2).

An Association Member must not make an officer or employee of a financial instruments intermediary service provider registered as its own sales representative (art. 5, para. 3).

(4) Compliance with Various Rules concerning Investment Solicitation

An Association Member must thoroughly disseminate matters including the principle of suitability, explanation of important matters and principle of self-responsibility of investors to financial instruments intermediary service providers and ensure their compliance with these matters (art. 6, para. 1). An Association Member must establish a system that enables a financial instruments intermediary service provider to conduct proper investment solicitation by using a “customer card” to be prepared by the Association Member pursuant to Article 5 of the “Rules Concerning Solicitation for Investments and Management of Customers, etc. by Association Members” and as prescribed in Article 5-2 and Article 5-3 of the same rules (art. 6, para. 2).

An Association Member must have a financial instruments intermediary service provider
avoid recommending to its customers the securities of specific issues in a uniformed and intensive manner, which represents a provision of subjective and arbitrary information. (art. 8, para.1).

(5) **Thorough Implementation of Internal Administration, Etc. towards Financial Instruments Intermediary Service Provider**

An Association Member must thoroughly instruct a financial instruments intermediary service provider to establish, maintain, and comply with internal rules and grasp the status of business operations of the financial instruments intermediary service provider for the purpose of ensuring proper conduct of transactions with customers through the financial instruments intermediary service provider and customer management, and ensure that its internal administrator appropriately controls and audits that a financial instruments intermediary service provider conducts the business properly and complies with the laws and regulations (art. 7).

Any prospective advertising, etc. and offers of premiums to be made by a financial instruments intermediary service provider for its service must be examined by the Association Member (art. 13).

(6) **Reference to the JSDA**

An Association Member shall refer to the JSDA using a designated method in order to confirm whether a person (limited to individuals) with whom the Association Member intends to execute a business entrustment agreement relating to the financial instruments intermediary service or who belongs to the financial instruments intermediary service provider and intends to be registered as a sales representative (hereinafter “referred person” in these Rules) has been treated as Class-1 perpetrator of an inappropriate act pursuant to the Rules Concerning Employees of Association Member, Article 12, Paragraph 1 or whether such person has been subject to decision concerning treatment and/or action, and/or disciplinary action set forth in (i) through (iv) below in the last five years (art. 15, para. 1 and para. 2).

The JSDA shall, upon receiving a request for reference, reply to the Association Member making the request in the prescribed method as to whether the referred person has been subject to the decision of treatment as a Class-1 perpetrator of an inappropriate act or the decision of treatment and disciplinary action by the JSDA as set forth in (i) through (iv) below within the five years preceding the date of the reply, and the summary thereof, without delay (art. 15, para. 3 and para. 4):

| (i) | Disciplinary action to revoke the registration as a sales representative or to order the suspension of duties; |
| (ii) | Action prohibiting assignment to duties of a sales representative; |
| (iii) | Treatment as a class 2 perpetrator of an inappropriate act; or |
| (iv) | Action prohibiting appointment as a sales manager or internal administrator. |
(7) **Sales Representative Qualifications and Training Courses**  
Association Members must not permit an individual working as an individual financial instruments intermediary service provider or an employee or officer of a financial instruments intermediary service provider who has not obtained the necessary qualifications as a sales representative to engage in sales representative activity, nor must Association Members permit such parties to engage in sales representative work that are outside the scope of their qualifications (art. 16).

Association Members must ensure that individual financial instruments intermediary service providers and the sales representatives of financial instruments intermediary service providers attend training courses conducted by the JSDA to renew their qualifications (within 180 days from the date of registration as sales representative and every five years from such date of registration) (art. 19).

(8) **Prohibited Acts of Sales Representatives**  
Association Members shall ensure that individual financial instruments intermediary service providers or the Sales Representatives of financial instruments intermediary service providers do not, in connection with their financial instrument intermediary service, engaged in prohibited acts such as compensating customers for losses, or the sale and purchase or other transactions of securities without the consent of customers or improper acts (art. 24 and art. 25).

(7) **Rules Concerning Elimination of Relationships with Antisocial Forces**  
The purpose of these Rules is to provide necessary matters for the elimination of any relationship with any antisocial force, ensure the sound operations of businesses by Regular Members and preclude any antisocial force from financial instruments transactions and financial instruments markets, thereby contributing to the sound development of capital markets and the protection of investors (art. 1).

In these Rules, “antisocial forces” mean organized crime groups (*boryokudan*), organized crime group members, associate member of organized crime group, associate corporation of organized crime group, corporate racketeer (*sokaiya*, etc.), blackguard claiming itself a social activist, etc., special intellectual crime group, etc. and other person similar to thereto (art. 2; Rules Concerning the Enforcement of the Articles of Association, art. 15).

(1) **Basic Stance**  
A Regular Member must not effect any sale and purchase or other transactions of securities, etc. with any person knowingly being an antisocial force (art. 3, para. 1).

Furthermore, a Regular Member must not provide any funds or other benefits to any person knowingly being an antisocial force (art. 3, para. 2).

(2) **Development and Announcement of Basic Policies**  
A Regular Member must develop basic policies to shut off any relationships with any antisocial forces and disseminate such basic policies internally and publish the basic policies or
their outline (art. 4).

(3) **Undertaking that a Customer is not an Antisocial Force**

A Regular Member must in advance obtain the undertaking that the customer is not a member of an antisocial force before it attempts to open an account for any sale and purchase or other transactions of securities for the customer for the first time (art. 5).

(4) **Conclusion of Contract to Preclude Antisocial Forces**

A Regular Member must prescribe the matters mentioned in (i) through (iii) below into a contract or trading agreement when it accepts any order for sale and purchase or other transactions of securities, etc. from the customer (art. 6):

(i) The statement that if the undertaking that the customer is not an antisocial force proves to be false, the contract or agreement shall be terminated by notification from the Regular Member;

(ii) The statement that if the customer proves to meet any category of antisocial forces, the contract shall be terminated by notification from the Regular Member; and

(iii) The statement that in the case where a customer makes a demand with nature of violence and makes an unduly demand beyond the responsibility set forth by laws and the Regular Member acknowledges that it will be difficult to maintain the contract, the contract shall be terminated by notification from the Regular Member.

(5) **Implementation of Examination**

A Regular Member must endeavor to examine whether a customer who wishes to open an account for sale and purchase or other transactions of securities, etc. for the first time meets any category of antisocial forces in advance (art. 7, para. 1).

A Regular Member must examine a customer, who wishes to open an account for sale and purchase or other transactions of securities, etc. for the first time, by a method that has been determined between the JSDA and the Regular Member in advance (art. 7, para. 2), and when conducting the examination, a Regular Member must comply with matters that have been agreed upon in advance between the JSDA and the Regular Member (art. 7, para. 3).

In addition, a Regular Member must endeavor to regularly examine whether there is any person or entity who meets any category of antisocial forces in the customers for whom the Regular Member has opened an account for sale and purchase or other transactions of securities, etc. (art. 7, para. 4).

Furthermore, a Regular Member must examine whether a customer meets any category of antisocial forces whenever a suspicion arises (art. 7, para. 5).
(6) Prohibition of Conclusion of Contract and Dissolution of Relationship

In the case where, as a result of the examination prescribed in Article 7, Paragraph 1 or Paragraph 2 against the customer who wishes to open an account for the first time, a person or entity proves to meet any category of antisocial forces, the Regular Member must never be permitted to enter into any contract with the person or entity; provided, however, that this shall not apply to cases when the contract is entered into to preclude the antisocial forces from the financial instruments transactions and financial instruments markets (art. 8, para. 1).

In addition, in the case where, as a result of the regular examination prescribed in Article 7, Paragraph 4 for the customer who has an account or the examination prescribed in Article 7, Paragraph 5 when a suspicion arises, a person or entity proves to meet any category of antisocial forces, the Regular Member must endeavor to dissolve the relationship with the person or entity as soon as possible (art. 8, para. 2).

(7) Gathering of Information

A Regular Member must endeavor to gather information about antisocial forces (art. 9).

(8) Provision of Trainings, Etc.

In regards to the procedures for the responses to any antisocial force and the control of information on antisocial forces, a Regular Member must endeavor to enlighten officers and employees by providing internal educations and training, etc. (art. 10).

(9) Establishment and Improvement of Internal Administration System

A Regular Member must establish internal rules to implement the basic policies and oblige all the officers and employees to comply with them and endeavor to develop and improve the administration system to shut off the relationship with any antisocial force pursuant to the internal rules prescribed in the preceding Paragraph (art. 11).

(10) Enhancement of Management System

A Regular Member must regularly review the management system to eliminate any relationship with antisocial forces (art. 12).

(11) Collaboration and Cooperation with JSDA and Police, Etc.

A Regular Member must endeavor to have a close collaboration and cooperation with the JSDA and police, etc. with a view to eliminating any relationship with antisocial forces, and whenever any dispute or trouble takes place between a Regular Member and antisocial forces, the Regular Member must endeavor to prevent any occurrence of damages caused by antisocial forces by immediately referring the incident to and consulting with lawyers, the JSDA, police and other relevant organizations, etc. (art. 13).

(12) Application Mutatis Mutandis to Specified Business Members

The provisions of these Rules, except for Article 7, Paragraphs 2, 3, and 6, shall apply
mutatis mutandis to Specified Business Members (art. 14).

4 2 Employees, Sales Representatives

1 Rules Concerning Employees of Association Members

The purpose of these Rules is, in view of the public nature and importance of the social mission of the financial instruments business, to contribute to the investor protection by prescribing the service standards, etc. for the employees of the Association Members as well as defining the responsibilities of the Association Members to supervise their employees (art. 1).

Under the rules, “employee” means, in the case of a Regular Member, its employees (including seconded persons) that work at the principal office or branch office located in Japan (art. 2, item 6 (a)). On the other hand, in the case of a Special Member, this refers to employees (including seconded persons) engaged in the registered financial institution business (including persons engaged in the specified financial instruments business provided for in FIEA, art. 33-8, para. 2) at the principal office or other business offices or outlets in Japan (art. 2, item 6 (c)). Among dispatched workers under the Act for Securing the Proper Operation of Worker Dispatching Undertakings and Protection of Dispatched Workers, those who are registered as the sales representative prescribed in the provision of FIEA, Article 64, Paragraph1, are the employees under these Rules (art. 2, item 6 (d)).

These Rules also apply mutatis mutandis to officers of the Association Member, except for certain portions of the rules, such as Article 4, Paragraph 1 (prohibition on employing the employees of another Association Member) and Article 6 (basic service standards), etc. (art. 17).

The remainder of this section shall briefly describe these Rules.

(1) Hiring of Employees

(i) Treatment of Employees Who Have Violated Laws and Regulations, Etc.

If it is found in the examination for hiring that a person whom an Association Member seeks to hire has been subject to, inter alia, the decision of treatment as a Class-2 perpetrator of an inappropriate act under Article 12, Paragraph 1 of the Rules Concerning Employees of Association Members, the Association Member concerned shall provide training courses, etc. to such person regarding the prevention of breaches of laws and regulations and the protection of investors (art.3-2).

(ii) Prohibition of Hiring

In order to clarify the locus of oversight responsibility for an employee, Association Members are prohibited from hiring any persons who are the employees of another Association Member as their own employees. However, cases where such persons are hired under a secondment, etc. are excluded from this prohibition (art. 4, para. 1).

Also, an Association Member must not hire any person who has been treated as a Class-1 perpetrator of an inappropriate act under the system of perpetrators of inappropriate acts as an
employee of an Association Member for an indefinite term. An Association Member must not hire any person who has been treated as Class-2 perpetrator of an inappropriate act within five years from the date when the said person was determined to be a Class-2 perpetrator of an inappropriate act (art. 4, para.2 and para. 3).

(iii) Reference to the JSDA

The JSDA has prescribed a reference system prior to the hiring of an employee with the intent to take all possible measures to exclude persons deemed unqualified to serve as employees, especially those who have been treated as a perpetrator of an inappropriate act (art. 5).

When an Association Member hires a new employee who is currently or was an employee of another Association Member or a financial instruments intermediary service provider or its sales representative, the Association Member must refer to the JSDA in the prescribed manner as to whether or not the applicant has been treated as a Class-1 perpetrator of an inappropriate act. When an Association Member intends to hire a new employee who is currently or was in the past five years an employee of another Association member or a financial instruments intermediary service provider or its sales representative, the Association Member must refer to the JSDA in the prescribed manner as to whether or not the applicant has been subject to decision concerning treatment and/or action, and or disciplinary action set forth in (a) through (d) below (art. 5, para. 1 and para. 2).

The JSDA shall, upon receiving a request for reference, reply to the Association Member making the request in the prescribed manner whether the referred person has been subject to the decision of treatment as a Class-1 perpetrator of an inappropriate act or the decision of treatment and disciplinary action by the JSDA as set forth in (a) through (d) below within the five years preceding the date of the reply, and the summary thereof (art. 5, para. 4 and para. 5):

(a) Treatment as a Class-2 perpetrator of an inappropriate act;
(b) Disciplinary action to revoke the registration of a sales representative or suspend its duties;
(c) Action prohibiting assignment to duties of a sales representative; or
(d) Action prohibiting appointment as a sales manager or internal administrator.

(2) Prohibited Acts

A list of the prohibited acts of officers and employees of financial instruments business operators appears in Article 38 of the FIEA, as well as in Article 117 of the FIBCOO. This series of provisions is included to promote investor protection, secure transactional fairness, and at the same time maintain confidence in the financial instruments business operators and capital market.

In addition to containing a list of the prohibited acts of the officers and employees of an Association Member under these laws and regulations, provisions describing the prohibited acts of employees are also included in these Rules with a view to preventing occurrence of incidents
relating to financial instrument trading.

These provisions of prohibited acts literally provide the prohibited acts of Association Members themselves and clarify the Association Members’ oversight responsibility for their employees, and the JSDA does not directly bind the Association Members’ employees. However, if the behavior of an employee is found to conform to the description of prohibited acts, or if an employee has behaved in such a way as to violate laws or regulations which the employee is required to observe, or has engaged in improper acts prescribed in Article 8 of these Rules (with the exception of negligence), the JSDA imposes on an Association Member the obligation to handle the problem in an appropriate manner in light of the nature of the particular behavior and to submit a report to the JSDA outlining all the related facts (art. 10, para. 1).

This is because, in light of its organization, the scope to which the rules of the JSDA apply directly is limited to the Association Members of the JSDA. It is, therefore, assumed that the basis of these Rules is founded on the expectation that all employees are sufficiently aware of their obligation to follow the spirit of these Rules and to guard against the occurrence of any behavior which might be in violation of the rules as stipulated here in during the day-to-day execution of their work duties. Moreover, an appropriate attitude toward investment solicitation as well as a generally progressive attitude are also expected.

In addition, the provisions governing the prohibited acts apply mutatis mutandis to officers.

Below, the major acts prohibited by the rules are enumerated and explained:

(i) Prohibition Against Margin and Securities-Related Derivatives Transactions, Etc.

An Association Member must ensure that its employees, regardless of whatever name they may use, will not conduct margin transactions, securities-related derivative transactions, etc., or specified OTC derivative transactions, etc. on their own account (art. 7, item 4).

This rule, since the margin transactions, securities-related derivative transactions, etc. and specified OTC derivative transactions, etc. have a speculative nature, has been provided in order to avoid the circumstances where an employee himself/herself runs into excessive speculative trading and as a result leads the customer and the company to suffering losses.

This shall not apply, however, if the trade carried out by the Association Member’s employee concerns share or share options for which it has been decided that they will be granted from the Association Member as a part of the employee’s remuneration and the trade is carried out during the time periods set out below, and it is a trade conducted in order to reduce risk that may arise due to fluctuation in price pertaining to its retention as listed in FIEA, Article 2, Paragraph 21, Item 3;
Paragraph 22, Item 3; and from among those listed in Paragraph 23, those trades analogous to Paragraph 21, Item 3, and has been approved by the Association Member as not being for the purpose of pursuing solely speculative profits:

A. Share: From the day that the grant was decided until the day of the actual grant; or
B. Share options: From the day that the grant was decided until the day that it becomes possible to exercise rights.

(ii) Prohibition Against “Acceptance of So-Called Transactions under Fictitious Name”

In accepting orders from customers regarding sales and purchase or other transactions of securities, etc., employees must not accept an order knowingly that it is a transaction under fictitious name (art. 7, para. 9).

This rule and Article 13 of “Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members” prohibit the acceptance of transactions under fictitious name from the point of view of preventing unfair trades, as well as from the perspective of appropriate customer management, and tax system fairness.

“Transaction under fictitious name” means a transaction in which the person having title to the account and the person to whom the benefits of the trade revert are not one and the same. For example, it is a transaction in which a customer uses a fictitious name or the name of another person and tries to obtain the legal benefit of the transaction.

Because this rule and Article 13 of the “Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members” prohibit the acceptance of the said transactions under fictitious name, it does not impose restraints on acceptance of the account holder’s orders from the representative of the account holder or a person (the so-called “messenger”) who no more than transmits the intent of the account holder himself.

Provided, even in that case, from the standpoint of preventing acceptance of transactions under fictitious name, it is necessary to devise an internal system for prevention of acceptance of transactions under fictitious name such as by use of a manual that sets out acceptance procedures.

Further, where an order is placed by a relative having a close relationship to the account holder such as a spouse or blood relative within the second degree of consanguinity, it can be said that there is a high probability that it is not a transaction under fictitious name that is prohibited in this provision. Thus, in such case, if it has been confirmed that it is the spouse or blood relative within the second degree of consanguinity of the account holder, so long as there has been no declaration that it is a transaction under fictitious name, it is thought that the
possibility is low that acceptance of such order would be in violation of this provision.

In addition to the above, Article 7 also stipulates the examples of prohibited acts for Association Member employees given below, each prescribed in order to protect the interests of investors while foremost maintaining confidence in financial instruments business operators and the capital markets. This includes the establishment of basic guidelines necessary for the development of a healthy attitude toward the solicitation of investments as well as a means of preventing securities incidents.

(iii) To make an offer or promise, or cause a third party to offer or promise to a customer (including the trustor in cases where a trust company, etc. conducts trades of securities, securities-related derivatives transactions, or specified OTC derivative transactions (hereinafter “securities, etc.” in these Rules) pursuant to the trust contract for the account of the trustor; hereinafter the same in (iii), (iv), and (v)) or a person designated by the customer to the effect that, with respect to a sale and purchase or other transaction involving securities (excluding transactions effected on condition of repurchase at a predetermined repurchase price or other transactions prescribed by FIEAEO, Article 16-5; hereinafter the same in (iv) and (v) below), the Association Member or a third party will provide property benefit to the customer or third party in order to compensate in whole or in part a loss arising from such transaction if the customer incurs a loss or make an addition to profit arising from such transaction if the customer does not realize a predetermined amount of profit (art. 7, item 1).

(iv) To make an offer or promise, or cause a third party to make an offer or promise to the customer or a person designated by the customer to the effect that, with respect to a sale and purchase or other transaction of securities, securities-related derivatives transaction or specified OTC derivatives transaction, the Association Member or a third party will provide property benefit to the customer or third party in order to compensate in whole or in part for losses incurred by the customer on the securities, etc., or to make an addition to profit realized by the customer on these transactions (art. 7, item 2).

(v) To provide, or cause a third party to provide, property benefit to a customer or a third party with respect to a sale and purchase or other transaction of securities, etc., securities related derivatives transactions or specified OTC derivatives transactions, in order to compensate in whole or in part for the losses incurred by the customer on the securities, etc., or to make an addition to profit realized by the customer from these transactions (art. 7, item 3).
To solicit a customer for a sale and purchase or other transaction of securities, etc. with an excessive volume in light of the amount of funds for investments or other information of which the employee has come to know through the customer card, etc. (art. 7, item 5) (see 4.1 “Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members” of this Chapter for details).

To solicit a customer for sales and purchase or other transactions in securities, etc., or execute such transactions by promising to share with the said customer the profits or losses resulting from the transaction (art. 7, item 6).

When receiving an order for a sale and purchase or other transaction in securities, etc. to execute the sale and purchase or other transaction of securities, etc. by acting as a counterparty to the transaction (art. 7, item 7).

To allow a customer to use the employee’s own name, the name of his/her relative or of a person who has a special relationship with him/her for a sale and purchase or other transaction in securities, etc., or a change in the name of the registered holder (art. 7, item 8).

To use the name or address of a customer for its own sale and purchase or other transaction in securities, etc. (art. 7, item 10).

To process changes in the name of the registered holder, etc., or other procedures requested by the customer without going through the Association Member for which the employee works (art. 7, item 11).

To fail to deliver the money or securities which a customer has instructed an employee to deliver to the Association Member for which he/she works, or to fail to deliver without delay the money and securities (in the case of a Specified Business Member, limited to the money and securities pertaining to the specified business.; in the case of a Special Member, limited to the money and securities pertaining to registered financial institution business), which the Association Member for which he/she works has instructed him/her to deliver to the customer (art.7, item 12).

To fail to deliver without delay to a customer documents concerning functions which the Association Member for which an employee works has instructed him/her to deliver to the said customer (in the case of a Specified Business Member, limited to documents concerning the specified business; in the case of a Special Member, limited to documents concerning registered financial institution business) (art. 7, item 13).

To lend to or to borrow from a customer money or securities concerning a sale and purchase or transaction in securities, etc. (including advance payment of the customer’s debt) (art. 7, item 14).

To disclose confidential information of which an employee has come to know in performing his/her duties (in the case of a Specified Business
Member, limited to documents concerning the specified business; in the case of a Special Member, limited to documents concerning registered financial institution business) (art. 7, item 15).

(xvi) To conduct advertising, etc. or offer a premium at the employee’s own discretion, without receiving the examination by the advertising examining manager (meaning the “advertising examining manager” set forth in Article 5 of the “Rules Concerning Representation of Advertising, Etc. and Offer of Premium”) (art. 7, item 17).

(xvii) To accept an order for the sale of securities from a customer that is conducted on a financial instruments exchange market without confirming whether the subject sale is classified as a short sale. However, this does not apply to those transactions described in Article 11 of the Cabinet Office Ordinance Concerning Regulation of Securities Transactions, Etc. (hereinafter the “Transaction Regulation Ordinance”). The provisions of the main clause and proviso of this item shall apply mutatis mutandis to the sale of securities in the proprietary trading system (the same applies in (xviii)) (art. 7, item 21).

(xviii) When conducting a short sale of securities entrusted by a customer on a financial instruments exchange market, to execute the short sale at a price equal to or less than the last quoted price (meaning the last quoted price prescribed in FIEA Ordinance, Article 26-4, Paragraph 1; hereinafter the “Last Quoted Price”; the same applies in (xix)) if the case falls under any of the items of the said Paragraph. However, this does not apply to those transactions described in Article 15 of the Transaction Regulation Ordinance and when the short sale is executed at the Last Quoted Price in cases where the Last Quoted Price is greater than the last different price from the Last Quoted Price announced before the announcement of the said Last Quoted Price (the same applies in (xix)) (art. 7, item 22).

(xix) In entrusting another Regular Member to carry out a short sale order received from a customer, to give instruction that the short sale is to be executed at a price that is less than the Last Quoted Price (art. 7, item 23).

(xx) Upon soliciting switching (meaning the acquisition, purchaser or the entrustment, etc. thereof of trust beneficiary certificates, etc. (meaning the beneficiary certificates of an investment trust or foreign investment trust (other than those enumerated in the FIBCOO, Article 65, Item 2(a) through Item 2(c) and securities possessing characteristics similar thereto), investment certificates or foreign investment certificates classified as investment certificates, but excluding those listed on a financial instruments market of an exchange) in association with the partial cancellation, or redemption of investment units of an investment trust contract or sale of investment trust beneficiary certificates, etc., or the entrustment thereof,
with respect to investment trust certificates, etc. that are currently being held) for investment trust beneficiary certificates, etc., to fail to explain the material matters concerning the said switching to the customer (other than professional investors prescribed in FIEA, Article 2, Paragraph 31; the same applies in (xxi) and (xxii)) (art. 7, item 24).

(xxi) To solicit the execution of a CFD transaction contract (referring to the CFD transaction contract prescribed in Article 3, Item 3 of the Rules Concerning CFD Transactions (excluding OTC CFD Transaction Contracts prescribed in Item 4 of the said Article); hereinafter the same shall apply in these Rules) to a customer, without confirming whether or not the customer intends to receive such solicitation prior to solicitation (art. 7, item 25).

(xxii) To continue the solicitation of the execution of a CFD transaction contract even though the customer being solicited manifested his or her intent not to conclude the CFD transaction contract (including the intent to not receive such solicitation in the future) (art. 7, item 26).

(xxiii) To conclude a contract in sales and purchase or other transactions, etc. in securities regarding while an Regular Member or Specified Business Member knowing that a customer is an antisocial force; provided, however, excluding cases where antisocial forces shall be eliminated from financial instruments trading and the financial instruments market (art. 7, item 27; only applicable to Regular Members and Specified Business Members).

(xxiv) To conduct or solicit a transaction relating to the registered financial institution business with a customer with a promise to provide the customer with special consideration concerning financing, guarantees, etc. (art. 7, item 18; only applicable to Special Members).

(xxv) To extend credit clearly intended to be used as initial or additional margin money for a transaction relating to the registered financial institution business (art. 7, item 19; only applicable to Special Members).

(xxvi) For transactions relating to the registered financial institution’s financial instruments intermediary service, to conduct registered financial institution’s financial instruments intermediary service with providing or promising to automatically extend credit to the customer in cases where the account of a customer opened with a Regular Member shows a deficit balance (art. 7, item 20; only applicable to Special Members).

(3) Improper Acts

Association Members must give guidance to or supervise their employees in order not to engage in any act enumerated in the following items (hereinafter “improper acts” in these Rules) (art. 8):
(i) To execute a customer order without confirming the issue name, price, volume, classification as a limit order or market order, etc. in sale and purchase or other transactions of securities, etc. (in the case of a Specified Business Member, limited to customer orders concerning the specified business; in the case of a Special Member, limited to customer orders concerning registered financial institution business; the same in (iv));

(ii) To solicit a customer in a way that will mislead him/her with respect to the nature of securities, etc. or terms of the transaction;

(iii) To solicit a customer in a way that will mislead him/her with respect to rise or fall of the price of a security or the value of an option in the transactions set forth in Article 8, Item 3; and

(iv) To make a mistake in administration process by negligence with respect to the execution of a customer order pertaining to sale and purchase or other transactions of securities, etc.

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(4) Reporting of Incidents

(i) Incident Notification

In cases where it becomes clear that any person who is currently or had been in the employment of an Association Member (hereinafter “employee, etc.” in these Rules) has committed any of the prohibited acts described in (2) above and an act provided for in Article 5 of the “Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members” or an act in violation of any law or regulation, etc. which the employee is required to observe, or any improper act under (3) above (hereinafter an “incident” in these Rules), the Association Member must immediately submit to the JSDA a notification of securities incident using the prescribed form, except where the improper act mentioned in (3) above was committed by negligence (art. 9, para. 1).

(ii) Report of Development and Results of the Incidents

When the particulars of the incident (excluding the case where the improper act mentioned in (3) above was committed by negligence) are found out, the Association Member must take a disciplinary action against the offending employee according to the nature of the incident and must submit to the JSDA without delay a report of development and results of the incidents stating the particulars of the case using the prescribed form (art. 10, para. 1).

An Association Member must, when it finds that the content of the incident is of a nature that causes an egregious loss of confidence in the financial instruments business, include a statement to such effect on the report of development and results of the incidents (art. 10, para. 2).
(5) **System of Perpetrators of Inappropriate Acts**

(i) **Treatment of Perpetrator of an Inappropriate Act**

In cases where the JSFA receives a report of development and results of the incidents, it must examine the contents thereof, and may, when deemed necessary in connection with the examination, ask the Association Member to give an explanation of the contents of the report submitted or provide other documentary evidence, etc. (art. 11, para. 1 and para. 2).

The JSFA may also conduct the examination prescribed in Article 11, Paragraph 1 based on any material it considers to be appropriate, in addition to the report of development and results of the incidents (art. 11, para. 4).

In cases where the JSFA finds, as a result of the examination mentioned above, that the employee concerned has resigned or has been internally disciplined by the Association Member concerned in a manner that is equivalent to discharge, or is an employee of an Association Member whose registration under Article 29 or Article 33-2 of the FIEA has been revoked, and that his/her act is deemed to have caused a significant loss of public confidence in the financial instruments business, it shall determine to treat the person as a perpetrator of an inappropriate act and revoke his/her sales representative qualification, sales manager qualification and internal administrator qualification. Among perpetrators of inappropriate acts, a person admitted to have conducted an act which has a material effect on the credibility of the financial instruments trading business is treated as a Class-1 perpetrator of an inappropriate act. Other persons are treated as Class-2 perpetrator of an inappropriate act (art. 12).

(ii) **Procedures for Taking Action**

When the JSFA intends to treat an employee, etc. as a perpetrator of an inappropriate act, it shall implement the procedures for explanation in accordance with the “Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members,” and send a notice of the treatment decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the treatment shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members, art. 8 and art. 23).

(iii) **Filling of Complaints**

An Association Member which is an addressee of a decision to treat its employee, etc. as a perpetrator of an inappropriate act and the employee, etc. who is subject to that decision may file a complaint on the decision with the JSFA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

(iv) **Application for Release**

Where an Association Member finds it appropriate to release a person who had been regarded as a perpetrator of an inappropriate act by the JSFA from such treatment because the person has shown clear signs of remorse, or a new fact is found regarding the incident that caused him/her to be regarded as a perpetrator of an inappropriate act, or if there is any other special reason, it may file with the JSFA an application for the release of such treatment (art. 374 Sales Representatives Manual 2019 • Volume 1
14, para. 1). In addition, when a person who is regarded as a perpetrator of an inappropriate act by the JSDA finds a new fact regarding the incident that caused him/her to be regarded as a perpetrator of an inappropriate act, or if there is any other special reason, the person may file with the JSDA an application for the release of treatment of a perpetrator of an inappropriate act (Rules Concerning Employees of Association Members, art. 14, para. 2).

(v) Release and Notification

The JSDA shall, when receiving an application for release of treatment of a perpetrator of an inappropriate act, examine it and may determine to release the person related to the application from the treatment of a perpetrator of an inappropriate act, when it finds it appropriate to do so (art. 15, para. 1). The JSDA shall notify the employee, etc. related to the application, the Association Member that submitted the report of development and results of the incidents, and the Association Member that filed the application, of the results of the examination of the application for release (art. 15, para. 2).

2 Rules Concerning Sale and Purchase, Etc. of Specified Securities, Etc. of Listed Companies, Etc. by Employees of Association Members

The purpose of these Rules is to prevent unfair transaction in the sale and purchase, etc. of specified securities of listed companies, etc. by employees of Association Members, by providing an establishment of internal rules and others necessary measures, thereby ensuring confidence in the capital market (art. 1).

In these Rules, “employee” means an employee under the Rules Concerning Employees of Association Members (art. 2). This definition applies mutatis mutandis to officers (art. 7).

In addition, “sale and purchase relating to the specified securities, etc. of listed companies, etc.” refer to trades, etc. concerning specified securities, etc. of listed companies, etc. provided for in Article 166 of the FIEA, which means the sale and purchase, etc. of securities that are subject to the so-called insider trading regulations (art. 2, item 2).

(1) Basic Stance

In the sale and purchase, etc. of the specified securities, etc. of listed companies, etc. by employees, considering that such investment should be conducted for the purpose of healthy wealth accumulation by such employee itself, the Association Member must make efforts to have such employee comply with laws and various rules and regulations and not to be suspected of conducting insider trading, transaction pursuing speculative profits, and other unfair transactions (art. 3).

This provides the purport that employees of financial instruments business operators, etc. as the leaders of the capital market must be trusted by investors at all times.

(2) Establishment of Internal Rules

The Association Member must establish internal rules on the sale and purchase, etc. relating
to the specified securities, etc. of listed companies, etc. by employees that include the matters set forth in each of the following items (art. 4):

(i) Matters relating to the scope of the employees;
(ii) Matters relating to procedures for sale and purchase, etc. (including matters concerning orders placed with other Association Members);
(iii) Matters relating to the prohibited actions under laws and various rules and regulations such as insider trading, transactions based on special information that is obtained during the course of business, and transactions exclusively aiming at speculative profits; and
(iv) Other matters the Association Member deems necessary.

Employees of Association Members are prohibited from conducting insider trading and speculative trading under laws, regulations and rules, but in order to further comply with these prohibited acts, Association Members are required to formulate internal rules.

(3) Self-Restriction of Sale and Purchase, Etc. by Employees Belonging to Corporate Business-Related Divisions

The Association Member must provide in its internal rules that, in principle, the employees who belong to corporate business-related divisions should not conduct for themselves the sale and purchase relating to the specified securities, etc. of listed companies, etc. of which they are in charge in the business (art. 5).

This provision prohibits sale and purchase relating to specified securities, etc. of listed companies, etc. by an employee handling the same from the viewpoint of preventing unfair transactions by employees belonging to a division with a high possibility of obtaining confidential corporate information in the course of business (Note) in particular among the divisions of the Association Member.

(Note) “Divisions with a high possibility of obtaining confidential corporate information” include divisions handling corporate activities, underwriting activities and trading management activities, and divisions involved in the merger, acquisition, tender offer, public offering of new shares, etc. of an issuer company, etc.

(4) Enhancement of Management Systems

The Association Member must conduct an inspection on a regular basis to check whether the sale and purchase relating to the specified securities, etc. of listed companies, etc. by the
employees are conducted properly pursuant to the internal rules (art. 6).

3 Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members

These Rules were enacted for the purpose of contributing to investor protection by promoting improvements in the quality of sales representatives of Association Members, and the proper and smooth operation of the sales representatives registration system (art. 1).

The outline of these Rules is as follows:

(1) Sales Representatives

For purposes of these Rules, “Sales Representatives” mean those officers and employees of an Association Member that engage in the business of sales representatives on behalf of the Association Member to which they belong(Note)(art. 2).

(Note) The business of sales representatives refers to the acts listed in the items of Article 64, Paragraph 1 of the FIEA, which pertain to the business operations of Regular Members, Specified Business Members or Special Members. Among deemed securities, rights provided for in the Items of Article 2, Paragraph 2 of the FIEA that are deemed as securities pursuant to the provisions of the said Paragraph are not included in the scope of business of sales representatives.

Sales Representatives of Regular Members are divided into three categories:

(i) Class-1 Sales Representative

These are persons that can perform all of the sales representative work. However, in order to conduct sales representative work pertaining to specified OTC derivatives transactions, etc., one must take and pass the Class-1 Sales Representative examination conducted after April 2009(Note).

(Note) Persons fulfilling the requirements of a Class-1 Sales Representative pursuant to examinations, etc. implemented on or prior to March 31, 2009 may conduct sales representative work pertaining to specified OTC derivatives transactions, etc. upon taking the internal training seminars designated by the JSDA the results of which are reported to the JSDA (art. 4-2).

(ii) Margin Transaction Sales Representative

These are persons that can perform Class-2 Sales Representatives work and the sales representative work pertaining to margin transactions and when-issued transactions(Note).

(Note) Upon taking the internal training seminars designated by the JSDA the results of which are reported to the JSDA, the sales representative may conduct the work concerning specified OTC derivative transactions, etc. at the Association Member
implementing the report (art. 4-2).

(iii) **Class-2 Sales Representative**

These are persons that can perform sales representative work pertaining to securities (meaning the securities set forth in FIEA, Article 2, Paragraph 1) and sales representative work pertaining to brokerage for clearing of securities, etc.

(Note) If sales representatives, who satisfy the requirements for Class-2 Sales Representatives by taking the examination, etc. implemented on or before March 31, 2009, have completed the internal training courses designated by the JSDA, and the results of their training have been reported to the JSDA, they may conduct the business of sales representatives concerning specified OTC derivative transactions, etc. as sales representatives of the Association Member which has reported the said results to the JSDA (art. 4-2).

However, they may not perform the business of sales representative pertaining to the following (art. 2, item 4):

- a. Securities-related derivatives transactions, etc.;
- b. Transactions in bonds with options;
- c. Margin transactions and when-issued transactions (provided, however, they can be performed in the case that orders are received when accompanied by a Class-1 Sales Representative or a Margin Transaction Sales Representative of the Association Member to which the Class-2 Sales Representative belongs (including the case where a Class-1 Sales Representative or a Margin Transaction Sales Representative has checked the sales activities of the Class-2 Sales Representative in the sales office or business office));
- d. Share option certificates (including those that have the character of share option certificates that are issued abroad or by foreign persons);
- e. Investment equity subscription right certificates;
- f. Covered warrants;
- g. DRs pertaining to those listed in d. and f. (meaning certificates or instruments that are to be issued in a country other than the country of issue of certificates or instruments, by a person with whom the said certificates or instruments have been placed on deposit, and which represent rights in connection with the certificates or instruments that have been placed on deposit);
- h. Complex Structured Bonds Similar to OTC Derivatives Transactions;
- i. Complex Investment Trust Similar to OTC Derivatives Transactions; and
- j. Leveraged Investment Trust.
(2) **Sales Representatives Qualification**

In view of the importance that sales representatives perform their business on behalf of Association Members whether or not they work in or outside of a business office or office, and the effect thereof attributes directly to the Association Member, the Association Member must not allow its officers or employees to conduct the business of a sales representative unless that officer or employee has a certain qualification in accordance with the classification of sales representatives and is registered as a sales representative (such as in the case of a Class-1 Sales Representative, a person having the Class-1 Sales Representative qualification examination) (art. 4 and art. 5).

(3) **Registration of Sales Representatives**

When an Association Member allows its officers or employees to perform the business of sales representative, it must register their names, dates of birth and other matters in the original registry of sales representatives kept by the JSDA (art. 3). The sales representative registration system provides for the disqualification requirements for eliminating persons who are unsuitable for serving as sales representatives, with the aim of protecting investors.

Additionally, when a registered sales representative changes his/her name or other information, falls under disqualification criteria set forth in the FIEA, or will no longer conduct sales activities due to retirement or other reasons, the Association Member must file a notice with the JSDA without delay (art.10).

(4) **Disciplinary Actions, Etc. Against Sales Representatives**

(i) **Disciplinary Actions Regarding the Registration of Sales Representatives**

(a) Disciplinary Action

When a registered sales representative becomes subject to any of the disqualification criteria set forth in the FIEA, is found to have been subject to any of the disqualification criteria at the time of registration, violates the law and regulations concerning the business of sales representative or its related businesses among the financial instruments trading business, or is found to have engaged in any other extremely inappropriate conduct concerning the business of sales representative, the JSDA will revoke the registration of that sales representative or suspend him/her from the duties of a sales representative for a period of up to two years (art. 11).

(b) Procedures for Taking Administrative Disciplinary Action

When the JSDA intends to impose the administrative disciplinary action, it shall hold a hearing as prescribed in the Administrative Procedure Act and send a notice of the administrative disciplinary action decided to the Association Member concerned. In principle, the notices regarding the procedure for hearing and the decision of the administrative disciplinary action shall also be sent to the Sales Representative concerned in order to provide the Sales Representative with the opportunity to state his/her opinion (Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association...
Members, art. 4 and 5).
(c) Filing of Complaint, etc.

An Association Member that is dissatisfied with the administrative disciplinary action may file a request for review with the FSA Commissioner under the Administrative Complaint Review Act (FIEA, art. 64-9). If an Association Member seeks to revoke the administrative disciplinary action in litigation, it may file an action for revocation under the Administrative Case Litigation Act.

(ii) Action Prohibiting Business of Sales Representative
(a) Disciplinary Action

When the JSDA finds that a sales representative (including a former sales representative) has violated the laws and regulations concerning the business of sales representative or related businesses or has engaged in any other extremely inappropriate conduct concerning the business of sales representative, it will make a decision to take action to prohibit the Association Member to which the sales representative belonged at the time of such conduct from assigning him/her to the business of sales representative for a period not exceeding five years (Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members, art. 6).

(b) Procedures for Taking Action

When the JSDA intends to take action prohibiting the business of sales representative, it shall implement the procedures for explanation in accordance with the “Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members,” and send a notice of the action decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the action shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members, art. 8 and 25).

(c) Filing of Complaint

An Association Member which is an addressee of a decision to take action prohibiting business of sales representative and its employee, etc. who is subject to that decision may file a complaint on the decision with the JSDA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

(iii) Training Courses for Persons Subject to Disciplinary Actions, Etc.

An Association Member must immediately make a person who has been subject to the disciplinary action of suspension of the business of sales representatives among the persons set forth in (i) above or a person who has been subject to the prohibition of assignment to duties of a sales representative among the persons set forth in (ii) above take the training courses designated by the JSDA (art. 13).

This training is implemented to have the sales representatives gain thorough knowledge on the prohibited acts, etc. again and to strive to prohibit the occurrence of such acts, by giving trainings to the persons who have conducted acts of violation of laws and regulations, etc.
(5) **Training Courses for Renewal of Sales Representative Qualification**

Association Members must require the following persons to attend the training courses for renewal of sales representative qualification, offered by the JSDA, during the periods specified respectively (required training periods) (art. 18):

(i) As for registered sales representatives: within one year from the first day of the month in which every fifth anniversary of the date of their sales representative registration falls; and

(ii) As for persons who are newly registered as sales representatives: within 180 days after the sales representative registration date.

* Persons who passed the sales representative qualification examination within two years prior to the first day of the required training period will be deemed to have completed attendance of the sales representative qualification renewal training course.

If a sales representative fails to complete the sales representative qualification renewal training within the required training period, all of his or her sales representative qualification will be suspended and he or she may not perform the business of sales representatives during the period of suspension.

If a sales representative fails to complete the sales representative qualification renewal training within 180 days from the day following the last day of the required training period, all of his or her sales representative qualification will be revoked.

(6) **Participation in Internal Training Courses for Improvement of Quality of Sales Representatives**

In addition to these sales representative qualification renewal training courses, Association Members must have their registered sales representatives attend internal training courses every year in order to improve the quality of their sales representatives (art. 19).
1 Rules Concerning Representation of Advertising, Etc. and Offers of Premiums

(1) Purpose

The purpose of these Rules is, with respect to representation of advertising and offer of premiums placed or made by an Association Member, to ensure appropriate representation of advertising and offer of premiums, and thereby contribute to investor protection by prescribing representations, methods, matters to be observed, etc. (art. 1).

The rules are summarized below.

(2) Definitions

These Rules define as advertisements set forth in FIEA, Article 37 and representations carried out pursuant to the acts set forth in FIBCOO, Article 72 concerning details of a financial instruments business (limited to those conducting sale and purchase or other transactions, etc. of securities in the course of trade) as “representation of advertisements, etc.” (art. 2, item 2).

(3) Basic Principles of Advertising, Etc. and Offers of Premiums

The rules contain the following basic principles regarding advertising, etc. made and premiums offered by Association Members with the intent of promoting the further adequacy thereof:

(i) Whenever making representations of advertising, etc., an Association Member must observe fair and equitable principles of transactions and maintain dignity, as well as endeavor to provide accurate information and correct and clear representations in the spirit of the protection of investors (art. 3, para. 1); and

(ii) Whenever offering premiums, an Association Member must observe fair and equitable principles of transactions, maintain dignity and endeavor to offer premiums in an appropriate manner (art. 3, para. 2).

(4) Prohibited Acts

An Association Member may not place representation of advertising, etc. that falls, or is likely to fall, under any of the items (i) to (viii) below (art. 4, para. 1):

(i) Representation of advertising, etc. which runs counter to fair and equitable principles of transactions;

(ii) Representation of advertising, etc. which impairs the dignity of the Association Member;

(iii) Representation of advertising, etc. which contains representations that
 violate the FIEA or other laws and regulations;
(iv) Representation of advertising, etc. which suggests unlawful acts;
(v) Representation of advertising, etc. which contains representations that may mislead investment decision of an investor;
(vi) Representation of advertising, etc. which hampers fair competition among Association Members;
(vii) Representation of advertising, etc. which has arbitrary or excessively subjective representations; and
(viii) Representation of advertising, etc. which includes a judgment or evaluation of which the basis is not clearly indicated.

When an Association Member offers premiums to its customers, it must not offer premiums which violate or are likely to violate the Act Against Unjustifiable Premiums and Misleading Representations or other laws (art. 4, para. 2). An Association Member must not, directly or indirectly, make any third party conduct the representation of advertisings, etc. or provide premiums which violate the provisions of Article 4, Paragraph 1 prescribed above (art. 4, para. 3).

(5) Internal Examination, Etc. by Association Members
(i) When an Association Member makes the representation of advertising, etc. or offers premiums, it must appoint an officer in charge of examining the representation of advertising, etc. and the offer of premiums (hereinafter referred to as “advertising examining officer” in these Rules), and make the advertising examining officer examine that there has been no violation of the prohibited acts mentioned in (4) above (art. 5, para. 1, main clause).

However, this provision does not apply to representation of advertising, etc. for professional investors prescribed in Article 2, Paragraph 31 of the FIEA and representation of advertising, etc. made by a Special Member, that are related to the financial instruments intermediary service activity as registered financial institutions and that have already been examined by the advertising examining officer of the entrusting member (a Regular Member that entrusts the financial instruments intermediary service activity as registered financial institution to the Special Member) (art. 5, para. 1, proviso).

(ii) Association Members must appoint only the persons set forth in (a) to (f) below to act as the advertising examining manager (art. 5, para. 2 through para. 5):

(a) Internal administration supervisor;
(b) Persons who have passed the qualification examination for Regular Member’s sales manager prescribed in the “Rules Concerning Qualification Examination for Securities Sales Representatives, Etc.” (enacted before April 1, 2006; the same shall apply hereinafter);
(c) Persons who passed the qualification examination for Regular Member’s internal administrators prescribed in the “Rules Concerning Qualification Examination for Securities Sales Representatives, Etc.”;
(d) Persons who passed the qualification examination for Special Member’s sales manager prescribed in the “Rules Concerning Qualification Examination for Securities Sales Representatives, Etc.” (Special Members and Specified Business Members only; however, this does not include Special Members who act as advertising examining managers conducting examinations of representation of advertisements, etc. and offers of premium relating to registered financial institution’s financial instruments intermediary service activities);

(e) Persons who passed the qualification examination for Special Member’s internal administrators prescribed in the examination rules (Special Members and Specified Business Members only; however, this does not include Special Members who act as advertising examining officers conducting examinations of representation of advertisements, etc. and offers of premiums relating to registered financial institution’s financial instruments intermediary service activities); or

(f) Other persons who are recognized by the JSDA as being appropriate to examine the representation of advertising, etc. and the offer of premiums based on their knowledge, etc. (Regular Members and Special Members only)

Advertising examining officers who conduct examinations of representation of advertising, etc. and offers of premium pertaining to specified OTC derivatives transactions, etc. and advertising examining officers of Specified Business Members shall be limited to those persons who fall under Article 4-2, Paragraph 1, Item 1 of the Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members, those who have participated in the Paragraph 1 internal training prescribed in Paragraph 2, Item 2 of the said Article and have reported their training results to the JSDA or those who fall under Items 2 and Item 3 of the said Paragraph and also fall under any of items (a) to (e) above (art. 5, para. 2, proviso, art. 5, para. 3, proviso).

(6) Development of Internal Administration System

An Association Member shall develop internal rules on the examination system, examination criteria, and retention system concerning the representation of advertising, etc. and the offer of premiums for the purpose of appropriate and proper representation of advertising, etc. and the offer of premiums, disseminate it to all the officers and employees, and thoroughly make them comply with it (art. 6).

(7) Investigation of Violations

If the JSDA determines that the representation of advertising, etc. and offer of premiums, made by an Association Member or its employee violate or are likely to violate the provisions of the provisions of Article 3 ((3) above) or Article 4 ((4) above), the JSDA may request that such Association Member submit the relevant materials and may obtain an explanation (art. 7, para. 1).
An Association Member must reply to the request for submitting materials or making an explanation as prescribed in Article 7, Paragraph 1 (art. 7, para. 2).

(8) "Guidelines Concerning Advertising, Etc.

Matters necessary for representation of advertising, etc. made by Association Members which are not prescribed in these Rules shall be prescribed in the “Guidelines Concerning Advertising, etc.” separately prepared by the JSDA (art. 8).

(9) Handling of Analysts Reports

Regardless of the provisions of these Rules, internal investigations, etc. pertaining to analyst reports must be conducted in accordance with the provisions of the “Rules Concerning Handling of Analyst Reports” (art. 9) (Note).

(Note) “Rules Concerning Handling of Analyst Reports”

The purpose of these Rules is to ensure that business pertaining to the preparation and the use, etc. of analyst reports is implemented in an appropriate and fair manner by prescribing matters that an Association Member (as for a Special Member, limited to the Special Member who conducts the acts of financial instruments intermediation; and as for analyst reports of the Special Member, limited to those reports relating to acts of financial instruments intermediation) must comply with in respect of the handling, etc. of analyst reports, thereby contributing to the provision of appropriate and valid information to investors and to the improvement of the quality of analysts.

These Rules require Association Members to coordinate their internal administration systems pertaining to analyst’s reports, such as internal examination, keeping, disclosure of any conflicts of interest, etc., and thorough going information management.

4 Personal Information Related Matters

1 Guideline For Protection of Personal Information

This guideline provides for matters concerning personal information, including specifying the purpose of use and safety control action, and also provides for concrete measures that should be taken by an Association Member with the purpose of ensuring proper handling of personal information in the course of business related to the sale and purchase or other transactions of securities, etc. and other associated business by Regular Members; specified business by a Specified Business Member; and registered financial institution business by Special Members, based on the Act on the Protection of Personal Information (hereinafter referred to as the “PPIA”),
the Enforcement Ordinance for the Act on the Protection of Personal Information (hereinafter referred to as the “PPIA Enforcement Ordinance”), the Basic Policy on the Protection of Personal Information, various guidelines for personal information protection, and the Guideline for Personal Information Protection in the Financial Field, and others (art. 1).

The outline of this guideline is as follows.

(1) Definitions
The definitions of the terms used in this guideline are as follows (art. 2):

(i) Personal Information
Information about a living individual which can identify a specific individual (including such information as will allow easy reference to other information and will thereby enable a specific individual to be identified), or information containing an individual identification code.

“Information about an individual” shall mean not only information which allows a specific individual to be identified, such as name, address, gender, date of birth, and face image, but also all information that indicates facts, judgment and evaluation regarding personal attributes such as physical features, property, job type, and title, and shall include evaluation information and information that is publicly available by publications, video and voice, irrespective of whether the information is anonymized by such means as encryption. If such “Information about an Individual” is combined with a name and/or any other descriptions, by which “a specific individual can be identified”, such “information about an individual” shall become “Personal Information.”

(ii) Individual Identification Code
A combination of any character, letter, number, symbol or other codes specified by laws and regulations as a code which independently allows a specific individual to be identified (e.g. an individual number, driver’s license number, etc.).

(iii) Personal Information Database, Etc.
A set of information including Personal Information set forth in the following, except for information that is unlikely to harm an individual’s rights and interest in light of its method of use):

(a) Systematically aggregated information arranged in a manner such that the specific Personal Information can be searched by using a computer; and

(b) In addition to the information set forth in (a), systematically aggregated information that is arranged according to a certain set of rules in such a manner that the specific Personal Information can be readily searched, and that is in a state wherein Personal Information can be readily searched by reference to list of contents, indexes, symbols, etc.

(iv) Personal Data
Personal Information constituting a Personal Information Database, etc.

(v) Retained Personal Data
The Personal Data for which an Association Member has the authority to disclose,
correct, add, or delete the content, to suspend its use, to erase, and to suspend its provision to a third party in response to a request from the Person or his/her agent, and excluding Personal Data that are likely to pose a threat to the life, body, or property of the Person or a third party if presence or absence of the data is known and the like or Personal Data that are to be deleted within six months.

(vi) Person

A specific individual who can be identified by reference to the Personal Information.

(vii) Special Care-Required Personal Information

Personal Information containing descriptions etc. which requires special care in handling so as not to cause unfair discrimination, prejudice or other disadvantages to the Person.

(viii) Sensitive Information

A type of information used in the financial field, which includes Special Care-Required Personal Information and information on the Person’s affiliation to a labor union, family origin, registered domicile, health care record, and sexual life (excluding information on any of these matters that falls within the category of Special Care-Required Personal Information), but excludes: information disclosed by the Person, or by a certain scope of entities such as a State organ, a local public entity, a broadcasting organization, a newspaper company, a news agency, or any other news media; and information that is obvious from the appearance of the Person and can be acquired by visual inspection or visual recording.

(ix) Anonymously Processed Information

Information relating to an individual that can be produced through processing personal information by taking actions prescribed according to the types of personal information, so that the individual can neither be identified in reference to the personal information nor re-identified by restoring the personal information.

(2) Specification of Purpose of Use

When handling Personal Information, an Association Member shall specify, to the extent possible, for what business and for what purpose the Personal Information is used that enables the Person to reasonably assume such business and purpose (art. 3, para. 1). In addition, when specifying the purpose of use set forth in Article 3, Paragraph 1, as an abstract answer such as “using the Personal Information in a purpose required by our company” shall not be considered sufficient in terms of “specify to the extent possible,” an Association Member must present the financial instruments and services it intends to provide and endeavor to specify the purpose (art. 3, para. 2).

(3) Consent of Person

In the case where an Association Member acquires Personal Information of a Person contained in a document directly from the Person during the course of conducting the credit business, such as a margin transaction, a when-issued transaction, or making a loan based on securities under custody as collateral (limited to lending based on securities under custody as
collateral by a Regular Member), the member shall endeavor to acquire the consent of the Person by setting a confirmation column in a document that clearly indicates the purpose of use. In such case, the purpose of use under an agreement, etc. shall be clearly described separately from other provisions in the agreement, etc. (art. 4, para. 1).

In addition, an Association Member must not handle the Personal Information beyond the scope necessary for the achievement of the purpose of use specified by the Association Member without obtaining the prior consent of the Person (art. 6).

Further, when obtaining the consent of the Person, an Association Member shall, in principle, obtain it in writing (including a record made by an electronic means, magnetic means, or any other means that cannot be recognized by human senses). For example, the Person’s consent can be obtained by: (i) stating the purpose of use and words of consent on the document from which the Personal Information is obtained directly from the Person, or on a different document, and having the Person sign (and seal) the document, or (ii) using the internet to have the Person indicate consent on the screen (by clicking a consent button, etc.) or by receiving, etc. from the Person an email or SNS message stating words of consent.

(4) Sensitive Information
An Association Member must not acquire, use, or provide to a third party Sensitive Information except for the cases prescribed by laws and regulations, etc. The provision of Article 23, Paragraph 2 of the PPIA (opt-out procedure) does not apply when an Association Member provides Sensitive Information acquired under laws and regulations, etc. to a third party (art. 7).

(5) Proper Acquisition of Personal Information
An Association Member must not acquire Personal Information by a fraudulent or other type of dishonest means. When acquiring Personal Information from a third party, an Association Member must not unreasonably infringe the interest of the Person, and must confirm the provider’s status of compliance and that the provider has acquired the said Personal Information lawfully (art. 8).

(6) Notification, Publication and Expression, Etc. of the Purpose of Utilization at the Time of Acquiring the Personal Information
When an Association Member acquires the Personal Information, it must immediately notify the Person of the purpose of use or publicize it unless the Association Member publicizes it in advance. In such case, the “notice” must be made in writing in principle, and the “publication” must be made in a proper way; e.g., by announcing the purpose of use on its website, etc., or displaying or placing a document at a counter of its sales office, or, depending on the nature of its business, such as a method of marketing financial instruments (art. 9, para. 1).

Notwithstanding the provisions of Article 9, Paragraph 1, when acquiring the Personal Information that is described in an agreement or other documents at the time of executing the agreement with the Person, an Association Member must expressly indicate the purpose of use to the Person in advance. However, this shall not apply to the case where the acquiring of the
Personal Information is necessary to protect the life, body, or property of a person (art. 9, para. 2).

Further, except for certain cases, when an Association Member changes the purpose of use, the member must notify the Person of the changed purpose of use or publicize it (art. 9, para. 3).

(7) **Maintenance of the Accuracy of Data**

An Association Member must endeavor to maintain Personal Data in an accurate and up-to-date manner within the scope that is necessary to achieve the purpose of use, by taking such measures as developing the procedures for verifying and confirming personal information when inputting it into the Personal Database, developing the procedure for correcting errors in the stored data, updating the records, and setting the retention period.

In addition, an Association Member must delete the retained Personal Data without delay when it is no longer necessary to use the data, such as when the purpose of use has been achieved and the rational reason for retaining the data no longer exists in relation to that purpose. However, this shall not apply if a retention period is prescribed under laws and regulations (art. 10).

(8) **Security Control Measures**

An Association Member must take necessary and appropriate measures such as the establishment of basic policy on security control, handling rules, and a system pertaining to security control measures for the purpose of preventing leakage, loss, or damage of the Personal Data handled and taking other measures for security control of the Personal Data. The necessary and appropriate measures must include “Institutional security control measures,” “Human security control measures,” and “Technological security control measures” which are laid out according to the respective levels of acquisition, use, and retention of the Personal Data (art. 11, para. 1).

(i) **Institutional security control measures**

The establishment of systems and implementation of measures by an Association Member such as defining the responsibilities and authorization of officers and employees for the security control measures of the Personal Data, preparing and operating the rules on security control, and checking and inspecting the implementation status.

(ii) **Human security control measures**

To execute a non-disclosure agreement on the Personal Data with officers and employees, to give education and training for officers and employees, and to supervise officers and employees for ensuring the security control of the Personal Data.

(iii) **Technological security control measures**

Technical measures for security control of the Personal Data such as access control to an information system that handles the Personal Data, and monitoring of information systems.

(9) **Restriction of Provision to a Third Party in Japan or in a Foreign Country**

An Association Member must not provide the Personal Data to a third party without obtaining the prior consent of the Person except for the cases prescribed by laws and regulations, etc. When obtaining the consent, the member must clearly indicate to the Person a reasonable and
appropriate scope of content of the Personal Data as may be necessary to enable the Person to decide whether or not to give consent. If the member intends in advance to provide the Personal Information to a third party, it must include this as part of the purpose of use (art. 14, para. 1).

However, regarding the Personal Data that is to be provided to a third party, an Association Member may provide the Personal Data (excluding the Sensitive Information) to a third party in the case where the provision of the Personal Data to a third party that can identify the Person is to be suspended upon request of the Person and the Association Member notifies the Person of the necessary matters, including the fact that the provision to a third party is included in the purpose of use, or puts these matters in a state where the Person can easily know them, and notifies the Personal Information Protection Commission of these matters while publicizing the content of the notification by a proper method (art. 14, para. 2).

When an Association Member provides Personal Data to a third party in a foreign country, it must obtain the Person’s consent to the provision of the data to a third party in a foreign country, except in cases where it is based on laws and regulations (art. 14-2).

(10) Obligations to Confirm and Record Matters Related to Third-Party Provision, etc.

If an Association Member provides Personal Data to a third party, it must prepare a record of matters specified by the PPIA Enforcement Order, such as the date on which the Personal Data was provided to the third party, and the name of the third party, and preserve such record, except in cases where the provision of the data is based on laws and regulations (art. 14-3 and art. 14-5).

If an Association Member receives Personal Data provided by a third party, it must confirm the name of the third party and the circumstances where the third party acquired the data, and must also prepare a record of the confirmed matters as well as matters specified by the PPIA Enforcement Order, such as the date on which the Personal Data was received from the third party, and the name of the third party, and preserve such record, except in cases where the recipe of the data is based on laws and regulations (art. 14-4 and art. 14-5).

(11) Disclosure, Etc.

When an Association Member is requested by the Person to disclose the Retained Personal Data that can identify the Person, the member must disclose such Retained Personal Data (including the nonexistence of the Retained Personal Data if it does not exist) without delay by delivering a document or in a method agreed with the person who requested the disclosure. However, if the disclosure may cause a threat to the life, body, property or other rights or benefits of the Person or a third party, the Member may avoid disclosing the whole or party of such data (art. 16, para. 1).

Further, when an Association Member is requested by the Person to correct, add, or delete (hereinafter referred to as the “correction, etc.” in these Rules) the Retained Personal Data for the reason that the Retained Personal Data that can identify the Person is incorrect due to errors contained therein, the member must conduct a necessary investigation such as confirming the fact without delay within the scope necessary for the achievement of the purpose of use, and make the correction, etc. to such Retained Personal Data based on the result of the investigation, in
principle. When an Association Member makes the correction etc. on the whole or part of the Retained Personal Data upon request or decides not to make the correction, etc., the Association Member must notify the Person of such handling (including what has been changed if any correction, etc. is made) without delay (art. 17, para. 1 and para. 2).

When requested by the Person to notify him/her of the purpose of use or to disclose the retained personal data, an Association Member may charge a fee for the conduct of such measures (art. 21, para. 1).

(12) Response to Leakage, Etc.

An Association Member must endeavor to address a complaint regarding the handling of the Personal Information properly and promptly, and strive to establish a system necessary for this purpose (art. 22, para. 1 and para. 2).

When an incident occurs such as leakage, etc. of the Personal Information or leakage of information related to any descriptions or the individual identification code removed from the Personal Information used to produce Anonymously Processed Information or the manner used to produce such information, an Association Member shall immediately report it to the Financial Services Agency (in the case of an incident of leakage of Personal Information specified by laws and regulations, a report must also be made to the Personal Information Protection Committee) and the JSDA, immediately publicize the fact of such leakage, etc. and the preventive measures to be taken from a viewpoint to prevent secondary damage from occurring and a similar incident from reoccurring and immediately notify the Person, who is subject to such leakage, of the fact that such leakage has occurred and other facts, as well as the preventive measures to be taken (art. 23, para. 1, para. 2 and para. 3).

Further, given the importance to explain in advance a policy on Personal Information handling in an easy-to-understand manner, an Association Member shall prepare and publicize the statement of its concept and policy on the Personal Information protection (a so-called privacy policy or privacy statement, etc.) (art. 24, para. 1).

4 Shares Related Matters

1 Rules Concerning Over-the-Counter Securities

These Rules prescribe matters concerning over-the-counter transactions in over-the-counter securities conducted by Regular Members and the solicitation of investment in over-the-counter securities conducted by Association Members, etc.

(1) Breakdown of Over-the-Counter Securities

Over-the-counter securities (see Chart 4-1, (i)) consist of share certificates, share options and bonds with share option certificates that a domestic juridical person issues in Japan and are not listed on a financial instruments exchange market.
As for equity-based crowdfunding (Chart 4-1, (ii)) and shareholders community (Chart 4-1, (iii)), please see the description below (See 4.5 (1) What Is Equity-based Crowdfunding Business? and (1) Composition of a Shareholders Community” in this Chapter for details).

Over-the-counter handled securities (see Chart 4-1, (iv)) consist of share certificates, share option certificates and bonds with share options that are over-the-counter securities for which the issuing company is a company that is required to submit an annual securities report pursuant to the provisions of FIEA, Article 24, Paragraph 1, or a company that prepares a “explanatory note on business conditions(Note)” that Regular Members, or Special Members and financial instruments intermediary service providers that the Regular Member entrusts the financial instruments intermediary business to use to give explanations at the time of soliciting investment.

As for Phoenix Issues (Chart 4-1, (v)), please see the description below. (See 4.5 (1) What is a Phoenix Issue?” in this Chapter for details)).

(Note) An “explanatory note on business conditions” is prepared by the issuing company, and makes the statements in accordance with the categories for stating “confidential corporate information” out of an annual securities report as set forth in the Cabinet Office Ordinance Concerning Disclosure of Corporate Matters, Etc. The financial statements and consolidated financial statements must also be stated in accordance with the FIEA. Moreover, an audit similar to that under the FIEA must be conducted by a certified public accountant, etc., or an audit by a certified public accountant under the Companies Act or a similar audit must be conducted, and an auditor’s report with an unqualified general opinion must be attached. In this case, the handling of the auditor’s report is the same as a company filing annual securities reports (art. 5).
(2) **Prohibition of Solicitation for Investment in Over-the-Counter Securities**

Association Members are prohibited from soliciting customers to invest in over-the-counter securities, except in the event of soliciting investment of qualified institutional investors, handling public offering, secondary distribution, private placements or private secondary distribution (meaning any offer to sell, etc. falling under (a) through (c) of the FIEA, Article 2, Paragraph 4, Item 2) of, or engaging in the secondary distribution or private secondary distribution of over-the-counter handled securities issued by unlisted companies (hereinafter referred to as “handling, etc. of public offering, etc.” in these Rules), soliciting investments in accordance with the “Rules Concerning Equity-Based Crowdfunding Business” or “Rules Concerning Shareholders Community,” or soliciting investments in over-the-counter handled securities issued by companies issuing listed securities (art. 3).

When soliciting investment for a qualified institutional investor, restrictions against the transfer of these securities to persons other than qualified institutional investors must be imposed (art. 4, para. 1 and para. 2).

(3) **Solicitation for Investment in Over-the-Counter Handled Securities**

When an Association Member, at a time of handling, etc. of offering, etc., solicits investment in over-the-counter handled securities (excluding among over-the-counter handled securities, share certificates and bonds with share options delisted by a financial instruments exchange, which are issued by the company whose financial statements for the immediately preceding business year contained in an annual securities report, securities registration statement or company information memorandum are accompanied by an audit report(Note) with an unqualified general opinion) to a person other than a qualified institutional investor, the Association Member must impose restrictions on the transfer of securities prohibiting the transfer to investors other than qualified institutional investors until the day preceding the day on which the securities are listed on a financial instruments exchange market, or of the day preceding the day on which two years have elapsed from the day on which they were acquired, whichever is earlier (art. 6, para. 1 and para. 2).

(Note) The handling of auditors reports differ in accordance with the following categorization:

1. Auditors reports attached to the annual securities report or the securities registration statement prepared by the issuing company of an issue listed on a financial instruments exchange market: an unqualified general opinion for the financial statements and consolidated financial statements for the immediately preceding business year.

2. Auditors reports attached to the annual securities report, the securities registration statement or the explanatory note on business conditions prepared by the issuing company other than 1 above: an unqualified general opinion for all financial statements and consolidated financial statements or other financial information included in the annual securities report, the securities registration statement or the
explanatory note on business conditions.

(4) Solicitation for Investment in Over-the-Counter Handled Securities with Transfer Restrictions

An Association Member, when it carries out handing of the public offering or secondary distribution, or secondary distribution of over-the-counter handled securities for which a prospectus must be prepared and delivered pursuant to Article 13 and Article 15, Paragraph 2 of the FIEA, must give a customer a full explanation with respect to the details of the over-the-counter handled securities and their issuing companies after delivering such prospectus (art. 7, para. 1).

An Association Member, when it carries out dealing, etc. of public offering of over-the-counter handled securities (excluding those issued by an issuing company of listed securities and not listed on Financial Instruments Exchange Markets) for which preparation and delivery of a prospectus pursuant to Article 13 and Article 15, Paragraph 2 of the FIEA are not required, must give a customer a full explanation with respect to the details of the over-the-counter handled securities and their issuing companies, using an annual securities report or explanatory note on business conditions (art. 7, para. 2).

Moreover, an Association Member, when it carries out dealing, etc. of public offering of over-the-counter handled securities (limited to non-listed on Financial Instruments Exchange Markets which are issued by an issuing company of listed securities) for which preparation and delivery of a prospectus pursuant to Article 13 and Article 15, Paragraph 2, of the FIEA are not required, must give a customer a full explanation with respect to the details of the over-the-counter handled securities using explanatory note on business conditions (art. 7, item 3).

In any of these cases, each time an Association Member accepts an order from its customer for a transaction of over-the-counter handled securities, it must clearly specify that such securities are over-the-counter handled securities (art. 7, para. 5) and an Association Member, when it carries out dealing, etc. of offering of over-the-counter handled securities, must maintain a registration statement, prospectus, or explanatory note on business conditions in its handling departments and branches and make it available to customers (art. 7, para. 6).

(5) Trading, Etc. of Over-the-Counter Securities

Transactions in over-the-counter securities that employ fictitious, wash trades, etc., or other improper trading methods, over-the-counter transactions viewed as excessive, margin transactions and over-the-counter transactions in unissued over-the-counter securities, as well as over the counter transactions for the purpose of distribution among Regular Members (excluding the cases set forth in art. 4, art. 6, and art. 8) are prohibited (art. 11, art. 12, art. 14 and art. 15).

Rules Concerning Equity-Based Crowdfunding Business

The purpose of these Rules is to provide for the necessary matters for the equity-based crowdfunding business conducted by Regular Members or by Specified Business Members.
engaged only in the type I small amount electronic offering handling business in the scope of type I financial instruments business (for details, see 1-1 “(2) Specified Business Members” in this Chapter) (collectively referred to as “Regular Members, etc.”; hereinafter the same shall apply in these Rules) in connection with over-the-counter securities, and to ensure proper management of business and protection of investors so that equity-based crowdfunding will be used based on a proper understanding of the risks inherent therein and will contribute to facilitating the supply of risk money to emerging and growth companies.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 “(1) Breakdown of Over-the-Counter Securities” of this Chapter).

(1) **What is Equity-based Crowdfunding Business?**

Crowdfunding is generally understood as a scheme that connects emerging and growth companies in need of funds with prospective fund suppliers by collecting a small amount of funds from a number of fund suppliers.

The equity-based crowdfunding business refers to type I small amount electronic offering handling business conducted by Regular Members, etc. in connection with share certificates or share option certificates among over-the-counter securities (art. 2, item 2).

The type I small amount electronic offering handling business is defined as: (i) electronic offering handling business,\(^{\text{(Note) }}\) which is the handling of public offering or handling of private placement of share certificates or share option certificates not listed on a financial instrument exchange (excluding those specified by Cabinet Order) and which satisfies the small amount requirement (see (2) and (7) below) in connection with the total issue value of these securities and the amount to be paid in by the person who acquires the securities; or (ii) receiving of a deposit of money from customers in relation to electronic offering handling business (FIEA, art. 29-4-2, para. 10).

(\text{Note)} \quad “Electronic offering handling business” is defined as performing, on a regular basis, the handling of a public offering or secondary distribution of securities, or the handling of a private placement of securities or exclusive offer to sell, etc. to professional investors, by means of an electronic data processing system or by any other means of information and communications technology specified by Cabinet Office Ordinance ((i) using the Internet website and (ii) using email on the basis of the use of the Internet) (FIEA, art. 29-2, para. 1, item 6).

(2) **Examination of the Issuer**

In order to launch an equity-based crowdfunding business, a Regular Member, etc. must conduct strict examination of over-the-counter securities to be handled in the business in advance in terms of matters including (i) the existence of the issuer and its business, (ii) the issuer’s financial condition, (iii) the validity of the issuer’s business plan, and (iv) the issuer’s social
acceptability including its compliance with law, in accordance with the internal rules established based on these Rules (art. 4, para. 1).

A Regular Member, etc. must also pay attention to whether the issuer will be capable of meeting investors’ expectations, whether the intended business is appropriate as a financing scheme to be carried out in the form of equity-based crowdfunding business, and whether the issuer has prepared its confidential corporate information under laws and regulations. A Regular Member, etc. must not conduct the intended business if it is not deemed to be appropriate to conduct the said business as an equity-based crowdfunding business based on the examination result (art. 4, para. 2).

A Regular Member, etc. must not conduct the equity-based crowdfunding business unless the public offering or secondary distribution of the securities involved in the equity-based crowdfunding business meets the small amount requirement (Note) (art. 4, para. 3).

A Regular Member, etc. must prepare records of matters such as the details of the examination, the grounds for reaching a decision as to the examination result, and problems identified during the examination process, and preserve such records for ten years from the day of completion of examination (art. 4, para. 4).

(Note) The sum of the amount of funds to be raised by the public offering or secondary distribution and the amount of funds raised through the issuance of the same class of securities by the same issuer within the last one year must be less than 100 million yen (FIEAEO, art. 15-10-3, item 1). Under the FIEA, this small amount requirement applies only to the type I small amount electronic offering handling business (equity-based crowdfunding business) conducted by type I small amount electronic offering handling business operators, but it is also applicable under the JSDA’s self-regulatory rules to the said business conducted by Regular Members.

(3) Measures Toward the Elimination of Antisocial Forces

A Regular Member, etc. must provide for the necessary matters in a contract to be concluded with the issuer in relation to the equity-based crowdfunding business, such as the issuer’s assurance to not be an antisocial force (art. 5).

If, before a Regular Member, etc. commences the equity-based crowdfunding business, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Regular Member, etc. must not conduct the equity-based crowdfunding business in relation to the over-the-counter securities to be issued by the issuer (art. 6, para. 1).

If, after a Regular Member, etc. commences the equity-based crowdfunding business, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Regular Member, etc. must suspend the equity-based crowdfunding business immediately (art. 6, para. 2).
(4) Prohibition of Engagement in the Equity-based Crowdfunding Business due to Violation of Laws and Regulations

If a Regular Member, etc. is requested to improve its operational control system on the grounds of violation of laws and regulations or the JSDA Rules, it must not engage in the equity-based crowdfunding business until it completes improvement (art. 7).

If, after a Regular Member, etc. commences the equity-based crowdfunding business, the situation examined as referred to in (2) is found to differ from the actual situation or to have changed subsequently and as a result it is necessary or it is likely to be necessary to change the previous decision, the Regular Member, etc. must conduct the equity-based crowdfunding business carefully (art. 8).

(5) Provision of Information via the Website

While a Regular Member, etc. conducts the equity-based crowdfunding business, it must post on its website the information on the issuer and fund raising relating to the business as well as the information on risks, etc. involved in the acquisition of over-the-counter securities handled in the business (including the fact that the issuer is not required to make the same level of disclosure as the disclosure required under the FIEA or the timely disclosure required at an exchange) and make such information available for inspection by investors (art. 9; FIEA, art. 43-5).

(6) Prohibition of Combined Use of Solicitation Methods

When conducting the equity-based crowdfunding business, a Regular Member, etc. must use the methods prescribed in the items of Article 6-2 of the FIBCOO ((i) using the Internet website and (ii) using email on the basis of the use of the Internet), and it must not solicit customers to invest through the business by making phone calls or paying visits to them (art. 12).

(7) Verification of the Paid-in Amount Meeting the Small Amount Requirement

A Regular Member, etc. must verify that the amount paid in by customers whom it invites to acquire over-the-counter securities though the equity-based crowdfunding business meets the small amount requirement (Note) (art. 13).

(Note) The sum of the amount paid in by a customer through the equity-based crowdfunding business and the amount paid in by that customer for the issuance of the same class of securities by the same issuer within the last one year must be less than 500,000 yen (FIEAEO, art. 15-10-3, item 2). Under the FIEA, this small amount requirement applies only to the type I small amount electronic offering handling business (equity-based crowdfunding business) conducted by type I small amount electronic offering handling business operators (Specified Business Members), but it is also applicable under the JSDA’s self-regulatory rules to the said business conducted by Regular Members.
(8) **Fair Distribution**
When conducting the equity-based crowdfunding business, a Regular Member, etc. must endeavor to ensure that over-the-counter securities handled in the equity-based crowdfunding business are distributed among investors in a fair manner and are not excessively skewed to specific investors without reasonable grounds, while fully taking into consideration the trends of investment demand (art. 15).

(9) **Periodical Provision of Information by the Issuer**
A Regular Member, etc. must enter into a contract with the issuer of the over-the-counter securities handled in the equity-based crowdfunding business, to the effect that after customers pay in the amount of subscription through the equity-based crowdfunding business, the issuer will provide appropriate information concerning the status of its business periodically to the customers who have acquired the over-the-counter securities. A Regular Member, etc. must also verify that the issuer provides information as required under the contract (art. 16, para. 1 and para. 2).

(10) **Explanation to Customers**
In order to confirm with customers, who are to acquire over-the-counter securities through the equity-based crowdfunding business for the first time (excluding professional investors **(Note)**), that they understand the risks, fees and other matters concerning the act of financial instruments transaction as stated in the documents to be delivered prior to conclusion of contract and that they intend to acquire the securities at their own discretion and responsibility, a Regular Member, etc. must in advance prepare a document containing the matters stated in the documents to be delivered prior to conclusion of contract and that they intend to acquire the securities at their own discretion and responsibility, a Regular Member, etc. must in advance prepare a document containing the matters stated in the documents to be delivered prior to conclusion of contract and deliver it to the customers, and then collect a confirmation letter from them regarding the acquisition of over-the-counter securities through the equity-based crowdfunding business (art. 11).

The delivery and collection of these documents may be performed by electromagnetic means (art. 28).

When conducting the equity-based crowdfunding business, a Regular Member, etc. must include, in the documents to be delivered prior to conclusion of contract, at least the information that needs to be made public on its website as referred to in (5), and deliver such documents to customers (excluding professional investors **(Note)**) (art. 10).

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**Note**
“Professional investors” do not include persons who are deemed to be customers other than professional investors under Article 34-2, Paragraph 5 of the FIEA but include persons who are deemed to be professional investors under Article 34-3, Paragraph 4 of the FIEA.

(11) **Report and Disclosure of the Status of Transaction**
A Regular Member, etc. must report to the JSDA the status of the equity-based crowdfunding business through which the public offering is ongoing or closed, by the tenth day of the month.
following the month in which the equity-based crowdfunding business pertaining to the relevant over-the-counter securities is commenced or closed (if the said tenth day falls upon a holiday, the next business day). The JSDA must disclose the content of such report (art. 26, para. 1 and para. 2).

(12) Establishment of the Operational Control System

A Regular Member, etc. must establish internal rules to specify matters necessary for performing the equity-based crowdfunding business in compliance with the FIEA and these Rules, and must also establish systems for carrying out the matters as provided in the internal rules appropriately (art. 17, para. 1).

A Regular Member, etc. must also prepare operational guidelines based on the provisions of the internal rules, and submit these guidelines to the JSDA and make them available for inspection by investors by the same method as that for providing information to investors via the website described in (5) above. A Regular Member, etc. must also take these measures when it has changed the content of the operational guidelines (art. 17, para. 2 through para. 4).

In addition, a Regular Member, etc. must establish a system necessary for making appropriate responses to inquiries from investors in relation to the equity-based crowdfunding business (art. 18).

Furthermore, when a Regular Member, etc. receives deposits of money from customers whom it invites to acquire over-the-counter securities through the equity-based crowdfunding business, it must perform separate management of such money appropriately pursuant to the FIEA (art. 14).

3 Rules Concerning Shareholders Community

The shareholders community system is an unlisted stock trading system which allows only investors who are members of a “shareholders community” to be the target of solicitation for investment.

The purpose of the Rules Concerning Shareholders Community is to provide for the necessary matters for transactions of shareholders community issues that have limited liquidity and to secure appropriateness in the operation, so that the shareholder community system will be used based on a proper understanding of the risks inherent therein and will thereby ensure the fair and smooth transactions of shareholders community issues and contribute to the protection of investors.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 “(1) Breakdown of Over-the-Counter Securities” of this Chapter).

(1) Composition of a Shareholders Community

A shareholders community is a group of investors who intend to invest in a single issue of over-the-counter securities. A shareholders community issue is an issue of over-the-counter securities for which a single Operating Member operates a shareholders community and solicits
customers for investment (art. 2, items 3 and 5).

In order to set up a shareholders community, a Regular Member must be designated as an Operating Member by the JSDA (art. 2, item 4, and art. 4, para.1).

An Operating Member must set up a shareholders community for each issue (art. 4, para. 2).

With regard to over-the-counter securities which have been delisted by financial instrument exchanges, a Regular Member must not set up a shareholders community uninterruptedly after the period of their listing (art. 4, para. 3).

(2) Examination of the Issuer

An Operating Member must conduct strict examination of over-the-counter securities for which it is to set up a shareholders community, in terms of matters including (i) the existence of the issuer and its business, (ii) the issuer’s financial condition, and (iii) the issuer’s social acceptability including its compliance with law, in accordance with the internal rules established based on these Rules, and if the relevant securities are not found to be suitable to be a shareholders community issue, the Operating Member must not set up a shareholders community for the said securities (art. 5, para. 1).

In addition, when handling the public offering or secondary distribution of a shareholders community issue, an Operating Member must also strictly examine the issuer in terms of matters such as the validity of the issuer’s business plan (art. 8, para. 1).

An Operating Member must prepare records of matters such as the details of the examination, the grounds for reaching a decision as to the examination result, and problems identified during the examination process, and preserve such records for five years from whichever is the later of the day of completion of examination or the day of dissolution of the shareholders community (art. 5, para. 2, and art. 8, para. 2).

(3) Measures Toward the Elimination of Antisocial Forces

In order to set up a shareholders community, an Operating Member must provide for the necessary matters in a contract to be concluded with the issuer, such as the issuer’s assurance to not be an antisocial force (art. 6).

If, before an Operating Member sets up a shareholders community, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Operating Member must not set up a shareholders community in relation to the over-the-counter securities to be issued by the issuer (art. 7, para. 1).

If, after an Operating Member sets up a shareholders community, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Operating Member must dissolve the shareholders community immediately (art. 7, para. 2).

(4) Prohibition of Unauthorized Inclusion and Solicitation for Participation in a Shareholders Community

An Operating Member must not perform the procedure to include an investor in a
shareholders community, and must not solicit investors to participate in a shareholders community, unless the investor so requests (art. 9, para. 1 and para. 2).

Furthermore, an Operating Member must not solicit investors other than those who are members of the shareholders community it operates to invest in the shareholders community issue pertaining to the shareholders community (art. 16).

### (5) Provision of Information to Investors

An Operating Member is required to provide investors with information on the shareholders community issue it operates and the issuer thereof, as described below.

<table>
<thead>
<tr>
<th>To whom and how information should be provided</th>
<th>Content of information to be provided</th>
</tr>
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</table>
| Information should be disclosed to all investors (including those who are not members of the shareholders community) (art. 12, para. 1) | (i) Issue name  
(ii) URL of the website where the issuer information is available (or in the case of the issuer who does not have its own website, its main phone number)  
(iii) Special benefits offered to the shareholders  
(iv) If the service of handling public offering, etc. [Note] is available, a statement to that effect and the period for application for such service |
| Information should be provided to shareholders who have applied to be members of the shareholders community (art. 9, para. 3) | (i) Basic information on the issuer, such as the business year, the time of holding an annual shareholders meeting, and the record date regarding voting rights to be exercised at an annual shareholders meeting  
(ii) Information on the method of receiving or inspecting the issuer information |
| Information should be provided only to investors who are members of the shareholders community or made available for inspection by such investors (art. 14) | (i) Registration statements, annual reports, semiannual reports, quarterly reports or extraordinary reports under the FIEA  
(ii) In the absence of the information mentioned in (i) above, the following information:  
(a) Financial statements and business reports under the Companies Act (or documents equivalent thereto a public company under the Companies Act is required to prepare)  
(b) Information compiled in terms of matters that would have been included in “business risks” and “overview of administrative tasks pertaining to shares of the filing company” in the “confidential corporate information” section of an annual report  
(c) Information compiled in terms of matters that would have been included in the “securities information” section of the securities registration statement  
(iii) Other information deemed necessary by the Operating Member |

(Note) Handling of public offering, secondary distribution, private placement or private secondary distribution (meaning any offer to sell, etc. falling under (a) through (c) of the FIEA, Article 2, Paragraph 4, Item 2), or secondary distribution or private secondary distribution
(6) **Explanation to Customers**

In order to confirm with customers, who are to participate for the first time in a shareholders community operated by an Operating Member (excluding professional investors (Note)), that they understand the risks, fees and other matters concerning the act of financial instruments transaction as stated in the documents to be delivered prior to conclusion of contract and that they intend to conduct over-the-counter transactions of the shareholders community issue at their own discretion and responsibility, the Operating Members must prepare in advance a document containing the matters stated in the documents to be delivered prior to conclusion of contract and deliver it to the customers, and then collect a confirmation letter from them regarding the over-the-counter transactions of the shareholders community issue (art. 10).

The delivery and collection of these documents may be performed by electromagnetic means (art. 31).

An Operating Member must also include, in documents to be delivered prior to conclusion of contract to members of a shareholders community who conduct over-the-counter transactions of the shareholder community issue (excluding professional investors (Note)), at least the information on risks, etc. involved in the shareholders community issue (including the fact that the issuer is not required to make the same level of disclosure as the disclosure required under the FIEA or the timely disclosure required at an exchange) and deliver such documents to them while providing them with sufficient explanation on these matters (art. 15, para. 1).

When an Operating Member solicits members of a shareholders community who conduct over-the-counter transactions of the shareholder community issue to invest in the said issue, the Operating Member must notify these members that they may seek an explanation of the details of the information to be provided under Article 14 of these Rules as referred to in (5) above (art. 15, para. 2).

(Nota) “Professional investors” do not include persons who are deemed to be customers other than professional investors under Article 34-2, Paragraph 5 of the FIEA but include persons who are deemed to be professional investors under Article 34-3, Paragraph 4 of the FIEA.

(7) **Withdrawal from a Shareholder Community**

An Operating Member shall perform the procedure for a member of a shareholders community to withdraw from the shareholders community upon the member’s request for withdraw or on any grounds prescribed in the operational guidelines (art. 11).

(8) **Scope of Over-the-Counter Transactions and Prohibition of Unfair Trading Practice**

Over-the-counter transactions of a shareholders community issue must be conducted between members of the shareholders community operated by an Operating Member or between such members and the Operating Member (art. 17).

When an Operating Member conducts over-the-counter transactions of the shareholders community...
community issue, it must confirm that these over-the-counter transactions do not violate any provisions of the FIEA or other related laws and regulations, or these Rules (art. 18).

(9) Report and Disclosure of the Status of Transaction
   An Operating Member must report to the JSDA the status of over-the-counter transactions of the shareholders community issue that it handles and the handling of public offering, etc. thereof every Monday (if Monday is a holiday, the next business day). The JSDA must disclose the content of such report (art. 29, para. 1 and para. 2).

(10) Establishment of the Operational Control System
   An Operating Member must establish internal rules to specify matters provided in these Rules, including matters concerning the examination of the issuer, the requirements and procedures for participation in, withdrawal from and dissolution of a shareholders community, and provision of information to members of a shareholders community, and must also establish systems for carrying out the matters as provided in their internal rules appropriately (art. 25, para. 1).

   An Operating Member must also prepare operational guidelines based on the provisions of the internal rules, and submit these guidelines to the JSDA and disclose them. An Operating Member must also take these measures when it has changed the content of the operational guidelines (art. 25, para. 2 through para. 4).

(11) Designation as an Operating Member
   A Regular Member that seeks to be an Operating Member must file an application with the JSDA 15 business days prior to the day on which it intends to set up a shareholders community, while submitting the operational guidelines, a written oath as an Operating Member, and other necessary documents (art. 26, para. 1 and para. 2).

   If the JSDA finds the documents submitted by the Regular Member which has filed the application to be free of defects, it designates the Regular Member as an Operating Member and publicizes this designation. However, the JSDA may refuse to designate the Regular Member as an Operating Member when it is deemed necessary on grounds such as the Regular Member’s violation of laws and regulations or the JSDA Rules (art. 26, para. 3 and para. 4).

(12) Revocation of Designation as an Operating Member
   An Operating Member that seeks revocation of its designation as an Operating Member must notify the JSDA to that effect five business days prior to the day on which it wishes its designation to be revoked (art. 27, para. 1).

   When the JSDA deems it especially necessary on grounds such as an Operating Member’s violation of laws and regulations or the JSDA Rules, the JSDA may revoke the designation of the Operating Member or suspend the designation for a certain period without relying on this notification (art. 27, para. 2).

   When an Operating Member has its designation as an Operating Member revoked by the
4 Rules Concerning Phoenix Issues

These Rules are prescribed with respect to the “tradable securities” (i.e., “Phoenix Issues”) as set forth in FIEA, Article 67-18, Item 4. This section mainly discusses the handling, etc.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 “(1) Breakdown of Over-the-Counter Securities” of this Chapter).

(1) What is a Phoenix Issue?

Among Over-the-Counter Handled Securities (limited to those issued by an issuing company that meets the qualification prescribed in Article 2, Item 4 (b) or (d) of the Rules Concerning Over-the-Counter Securities), those which were determined by a Regular Member who intended to be a Handling Member to give distribution opportunities to the holders when these were listed on the financial instruments exchange, and designated by the JSDA as securities that an Association Member and a financial instruments intermediary service provider can handle in conducting its solicitation of investments (art.2, item 5).

Investment solicitations must not be conducted by an Association Member other than a Handling Member, etc. except the solicitation of selling Phoenix Issues for the account of the customer (art. 20, para. 1).

(2) Handling Member and Associate Handling Member

A “Handling Member” shall mean a Regular Member designated by the JSDA, after such Regular Member notifies the JSDA that Over-the-Counter Handled Securities shall be Phoenix Issues and the JSDA designates the Over-the-Counter Handled Securities as Phoenix Issues, as a member that is allowed to conduct solicitation for investment in the Phoenix Issues with a Special Member and a financial instruments intermediary service provider entrusted by such Regular Member to carry out financial instruments intermediary service, and that bears obligation as prescribed in the rules of the JSDA (art. 2, item 6).

An “Associate Handling Member” shall mean a Regular Member designated by the JSDA as a member that is allowed to conduct solicitation for investment in Phoenix Issues with a Special Member and a financial instruments intermediary service provider commissioned by such Regular Member to carry out a financial instruments intermediary service, and that bears obligation as prescribed in the rules of the JSDA (art. 2, item 7).

(3) Conditions for Designation as Phoenix Issues

Securities to be designated as Phoenix Issues and their issuer must satisfy all of the following conditions (art. 6, para. 1).

(i) The issuer of the securities has entrusted a shareholder register administrator with clerical work regarding the securities (including the case where the issuer has obtained informal consent from a shareholder register administrator for undertaking such clerical
work).

(ii) The issuer of the securities has not imposed any transfer restriction on the securities by the date of designation.

(iii) The issuer of the securities is not an antisocial force and does not have any relationship with any antisocial forces, and it has in place a structure for eliminating antisocial forces.

(iv) The issue of the securities was delisted because the financial instruments exchange considered the delisting to be appropriate due to insufficiency in the issuer’s disclosure system or for public interest or investor protection, but such insufficiency in the disclosure system, etc. has been improved, corrected or resolved.

(v) The issue of the securities was delisted by the financial instruments exchange due to the issuer falling into the situation where it needed to go through bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings, and the relevant proceedings have been completed.

(vi) The issuer of the securities has given consent to a designated book-entry transfer institution to handle its issue as prescribed in Article 13, Paragraph 1 of the Act on Book-Entry Transfer of Corporate Bonds and Shares or agreed to the matters specified by the designated book-entry transfer institution, or is expected to express such agreement by the time the JSDA designates the issue as a Phoenix Issue.

(4) Consent for Timely Disclosure

Upon designation as a Phoenix Issue, a letter of consent must also be submitted along with the notification of designation as a Phoenix Issue by the issuing company, stating among other things that it will actively cooperate in, *inter alia*, timely and appropriate disclosure of confidential corporate information, as well as an interview conducted by the JSDA (art. 8, para. 1). Furthermore, it must be confirmed by a prescribed document that the issuer is not an antisocial force and has no relationship with antisocial forces, and the copy thereof must be submitted to the JSDA (art. 8, para. 2).

When an issuing company conducts allotment of shares or share options for subscription through third-party allotment, a Handling Member must obtain a confirmation in a prescribed document from the issuing company that the party who is to receive such allotment of shares or share options is not an antisocial force or does not have a relationship with an antisocial force, and must submit its copy to the JSDA (art. 18-2).

(5) Notification and Designation

A notification of a Phoenix Issue must be submitted by a Regular Member who intends to be a Handling Member of such issue, together with an explanatory note on business conditions, etc. and other necessary documents, at least five business days prior to the date when the offering of quotations for the said issue begins (art. 9, para. 1 and para. 3).

If the JSDA confirms that there are no flaws in the documents submitted thereto, it will designate the issue as a Phoenix Issue. At the same time, the JSDA will designate the Regular
Member that filed the notification as a Handling Member (art. 9, para. 4).

In the event of a notification of a Phoenix Issue as Associate Handling Member, the Regular Member who intends to be the Associate Handling Member of the issue must file the notification with the JSDA at least five business days prior to the date when the offering of quotations for the said issue begins (art. 11).

(6) Disclosure of Company Information

The Handling Member must submit an explanatory note on business conditions or an annual securities report, which is prepared by the company issuing Phoenix Issues for each accounting term, to the JSDA within three months in principle after the last day of the accounting term of the issuing company. In addition, the matters to be reported as separately prescribed by the JSDA must be reported to the JSDA and disclosed using TDnet (meaning the timely disclosure information communication system that is operated and managed by the JSDA and domestic financial instruments exchanges). The Handling Member, etc. and the JSDA must make these documents available for public inspection for a certain period of time (art. 15 and art. 16).

Furthermore, the Handling Member is responsible for providing guidance to the issuing company of the Phoenix Issue regarding preparation of documents such as the explanatory note on business conditions and other disclosure of company information (art. 14).

(7) Explanation to Customers

Association Members must deliver to customers (excluding professional investors (Note)) who engage in transactions of Phoenix Issues a document to be delivered prior to conclusion of contract that describes the characteristics and risks, etc. of investing in Phoenix Issues in simple language, and fully explain the same. Additionally, these parties must collect a “written confirmation concerning a transaction of Phoenix Issue” from customers who engage in such transactions for the first time (excluding customers selling Phoenix Issues) (art. 19).

Furthermore, delivery and collection of these documents may be done through electronic means (art. 40).

When soliciting investments in a Phoenix Issue, an Association Member must give a full explanation regarding the said issue and the issuing company to the customer (excluding qualified institutional investors) using the most recent explanatory note on business conditions and document stating matters to be reported as separately prescribed by the JSDA. Furthermore, in a public offering, etc., where it is necessary to prepare and deliver a prospectus pursuant to the provisions of the FIEA, a full explanation must be given to the customer after delivering the prospectus (art. 20 and art. 21).

Each time an Association Member receives an order from a customer (excluding professional investors (Note)) for a Phoenix Issue, the Association Member must divulge that the issue is a Phoenix Issue (art. 22).

(Note) In this instance, professional investors exclude persons deemed as customers other than professional investors pursuant to the provisions of Article 34-2, Paragraph 5 of
the FIEA, and include persons deemed as professional investors pursuant to the provisions of Article 34-3, Paragraph 4 of the FIEA.

(8) Prohibition, Etc. of Unfair Trading Practices

When a Handling Member, etc. or a Special Member that is entrusted by such Handling Member, etc. to carry out financial instruments intermediary service, conducts Over-the-Counter Transactions in Phoenix Issues, the Handling Member, etc. or Special Member must confirm that such Over-the-Counter Transactions do not violate any provisions of the FIEA, other related laws and regulations, and the rules, and must establish internal rules and trading management systems necessary for such purpose (art. 32, para. 1 and para. 2).

(9) Report, Etc. of Quotations and Sale and Purchase

When making notification of designation as a Phoenix Issue, a Handling Member, etc. must choose and specify clearly whether it will update quotations and make reports of sale and purchase daily or weekly, and then must continually display quotes at the trading desks, etc. of its transacting branches each business day for issues that it chooses to announce daily, or at least once each week for issues it elects to announce weekly (art. 35, para. 1).

Additionally, the last quotation and details of over-the-counter transactions must be reported to the JSDA by 5:00 PM each business day for daily announced issues, or by 5:00 PM each Monday (or the following business day if Monday is a holiday) for weekly announced issues (art. 35, para. 3 and para. 5). The JSDA must make public the contents of the quotes and sale and purchase reported by Regular Members (art. 35, para. 7).

(10) Guidance Regarding a Structure for Eliminating Antisocial Forces

Handling Members must provide appropriate guidance to the issuer of a Phoenix Issue with respect to the structure for eliminating antisocial forces prescribed by the said issuer (art. 43).

(11) Revocation of Designation as a Handling Member, Etc.

Handling Members, etc. that desire revocation of their designation as a handling member, etc. must file notice to that effect with the JSDA by the “day preceding the corresponding date of the preceding month” of the date they desire the revocation (art. 36, para. 3).

When a Handling Member falls under matters prescribed by the JSDA (art. 36, para. 5), the JSDA may revoke the designation as a Handling Member for all applicable issues without the filing of a notice by that Handling Member, and in addition, when the JSDA deems it especially necessary on grounds such as a legal or regulatory violation or violation of JSDA rules, etc., the JSDA may revoke the designation of the Handling Member or suspend the designation for a certain period without relying on this notice (art. 36, para. 6).

When all Handling Members for a Phoenix Issue no longer exist, the designation as a Phoenix Issue will be revoked (art. 37, para. 1).
Rules Concerning Sale and Purchase, Etc. of Listed Share Certificates, Etc. Conducted Outside of Financial Instruments Exchange Market

The purpose of these Rules is to ensure fair and smooth sale and purchase, and its intermediary services, etc. of the listed share certificates, etc. conducted outside of financial instruments exchange markets by Association Members (for Special Members, limited to those who conduct the financial instruments intermediary service; the same shall apply in these Rules) and fair and smooth sale and purchase of the listed share certificates, etc. for which the intermediary service, etc. is conducted by Association Members outside of financial instruments exchange market, and thereby to contribute to the protection of investors.

(1) Exceptions

These Rules do not apply to: (i) an off-exchange sale and purchase conducted by the Regular Member with a volume of less than one sale-and-purchase unit prescribed by the financial instruments exchange; (ii) certain purchases made in the conduct of a tender offer; (iii) an off-exchange sale and purchase that is conducted in the OTC transactions of derivatives; and (iv) an off-exchange sale and purchase conducted, with the customer’s consent, between the customer’s account and the account for dealing with the incident in order to cancel the sales and purchase resulting from the incident or perform the obligation in compliance with the purpose of the customer’s order (art. 4, para. 1 through para. 4).

(2) Confirmation of Sale and Purchase Price, Etc., and Record Keeping

When an Association Member conducts the off-exchange purchase and sale, it must confirm that the price or the amount of money of the sale and purchase is appropriate and must keep the records of such confirmation (art. 5).

(3) Suspension of Sale and Purchase, Etc.

When an Association Member learns that the financial instruments exchange is suspending or planning for a suspension of the sale and purchase of the said listed share certificates, etc. due to a case where information related to the said Listed Share Certificates, etc. or the issuer, etc. thereof that is deemed to be likely to materially affect the investors’ investment judgement is disclosed, if the content of such information is unclear or if the Financial Instruments Exchange deemed it necessary to disseminate the content of such information, the Association Member must not conclude an off-exchange sale and purchase of the relevant listed share certificates, etc. until the financial instruments exchange resumes the sale and purchase (art. 6).

An Association Member must establish the following systems when it intends to conduct an off-exchange sale and purchase of listed share certificates, etc. (excluding an off-exchange sale and purchase or intermediary service, etc. thereof conducted under the Approved Business of an Approved Member (a Regular Member who obtains approval of proprietary trading system operation business (for details, see Chapter 2, 2-2 (1), “(x) Proprietary Trading System (PTS) Operations”); the proprietary trading system operation business conducted by such Regular Member is referred to as “Approved Business”; hereinafter the same shall apply in these Rules),
and intermediary service, etc. by a Participation Member (a Regular Member who can intermediate an order from a customer that is to be executed under the Approved Business conducted by an Approved Member; the same shall apply in these Rules) for an Approved Member regarding an order to be executed through the Approved Business of the Approved Member) (art. 6-2).

(i) System for confirming whether there is the following information:
   (a) Information concerning the suspension by the financial instruments exchange of the sale and purchase of listed share certificates, etc.;
   (b) Information that is found to be likely to materially influence investors’ investment decisions; and
   (c) Information concerning the suspension by an Approved Member of the sale and purchase of listed share certificates, etc.; and

(ii) System for suspending an off-exchange sale and purchase of listed share certificates, etc. immediately upon becoming aware of the information referred to in (i)(b) above after trading hours, until the starting time of trading on the financial instruments exchange.

An Approved Member must also have in place a system for confirming the existence of the information referred to in (i)(a) during the hours for handling the Approved Business, and a system for suspending an off-exchange sale and purchase under the Approved Business if there is any information that is found to be likely to materially influence investors’ investment decisions and the content of such information is unclear (art. 6-4, para. 1 and para. 2). If an Approved Member suspends an off-exchange sale and purchase of listed share certificates, etc. under the Approved Business, it must immediately publicize the relevant particulars, such as the issue subject to the suspension of sale and purchase and the period of suspension, by such method as making them freely accessible from the outside (art. 6-4, para. 3).

The JSDA may suspend an off-exchange sale and purchase to be conducted by a Regular Member and an off-exchange sale and purchase for which an Association Member conducts intermediary service, etc. if it deems necessary and appropriate to do so for public interest or protection of investors (art. 6-5).

(4) Establishment, Etc. of Administration System for Short Sale in the Proprietary Trading System

When an Approved Member conducts a short sale in the proprietary trading system (FIEA Enforcement Order, Article 26-2-2, Paragraph 7), it must fully establish a method and system to eliminate sale and purchase, etc. that may harm the fairness of a short sale, and describe such method and system in the business operation procedure document (FIEA, Article 30-3, Paragraph 2) (art. 6-6, para. 1).

A short sale conducted in the proprietary trading system is subject to the short selling restrictions under laws and regulations (for details, see Volume 2, Chapter 1, 3-1 (4) “(ii) Short
When an Approved Member conducts a short sale in the proprietary trading system and receives an order for short sale from its customer (excluding a Participation Member; the same shall apply in these Rules), it shall be subject to the same level of restrictions as short sale restrictions applicable to members of a financial instrument exchange, such as obligation to take settlement measures and to make clear statement and confirmation of conducting a short sale (art. 6-6, para. 2).

An Approved Member must not conduct a margin transaction through the Approved Business. A Participation Member must not conduct brokerage services for an order from a customer that is a margin transaction (art. 6-6, para. 3)

(5) Reporting and Publication

(i) In the case where a Regular Member (excluding an Approved Member; hereinafter the same applies in (5)) makes, outside of a financial instruments exchange market, an application for sale or purchase of the listed share certificates, etc. to a large number of persons simultaneously, it must report the name of the issues and the highest prices if the application pertains to purchase or the lowest price if the application pertains to sale, together with the volume and other matters pertaining to the application through the report and publication system to the JSDA (art. 7, para. 1). If an Approved Member makes such application through the Approved Business, it must report the name of issues and the highest prices as of the date of application if the application pertains to purchase or the lowest price as of the date of application if the application pertains to sale, together with the volume and other matters pertaining to the application through the report and publication system to the JSDA (art. 10, para. 1).

(ii) In cases where an off-exchange sale and purchase has been concluded, a Regular Member must report name of issues, sale and purchase price, sale and purchase volume, etc., to the JSDA through the report and publication system (art. 7, para. 2). The same applies when an Approved Member executes sale and purchase through the Approved Business (art. 11, para. 1).

(iii) A Regular Member must report as mentioned in (i) and (ii) above, at the time specified as follows for each type of transaction: (a) with respect to the sale and purchase applied and concluded from 8:10 a.m. to 4:59 p.m.: within five minutes from the time when the application is made or the sale and purchase is concluded; (b) with respect to the sale and purchase concluded from 5:00 p.m. to 11:59 p.m. or the sale and purchase concluded on a non-business day: from 8:10 a.m. to 8:29 a.m. of the next business day; and (c) with respect to sale and purchase concluded from 0:00 a.m. to 8:09 a.m.: from 8:30 a.m. to 9:00 a.m. of the next business day (art. 7, para. 3). An Approved Member must make a report mentioned in (i) by 8:30 a.m. of the business day following the date of application and a report mentioned in (ii) by 8:30 a.m. of the business day following the date of conclusion of the sale and purchase (art. 10, para. 2, art. 11, para. 2).

(iv) When the JSDA receives a report as prescribed in (i) or (ii) from a Regular Member, the JSDA will notify other Regular Members and publicize the contents thereof at the
prescribed timing (art. 9, para. 1 and para. 2).

(v) When the JSDA receives a report as prescribed in (i) or (ii) from an Approved Member, the JSDA will notify other Approved Members without delay (art. 14, para. 1 and para. 2).

(vi) The JSDA sums up the information obtained by way of the reports mentioned in (i) and (ii) which it considers necessary and publicizes such information on a daily basis (art. 9, para. 3 and para. 4, and art. 14, para. 3 and para. 4).

(6) Availability of the Price, etc. of Off-Exchange Sale and Purchase through Approved Business

If an Approved Member makes an application for or concludes sale and purchase through the Approved Business, it must make the designated information available for inspection within five minutes from the application or from the conclusion of sale and purchase, by a designated method (art. 17-2 and art. 17-3):

(7) Explanation to Customers

In cases where an Association Member receives an order concerning the off-exchange sale and purchase from a customer, it must explain in advance to the customer the matters prescribed in (i) and (ii) below, depending on the category set forth in (i) and (ii) below (art. 18):

(i) In cases where the Association Member receives a short sale order that is to be conducted in the proprietary trading system:

(a) Conditions of delivery and settlement;

(b) Handling of short sale transactions (matters concerning the settlement measures and clear confirmation by the Approved Member regarding a short sale, as described in (4) above); and

(c) Other matters deemed necessary by the Association Member;

(ii) In cases other than (i) above:

(a) Conditions of delivery and settlement; and

(b) Other matters deemed necessary by the Association Member.

6 Rules Concerning Underwriting, Etc. of Securities

Underwriting means, at the time of public offering, secondary distribution or private placement or exclusive offer to sell, etc. for professional investors of securities, either concluding a contract for acquiring all or part of the securities for the purpose of having other persons acquire them (firm commitment), or, with regard to all or part of securities, promising to acquire all of the remaining securities which are not acquired by another person (standby commitment), or concluding a contract for acquiring the share option certificates whose share options are yet to be exercised and exercising such share options by itself or a third party, where the relevant securities are share option certificates and the person who has acquired the share option certificates does not
exercise the share options for all or part of such certificates (commitment of a commitment-type rights offering), and is one category of the financial instruments business (FIEA, art. 2, para. 6, and para. 8, item 6).

The purpose of these Rules is to ensure proper business operations and protection of investors and thereby contribute to sound development of the capital market with respect to the underwriting of public offerings or secondary distributions of share certificates, etc. and company bonds, etc. in Japan by Regular Members, and handling of public offerings or secondary distributions of share certificates, etc. in Japan by Association Members.

A summary of these Rules is set forth below:

(1) Conduct of Appropriate Underwriting and Underwriting Examination

When a Regular Member Underwriter conducts the underwriting, it must secure a necessary and sufficient period of time to implement the underwriting examination and make an underwriting judgment with a comprehensive judgment and responsibility based on the result of the underwriting examination implemented pursuant to the rules (art. 3).

Further, when a Regular Member Underwriter conducts underwriting, the Regular Member Underwriter must carry out a rigorous underwriting examination in the Regular Member’s underwriting examination section concerning the underwriting examination items set forth in the rules (art. 12).

A Regular Member Underwriter must have the personnel structure that enables him or her to implement a proper underwriting examination and in principle must also have an organization system that satisfies the following requirements in order to form examination opinions that are independent from the underwriting promotion section and the underwriting examination section (art. 5):

(a) Establishing an underwriting examination section;
(b) Persons who conduct the underwriting examination in the underwriting examination section shall not be involved in the underwriting promotion business or the underwriting business; and
(c) Officers in charge of the underwriting examination section shall not be responsible for the underwriting promotion section or underwriting section.

Regular Member Underwriters must preserve for five years the materials, etc. collected in the underwriting examination, the contents of the analysis and evaluation of the said materials, etc. as well as the record created pertaining to the process of forming the underwriting judgment, etc. (art. 7).

When carrying out an underwriting examination, the Lead Managing Regular Member Underwriter must in principle receive underwriting examination materials from the issuer sufficiently ahead of time (art. 12, para. 2; “Detailed Rules Related to the Rules Concerning Underwriting, etc. of Securities (hereinafter “Detailed Underwriting Rules”), art. 6 and art. 7).

Where carrying out an underwriting examination, the Lead Managing Regular Member
Underwriter must receive a comfort letter (an examination report concerning the issuer of the share certificates or corporate bonds prepared by the auditor, which has stated matters and contents, etc. that are prepared in conformance with the Outline of “Letter to an Administrative Underwriting Manager Securities Company from an Audit Corporation” (The Japanese Institute of Certified Public Accountants, Japan Securities Dealers Association) from the auditor in order to carry out examinations, etc. pertaining to the accuracy of the financial information stated in the securities registration statement, etc., and later fluctuations in the said financial information (art. 12, para. 5).

The Lead Managing Regular Member Underwriter must provide, etc. the materials and information necessary for the underwriting examination to other Regular Member Underwriters sufficiently ahead of time and must to the extent possible cooperate with the said other Regular Member Underwriters’ underwriting examinations (art. 13, para. 1; Detailed Underwriting Rules art. 8).

Upon carrying out the underwriting examination, if the Lead Managing Regular Member Underwriter has come to know that there is a replacement of the previously planned Lead Managing Regular Member Underwriter for such project subject to underwriting examination, a replacement of the auditor, or a change in the financial instruments exchange market for which it was planned to apply for listing, along with confirming the reason for this with the issuer, the lead managing member must sufficiently consider the reasonableness of the details of the said confirmation (art. 14).

Where the issuer makes public disclosure of a material fact immediately after an initial public offering, the Lead Managing Regular Member Underwriter, etc. must confirm with the said issuer whether or not the said fact occurred prior to the initial public offering and whether or not there was any falsehood in the explanation from the said issuer during the course of the underwriting examination, and must verify whether the disclosures in the securities registration statement, etc. at the time of the initial public offering were appropriate (art. 15, para. 1).

Where as a result of this verification it becomes clear that there was a material difference between disclosures in the securities registration statement, etc. and the business circumstances, etc. of the issuer at the time of the underwriting examination, the Lead Managing Regular Member Underwriter must request the issuer to make a sufficient explanation of that reason to investors (art. 15, para. 2).

(2) Confirmation and Public Disclosure of Use of Funds

If the funds to be financed in an offering are to be used in an M&A (meaning company purchase, capital tie-up, etc.) the Lead Managing Regular Member Underwriter must confirm the possibility that the M&A will be achieved as well as reasonable substitute uses if the M&A is not achieved, and must also request the issuer to make public disclosure in the announcement materials concerning the future business scheme and the time limit for appropriation of funds upon carrying out the M&A and substitute uses for the funds (art. 20, para. 2).

Along with requesting the issuer to make public disclosure for each occasion concerning the circumstances where there is a change in use or allocation of the financed funds, the Lead
Managing Regular Member Underwriter must request the issuer to publicly disclose the allocation circumstances of the financed funds by notation in the summary of accounts (art. 20, para. 5; Detailed Underwriting Rules art. 12, para. 2 and para. 3).

If a considerable change has occurred in the use of funds financed pursuant to a previous offering of share certificates, etc., and no good reason existed for such change, the Lead Managing Regular Member Underwriter must request the issuer of securities to leave a substantial period of time between the new offering of share certificates, etc., that it intends to carry out and the previous offering of share certificates, etc. that it carried out (art. 20, para. 4).

Upon conducting an underwriting of share certificates, etc., the Lead Managing Regular Member Underwriter must announce the following enumerated information in a press release at the time the details are determined, and to the extent possible must also request the issuer to include these in the securities registration statement or shelf registration supplementary documentation (art. 23):

(i) The use of funds and impact of the funds financed on the company’s profitability (art. 20, para. 1). In the case of M&A, the future business scheme and the time limit for appropriation of funds upon carrying out the M&A as well as substitute uses where the funds are not allocated (art. 20, para. 2);

(ii) Dividend policy or distribution policy, such as the status of dividends of surplus, etc. to shareholders, etc., and the fundamental approach used in determining dividends of surplus (art. 21); and

(iii) Past stock price trends, etc., the date of any past offerings of share certificates, etc., and the contents thereof, the status of any potential shares, etc. (art. 22).

(3) Measures Toward the Elimination of Antisocial Forces

A Regular Member Underwriter must prescribe matters necessary in the wholesale underwriting contract executed between the issuer and the seller (hereinafter “issuer, etc.” in these Rules) such as the undertaking that the issuer, etc. is not an antisocial force, etc. (art. 8-2).

In addition, a Regular Member Underwriter must confirm in the underwriting examination whether or not the issuer, etc. is an antisocial force or related to an antisocial force (art. 8-3, para. 1), and if as a result of the confirmation the issuer, etc. is found to be an antisocial force or related to an antisocial force, it must not enter into the wholesale underwriting contract (art. 8-3, para. 2).

If a Regular Member Underwriter finds that the issuer, etc. is an antisocial force after the execution of the wholesale underwriting contract, it must not underwrite securities pursuant to the said contract (art. 8-3, para. 3)

(4) Fair Determination of Conditions

A Regular Member Underwriter must, upon underwriting securities, determine the conditions concerning the public offering or secondary distribution adequately respecting the market conditions such as conducting an investigation of investment demands as necessary, and refrain
from underwriting securities at an extremely unreasonable quantity, price or other conditions (art. 24).

In cases where the book building method is used (meaning the researching of the status of demand by investors) upon underwriting share certificates, etc. or corporate bonds, etc., the Regular Member Underwriter must determine a fundamental policy for ascertaining indications of interest and conduct its research based on this fundamental policy. In conducting their research, Regular Member Underwriters must be aware that statements clearly falling under those not based on investors demand, excessive statements made in order to garner more share of the offering or multiple statements based on the demand from a single investor will not be counted for this purpose. Additionally, if a Regular Member discovers an overlap in the statements received from other Regular Members, it shall deliberate with the other Regular Members to resolve the overlap (art. 25; Detailed Underwriting Rules, art. 14).

A Lead Managing Regular Member Underwriter must, when determining the assumed price, temporary conditions or initial offering price upon underwriting of shares certificates, etc. in a public offering or secondary distribution concerning initial public offerings, confirm the appropriateness of such price or the price range, etc. at a division or a committee that does not have a close business relationship with the issuer or the investor (art. 26).

The Regular Member Underwriter must prescribe the following matters in its internal regulations upon underwriting share certificates, etc. in a public offering or secondary distribution concerning initial public offering of share certificates, etc. However, this shall not apply to the following matters which the procedures concerning the said matter will not be performed (art. 27):

(i) **Matters necessary for adequately determining the assumed price**;
(ii) **Matters necessary for adequately determining the temporary conditions**;
(iii) **Matters necessary for adequately using the book-building method**;
(iv) **Matters necessary for adequately implementing competitive bids**;
(v) **Matters necessary for adequately determining the initial offering price**; and
(vi) **Other necessary matters**.

An Regular Member Underwriter must carry out periodic investigations or audits on the following (art. 8):

(i) **Compliance with internal regulations on underwriting examination**; and
(ii) **Due application of internal manuals on underwriting examination**.

(5) **Over-Allotment**

“Over-allotment” means, in connection with a public offering or secondary distribution for share certificates, etc., the Regular Member Underwriter’s selling additional shares at the same terms and conditions in addition to the scheduled volume of such public offering or secondary distribution; provided, however, in the case of public offering or secondary distribution of foreign
share trust beneficiary certificates or foreign infrastructure fund beneficiary certificates, over-allotment refers to the Regular Member Underwriter’s selling additional units at the same terms and conditions in addition to the scheduled volume of such public offering or secondary distribution (art. 2, item 20).

If the Regular Member Underwriter has temporarily borrowed shares from the issuing company or large shareholders, etc. in order to procure share certificates, etc. for an additional secondary distribution by the over-allotment, it should return these borrowed shares through the exercise of the green shoe option or by those share certificates, etc., acquired in the syndicate cover transactions.

The total over-allotment volume is limited to 15% of the anticipated domestic volume of the public offering or secondary distribution (in cases where public offering and secondary distribution are conducted simultaneously, the sum of the anticipated domestic volume of the public offering and secondary distribution) (art. 29, para. 1).

A “green shoe option” is the option granted to a Regular Member Underwriter upon the execution of a wholesale underwriting contract that allows the Regular Member Underwriter to purchase share certificates, etc. of the same issue as the share certificates, etc. pertaining to a public offering or secondary distribution from the issuer or holder (in the case of a public offering or secondary distribution of foreign share trust beneficiary certificates, the holder of foreign share certificates that are the entrusted securities provided for in FIEA Enforcement Order, Article 2-3, Item 3; in the case of a public offering or secondary distribution of foreign infrastructure trust beneficiary certificates, the holder of the foreign infrastructure funds that are the entrusted securities provided for in the said item) (art. 2, item 21).

A “syndicate cover transaction” is the buying back of the shares subject to the public offering or secondary distribution by a Regular Member Underwriter in its own account who exercised the over-allotment, which is conducted after the public offering or secondary distribution period in order to reduce the short position resulting from the over-allotment (art. 2, item 22).

(6) Commitment-Type Rights Offering

“Commitment-type rights offering” means, among the method of capital increase in which a listed issuer makes allotment of share options without contribution pursuant to the provisions of Article 277 of the Companies Act or allotment of investment equity subscription rights without contribution pursuant to the provisions of Article 88-13 of the Act on Investment Trusts and Investment Corporations, the exercise of share options or investment equity subscription rights yet to be exercised by a Regular Member Underwriter or a third party that acquires the relevant share options or investment equity subscription rights from the Regular Member Underwriter, based on the contract provided for in Article 2, Paragraph 6, Item 3 of the FIEA (art. 2, item 25).

Where a Regular Member Underwriter acquires new share option certificates or investment equity subscription right certificates from a listed issuer or another Regular Member Underwriter in the course of the business of underwriting commitment-type rights offering, the relevant Regular Member Underwriter must, immediately after the acquisition, disclose the state of acquisition of share option certificates or investment equity subscription right certificates by a
prescribed method (art. 30, para. 1). An Regular Member Underwriter must not exercise the voting rights of share certificates acquired by exercising the share options of the relevant share option certificates or the investment securities acquired by exercising investment equity subscription rights of the relevant investment equity subscription right certificates at the shareholders meeting or the investors meeting for which a record date (meaning the record date as prescribed in Article 124, Paragraph 1 of the Companies Act or the record date as prescribed in Article 77-3, Paragraph 2 of the Act on Investment Trusts and Investment Corporations) has been established during the period until 60 days pass from the day of acquisition (art. 31).

A Lead Managing Regular Member Underwriter must request the listed issuer to publicize the volume of share option certificates or investment equity subscription right certificates transferred to each Regular Member Underwriter in press release materials (art. 30, para. 2).

In cases where underwriting a commitment-type rights offering for which the exercise of share options or investment equity subscription rights by shareholders or investors residing in a specific foreign country is restricted, the Regular Member Underwriter must carry out underwriting examination from the perspective of finding whether or not there are any factors that hinder the liquidity of the share option certificates or investment equity subscription right certificates in a financial instruments exchange market (art. 32).

(7) Handling of Transactions by Officers of Listed Issuer

The Lead Managing Regular Member Underwriter must not underwrite the public offering or secondary distribution of share certificates, etc. (in the case of real estate investment trust securities, limited to those that fall within the category of investment securities; in the case of infrastructure funds, limited to those that fall within investment securities or foreign investment securities; and in the case of foreign infrastructure fund beneficiary certificates, limited to those for which the entrusted securities are foreign investment securities) if it is found that an officer of a listed issuer has traded the share certificates, etc. issued by such listed issuer while knowing that a public offering or secondary distribution of share certificates, etc. issued by the said listed issuer before the information concerning the public offering or secondary distribution is publicly disclosed (art. 34, para. 1).

The Lead Managing Regular Member Underwriter must, if it is found that an officer of a listed issuer has conducted transactions in share certificates, etc. issued by the said listed issuer during the preparation time of the public offering or secondary distribution of share certificates, etc., confirm for each instance by a document from the listed issuer that such transaction was not conducted by the officer while knowing that a public offering or secondary distribution of share certificates, etc. that has not been announced will be conducted (art. 34, para. 2).

In addition, when the Lead Managing Regular Member Underwriter is to underwrite a primary offering or a secondary distribution of share certificates, etc. by a listed issuer, if it is found that the Lead Managing Regular Member Underwriter that the listed issuer planned to designate was changed, the Lead Managing Regular Member Underwriter shall confirm with the listed issuer in writing that the plan to make a public offering or a secondary distribution of share certificates, etc. by the listed issuer was not cancelled pursuant to the provisions of Article 34,
Paragraph 1 of these Rules during the 6 months prior to the date (limited to a date that will be announced) determined by the organ determining the execution of business of the listed issuer concerning the public offering or secondary distribution (art. 34, para. 3).

If the Lead Managing Regular Member Underwriter cancels an underwriting pursuant to the provisions of Article 34, Paragraph 1 of these Rules, it must not underwrite the public offering or a secondary distribution of share certificates, etc. issued by such listed issuer until 6 months have elapsed (with respect to a secondary distribution, until the period determined as appropriate by the Lead Managing Regular Member Underwriter in light of the individual case has elapsed) from the date of the transaction conducted by the officer of such listed issuer to the date (limited to a date that will be announced) determined by the organ determining the execution of business of the listed issues concerning the public offering or secondary distribution of share certificates, etc. to be newly made by the listed issuer (art. 34, para. 4).

(8) Handling in Case of Information Leakage, Etc.

When the Regular Member Underwriter intends to underwrite a public offering or secondary distribution of share certificates, etc. issued by a listed issuer and it is found that the confidential corporate information related to such public offering or secondary distribution was leaked by an officer or employee of the Regular Member Underwriter (excluding the cases where such leakage is necessary for its business operations and the necessary procedures have been performed) before the information on such public offering or secondary distribution is publicly disclosed, the Regular Member Underwriter must not underwrite such public offering or secondary distribution. However, this does not apply if the Regular Member Underwriter reports such leakage to the listed issuer, and the listed issuer requests the Regular Member Underwriter to conduct the underwriting. In such case, the Regular Member Underwriter must report the leakage and the request to the Lead Managing Regular Member Underwriter (art. 34-2, para. 1).

When the Lead Managing Regular Member Underwriter underwrites the share certificates, etc. issued by a listed issuer, it must discuss the date of public offering or secondary distribution with the listed issuer if any of the following situations arises before the information on such public offering or secondary distribution is publicly disclosed:

(i) the share price of the listed issuer or the price of real estate investment trust securities (limited to those that fall within the category of investment securities), infrastructure funds (limited to those that fall within investment securities or foreign investment securities) or foreign infrastructure fund beneficiary certificates (limited to those for which the entrusted securities are foreign investment securities) sharply declines; or

(ii) it is found that a transaction of the share certificates, etc. issued by the listed issuer was conducted by a person who knows an undisclosed plan of public offering or secondary distribution (excluding the case that falls under Article 34, Paragraph 1 or Article 34-2, Paragraph 1 of these Rules) (art. 34-2, para. 2).

(9) Underwriting Terms

The Lead Managing Regular Member Underwriter shall, upon underwriting share
certificates, etc., with respect to share certificates, etc., confirm the investment activities of the allotees of the capital increase through the third party allotment conducted immediately preceding (limited to those conducted within 5 years prior to the day on which payment for the public offering was made), subsequent to the allotment concerning the share certificates, etc., and if it is discovered that the matters disclosed with respect to the holding policy upon the immediately preceding capital increase through third party allotment and the investment activities of the allotees thereafter are different, it must not underwrite the share certificates, etc. until the details thereof have been announced (art. 35).

(10) Underwriting Not Pursuant to These Rules, Etc.

Upon underwriting a secondary distribution which does not require the preparation of a prospectus, measures the Regular Member Underwriter deems necessary shall be taken by paying regard to the rules (art. 36, para. 1).

Rules Concerning Distribution to Customers Related to the Underwriting, Etc. of Public Offering, Etc. of Share Certificates, Etc.

The rules has been provided with the purpose of selling share certificates, etc. smoothly to a wide range of customers and distribute the share certificates, etc. fairly to the customers when an Association Member performs the underwriting of public offerings (excluding those related to commitment-type rights offering) or secondary distributions (limited to those for which a prospectus or written explanation of the details of the company shall be prepared), handling of public offerings (excluding the equity-based crowdfunding business conducted by Regular Members and Specified Business Members) or secondary distributions or engagement of secondary distributions (hereinafter collectively referred to as the “underwriting, etc. of public offering, etc.” in these Rules) by an Association Member (art. 1).

The outline of the rules is as follows:

(1) Fair Distribution

In conducting an underwriting, etc. of public offerings, etc., an Association Member must endeavor to make the distribution of share certificates in relation to the underwriting, etc. of public offerings, etc. fair and not to make it excessively skewed to specific investors without reasonable grounds, by sufficiently taking into consideration the actual conditions of the market and trends in the investment demands, etc. (art. 2, para. 1).

(2) Sales to Purchasers that are Designated or Suggested by the Issuing Company (“Oyabike”)

In conducting an underwriting of public offering or secondary distribution of share certificates, etc., an Regular Member Underwriter shall not conduct sales to purchasers that are designated or suggested by the issuing company (“oyabike”, meaning the sales to purchasers designated or suggested by the user; hereinafter the same shall apply in these Rules) unless it satisfies all of the following requirements (art. 2, para. 2).
(i) The Regular Member Underwriter has judged that the distribution would not be made in violation of (1) above, even if the said oyabike was conducted;

(ii) The issuer makes an appropriate publication regarding the relevant oyabike after the submission of the securities registration statement or shelf registration statement; and

(iii) The Lead Managing Regular Member Underwriter obtains from the planned purchaser of the oyabike a commitment that it will continuously hold the relevant share certificates until the day on which 180 days has passed from the due date of payment or last day of payment period for public offering or the due date for delivery for secondary distribution (lock-up).

(3) Concurrent Allocation to Third Parties

“Concurrent allocation to third parties” means the allocation to third parties the share certificates, etc. which are issued by the issuer thereof, that is made concurrently with the public offering or secondary distribution of share certificates underwritten by the Regular Member Underwriter.

In cases where a concurrent allocation to third parties is to be made, an Regular Member Underwriter must require the issuer to conduct the concurrent allocation to third parties by paying regard to the purpose mentioned in (2) above (excluding (ii)) (art. 2, para. 3).

(4) Partial Distribution by Drawing at the Initial Public Offering

When an Association Member distributes share certificates or beneficiary certificates of foreign share trusts to retail customers at the time of initial public offering, in principle, it shall determine the distributees by drawing for 10% or more of the quantity that is to be distributed by the Association Member to retail customers. However, where the demand for book building is not sufficiently accumulating or where the number of retail customers’ applications received by an Association Member does not reach the quantity that is planned for distribution to retail customers by the Association Member, the Association Member may either decrease the ratio for drawing, or may choose not to adopt the distribution by drawing or cancel the distribution by drawing (art. 3).

(5) Prohibition of Centralized Distribution and Unfair Distribution at the Initial Public Offering

In cases where an Association Member distributes share certificates or beneficiary certificates of foreign share trusts to retail customers at the initial public offering under a method other than drawing, it must not excessively centralize the distribution or conduct an unfair distribution to a specific customer. The Association Member must pay attention that the distribution to each customer by means other than drawing should not be excessive compared with the average quantity distributed by drawing to each customer, and must not repeatedly distribute to the same customer (art. 4).
(6) **Provision of Information on the Distributees**

In cases where an Regular Member Underwriter other than the Lead Managing Regular Member Underwriter distributes to customers the share certificates, etc. which it has underwritten, the Regular Member Underwriter must provide without delay to the Lead Managing Regular Member Underwriter the information of the name of the customers which is a bank, insurance company or non-resident, etc. (excluding individuals) and the quantity of share certificates, etc. distributed to such customers (hereinafter referred to as the “information on the distributing parties” in these Rules) (art. 6).

In cases where Lead Managing Regular Member Underwriter distributes to customers the share certificates, etc. which it has underwritten or receives the provision of information on the distributees from all of the other Regular Member Underwriters, the Lead Managing Regular Member Underwriter must provide without delay to the issuer of the share certificates, etc. (in the case of real estate investment trust certificates, including the asset management company of the investment corporation which issued the certificates; in the case of infrastructure funds, including the asset management company of the investment corporation which is the issuer of the relevant funds) the information on the distributees that are the customers for which the Lead Managing Regular Member Underwriter has made distribution and which are banks, insurance companies or non-residents, etc. (excluding individuals) and the information on the distributees received from other Regular Member Underwriters (art. 7).

In cases where an issuer is to receive the information on the distributing parties, the Lead Managing Regular Member Underwriter must obtain from the issuer in writing a promise to the effect that the issuer shall appropriately manage the information on distributees without any leakage (art. 8).

(7) **Basic Policy of Distribution**

In conducting an underwriting, etc. of public offering, etc., an Association Members must prepare a basic policy on distributing share certificates, etc. to investors, in advance, and disseminate the detailed contents of such basic policy to the investors by appropriate means such as the displaying it on its branch offices/sales counters or uploading it on its website (art. 9, para. 1 and para. 3).

The basic policy must be prescribed concretely and in an easy-to-understand manner for investors, the ratio of quantity under drawing, handling of drawing, possibility of decreasing the ratio for drawing or not adopting or canceling the distribution by drawing, if any, and the handling of distribution by means other than drawing (art. 9, para. 2).

An Association Member must submit the basic policy to the JSDA if it so requires (art. 9, para. 4).

(8) **Internal Rules Concerning Distribution**

An Association Member must establish internal rules concerning the distribution of share certificates, etc. subject to the underwriting, etc. of public offering, etc. and comply with them (art. 10, para. 1).
The internal rules must prescribe in detail and concretely the customers, etc. that are not allowed to apply for the distribution, handling of distribution related to hot issues, handling of distribution when the equity market environment deteriorates, and internal inspection procedures in addition to the contents of the basic policy prescribed in (7) above (art. 10, para. 2).

An Association Member must submit the internal rules to the JSDA if it so requires (art. 10, para. 3).

(9) **Enhancement of Internal Administration System**

An Association Member must regularly inspect whether the distribution of share certificates, etc. under the underwriting, etc. of public offering, etc. was properly conducted pursuant to its internal rules under the responsibility of the internal administration supervisor (art. 11).

(10) **Retention, Etc. of Record**

An Association Member must retain the record concerning distribution of individual issues, record concerning quantity under drawing (including the reason for decreasing the ratio of quantity under drawing, not adopting the drawing or cancelling the drawing, if any), and record concerning results of inspection set forth in (9) above, for five years so that an external audit and inspection, etc. are conducted properly (art. 12).

(11) **Announcement of Distribution Condition**

A Regular Member must collect the information on distribution of share certificates, etc. underwritten by it on a quarterly basis, analyze the information and report the result of the analysis to the JSDA (art. 13, para. 1).

An Association Member must summarize the distribution condition of share certificates, etc. of foreign share trust beneficiary certificates to retail customers at the initial public offering on a monthly basis, analyze it, and report it to the JSDA by the month after the next month in which the payment due date falls (art. 13, para. 2).

The JSDA shall regularly announce to the general public the distribution condition reported (art. 13, para. 3).

**Rules Concerning Handling of Allotment of New Shares to Third Party, Etc.**

The purpose of these Rules is to prescribe matters that should be complied with when purchasing share certificates, etc. relating to the allotment of new shares to third party, etc., and to ensure that secondary market transactions concerning MSCBs, etc., and the exercise of share options, etc. are conducted in a fair and smooth manner, thereby contributing to the sound development of capital markets. (art. 1).

The “allotment of new shares to third party, etc.” means public offering or secondary distribution of share certificates, share option certificates and bonds with share options by way of allocation to a third party (art. 2, item 1).

The “purchase” upon the allotment of new shares to third party, etc. means acquisition of all or part of share certificates, etc. relating to the allotment of new shares to third party, etc., without
intending to have the third party acquire such share certificates, etc. (art. 2, item 3).

“MSCBs, etc.” means securities enumerated below that are issued by a listed issuer (meaning the issuer of securities listed in a domestic financial instruments exchange market; hereinafter the same shall apply in these Rules) by way of allocation of new share certificates to a third-party, etc., containing an issuing term to the effect that the price payable per share (hereinafter referred to as the “Exercise Price” in these Rules) when exercising the share options or put options granted or represented thereon (hereinafter referred to as the “Share Options, etc.” in these Rules) may be adjusted, at a frequency greater than once every six-months, based on the price of the share certificates on the financial instruments exchange market or in the PTS, etc. (including an average price, volume weighted average price, or other price calculated using the said price; hereinafter the same shall apply in these Rules) delivered from the exercise of such Share Options, etc. (art. 2, items 2 and 7):

(i) Convertible-type bonds with share options (among bonds with share options, those bonds wherein the objective of the investment when exercising the share options is the bonds that are connected with such bonds with share options; the same shall apply in the following (ii));
(ii) Bonds with share options (bonds with share options (excluding convertible-type bonds with share options) and simultaneously offered and simultaneously allotted bonds and share options certificates issued to be traded as a single unit);
(iii) Share options certificates; and
(iv) Share certificates with put options (refers to those where the consideration delivered for exercise of put options is the listed share certificates issued by the listed issuer of such share certificates with put options).

(1) Matters to be Verified when Purchasing Share Certificates, Etc.

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc., a Regular Member must verify at least matters listed in the following items, and must make such purchase based on its comprehensive judgment and at its own responsibility (art. 3).

In addition, upon purchasing MSCBs, etc., the Regular Member must at least confirm the matters in parenthesis among the matters below (art. 9):

(i) Financial condition and business performance (adequacy of financial condition and cash flow situation, earnings record and earnings forecast, analysis of reasons for changes in financial condition and business performance, and earnings forecast and progress review already made public);
(ii) Intended use of funds raised (rationality of intended use of funds raised and review of appropriation of funds raised in the past);
(iii) Share price trend (share prices over time and trading volume over time);
(iv) Effect on the market and existing shareholders (rationality of the Exercise Price (including the revised provisions of the Exercise Price), exercise period, and other terms for Share Options, etc., and rationality of the MSCB, etc. issue amount and dilution accompanying such issuance in view of the liquidity and market capitalization of the underlying share certificates, etc.);
(v) Proper disclosure of company information etc. (proper disclosure of circumstances since the end of the latest business year); and
(vi) Other matters deemed necessary by the Regular Member.

(2) Explanation to the Listed Issuer

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer, and at the same time, structuring securities whose underlying assets are such share certificates, etc. (including a similar act), a Regular Member must explain that it plans to structure the securities to the listed issuer (art. 4, para. 1).

In addition, when structuring the securities, or purchasing share certificates, etc. relating to allotment of new shares to third party, etc. whose terms are determined based on the terms of a derivatives transaction) or other transactions, a Regular Member must explain the above matters to the listed issuer (art. 4, para. 2).

When proposing to a listed issuer the issuance of MSCBs, etc., a Regular Member must provide a product description to such listed issuer that is sufficient for such listed issuer to fully understand the characteristics of MSCBs, etc. as well as the advantages and disadvantages of issuing such MSCBs, etc. and to choose to issue MSCBs, etc. after fully considering the effects, etc. on existing shareholders (art. 8).

(3) Request to the Listed Issuer

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc., a Regular Member must request to the listed issuer that the listed issuer determine the amount paid for new share certificates, etc. pursuant to the “Guidance Concerning Handling of Allotment of New Shares to Third Party, Etc.” that is separately prescribed by the JSDA (art. 5, para. 1).

In addition, Regular Members must, upon purchasing share certificates, etc. relating to allotment of new shares to third party, etc., request the listed issuer to sufficiently disclose the following matters (art. 5, para. 2):

(i) Intended use of funds raised;
(ii) Reason(s) for choosing the allotment of new shares to third party, etc.;
(iii) Reason(s) for selecting the allottees for the allotment of new shares to third party, etc.;
(iv) Rationality of the issuing terms of the allotment of new shares to third party, etc.;
(v) Schedule for share certificate, etc. lending transactions with the listed issuer’s
(4) Purchase Conditions

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer, a Regular Member shall verify the manner in which share certificates, etc. relating to the immediately preceding allotment of new shares to third party, etc. by the same listed issuer (limited to those conducted within five years prior to such purchase) were subsequently invested by the allottees. If it is found that information contained in the disclosure on the holding policy for immediately preceding allotment of new shares to third party, etc. by the listed issuer and the subsequent investment activities by the allottees are inconsistent, the Regular Member must not purchase such share certificates, etc. before the details on such inconsistency are publicly announced (art. 6).

(5) Handling of Cancellation of Purchase

When confirming that an officer of a listed issuer has conducted a transaction of share certificates, etc. issued by such listed issuer with knowing that such listed issuer plans to offer share certificates, etc. and that such information is not disclosed, a Regular Member must not purchase share certificates, etc. relating to allotment of new shares to third party, etc. by such listed issuer (art. 7, para. 1).

When a Regular Member purchases share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer and becomes aware that an officer of the listed issuer has conducted a transaction of share certificates, etc. issued by such listed issuer during the period of preparing for the offering of share certificates, etc., the Regular Member shall verify with the listed issuer in writing that in conducting the transaction the officer did not know the undisclosed information that the offering of such share certificates, etc. was planned (art. 7, para. 2).

In addition, when a Regular Member purchases share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer and becomes aware that a purchaser whom the listed issuer plans to appoint as an allottee has been changed, the Regular Member shall verify with the listed issuer in writing that a plan for conducting allotment of new shares to third party, etc. has not been cancelled pursuant to the provision of Paragraph 1 during six months preceding the date of determining the allotment of new shares to third party, etc. by an organization which determines the business execution of the listed issuers (limited to those to be disclosed) (art. 7, para. 3).

After cancelling the purchase pursuant to the provision of the rules, Article 7, Paragraph 1, a Regular Member must not purchase share certificates, etc. relating to allotment of new shares to third party, etc. by such listed issuers until at least the period of six months has passed from the date of transaction of share certificates, etc. issued by the listed issuers that was conducted by an
of the listed issuer to the date of determining new allotment of new shares to third party, etc. by an organization which determines the business execution of the listed issuers relating to the new allotment of new shares to third party, etc. (limited to those to be disclosed) (art. 7, para. 4).

(6) Elimination of Antisocial Forces

Regular Members shall provide in the agreement concerning the purchase of and mediation for purchase of share certificates, etc. relating to the allotment of new share certificates to a third party, etc. executed with the issuer (regardless of whether it is a listed company or a private company) prescribed matters such as the undertaking by the issuer that it is not an antisocial force, and must take measures to eliminate antisocial forces upon purchase such as confirming whether or not the issuer is an antisocial force (art. 7-2 and art. 7-3).

(7) Handling of MSCBs, Etc.

Regular Members must note the following matters upon purchasing MSCBs, etc. issued by a listed issuer or upon holding MSCBs, etc. after the purchase:

(i) Short Sale and Market Sales During the Observation Period

A Regular Member holding MSCBs, etc. must not conduct a short sale for hedging MSCBs, etc. it holds during the observation period of the MSCBs, etc. at a price below the most recent price published by the financial instruments exchange if, on the market where the short sale is to be conducted, price control is enforced under certain conditions such as where the price of the share certificates, etc. subject to the short sale is 10% lower than the standard price calculated on the basis of the last closing price on the market. However, this shall not apply if the price published by the financial instruments exchange is in an upward phase and the short sale is conducted at the most recent published price.

A Regular Member holding MSCBs, etc. must not, if the Exercise Price of the MSCBs, etc. uses the closing price as reference, place general orders concerning the market sale of the underlying share certificates, etc. relating to the MSCBs for its own account during the 15 minutes prior to the close of the trading session at the financial instruments exchange market or in the proprietary trading system on each business day during the observation period of the MSCBs, etc.

A Regular Member holding MSCBs, etc. must not, if the Exercise Price of the MSCBs, etc. uses the volume weighted average price (VWAP) of the day as reference, conduct, in general, market sales of the underlying share certificates, etc. relating to the MSCBs for its own account in excess of 25% of the average trading volume (if such quantity is less than 1 trading unit, 1 trading unit) of the underlying share certificates, etc. in the financial instruments exchange market or in the proprietary trading system during the 10 business days prior to each business day during the observation period of the MSCBs, etc.

There are exemptions to the provisions above (art. 10 through art. 12).

(ii) Restrictions on Exercise of Share Options

In general, a Regular Member must, upon purchasing MSCBs, etc., provide in the purchase agreement prescribed matters that if the quantity of the exercised Share Options,
etc. will exceed 10% of the number of listed shares at the time of payment of the issuance of MSCBs during the calendar month which includes the day of exercise, etc., the exercise of the portion in excess of the 10%-limit (hereinafter “exercise in excess of the limit” in these Rules) shall not be allowed, and the Regular Member must comply with this provision.

With respect to an exercise exceeding the limit, the purchase agreement may provide that the exercise can be made in certain cases such as from the time of announcement of a merger, etc. which will cause the underlying share certificates, etc. relating to the MSCBs be delisted until the time of the merger, etc. or the announcement that no such merger, etc. will be conducted, and the share options, etc. must not be exercised in other cases while knowing that the exercise falls under an exercise exceeding the limit (art. 13).

(iii) Acceptance of Proper Short Sale

When a Regular Member accepts a short sale by an affiliate of the Regular Member while knowing that the affiliate is holding MSCBs, etc., it shall handle the same in the same manner as those required by a Regular Member holding MSCBs, etc. above (art. 14).

(iv) Developing Internal Systems

A Regular Member purchasing MSCBs, etc. shall establish necessary internal systems including the establishment of internal rules, etc. in order to confirm the matters that should be confirmed upon purchase, without influence from businesses promoting the purchase of MSCBs, etc.

In addition, a Regular Member holding MSCBs, etc. shall monitor the status of compliance with rules with respect to the short sale price and market sale during the observation period (art. 15).

(8) Response to the Case where a Person Other Than the Regular Member Purchases

If a Regular Member shall mediate the purchase of share certificates, etc. (excluding the purchase of MSCBs, etc.) relating to allotment of new share certificates to a third party, etc. by a person other than the Regular Member, it shall request such person to comply with these Rules or respect the gist of the provisions of these Rules, depending on the attribute of the counterparty to the mediation (art. 16).

In addition, if a Regular Member shall mediate the purchase of MSCBs, etc. by a person other than the Regular Member, it must request such person to comply with these Rules or respect the gist of the provisions of these Rules, depending on the attribute of the counterparty to the mediation (art. 17).

(9) Application to Deemed MSCBs, Etc.

In a case a Regular Member purchases or intermediates the purchase of share certificates, etc. relating to allotment of new shares to third party, etc. (excluding the purchase of MSCB, etc.), if a derivatives transaction or other transaction has a close and inseparable relationship with the share certificates, etc. relating to allotment of new shares to third party, etc., and such share certificates, etc. and such derivatives transaction or other transaction uniformly have an effect that is equivalent to MSCBs, etc., they shall be deemed as MSCBs, etc., and shall be treated in
accordance with these Rules (art. 18).

(10) Exemption of Application

These Rules shall not apply to share certificates, etc. issued in accordance with the decision pursuant to the Act on Special Measures for Enforcement of Financial Functions, etc. which are considered appropriate by the JSFA (art. 19).

4 Bonds Related Matters

1 Rules Concerning Publication of Over-the-Counter Trading Reference Prices, Etc. and Trading Prices of Bonds

The secondary markets for bonds consist of the financial instruments exchange market and the over-the-counter market. In practice, the bond trading takes place chiefly in over-the-counter markets. As such, the JSFA, in addition to publishing the Reference Statistical Prices [Yields] for OTC Bond Transactions (hereinafter referred to as the “Reference Statistical Prices [Yields] for Transaction”) between Association Members and their customers (including other Association Members), establishes the necessary matters for over-the-counter trading.

These Rules consist of five major components: (1) publication of the Reference Statistical Prices [Yields] for Transaction; (2) publication of monthly trading volume; (3) publication of information on corporate bond transactions; (4) ensuring fairness of transaction; (5) prohibition of extraordinary transactions; and (6) administration of the execution process. By prescribing necessary matters with respect to these components, the rules have as their purpose to occasion the fair and efficient over-the-counter sale and purchase or other transactions in bonds, thereby contributing to investor protection (art. 1).

Publication of information on corporate bond transactions is a new system introduced in November 2015 with the aim of revitalizing the bond market by improving the transparency and securing the reliability of the bond price information.

(1) Publication of Reference Statistical Prices [Yields] for Transaction

The JSFA publishes the Reference Statistical Prices [Yields] for Transaction each business day in order to contribute to Association Members’ and customers’ reference for the over-the-counter transactions of bonds conducted between Association Members and customers, based on the reports from the Association Members designated by the JSFA (art. 3).

(2) Publication of Monthly Trading Volume, Etc.

Each month the JSFA publishes the monthly Trading Volume of Over-the-Counter (OTC) Bonds (the gensaki trading amount shall be indicated separately), and the month-end balance of gensaki trading, based on reports from Association Members (art. 10).
(3) **Publication of Information on Corporate Bond Transactions**

The JSDA publishes information on corporate bond transactions based on reports from Regular Members every business day (art. 11-2 and art. 11-3).

The following corporate bonds are covered by publication (Detailed Rules Relating to the Rules Concerning Publication of Over-the-Counter Trading Reference Prices, etc. and Trading Prices of Bonds, art. 7).

(i) **Corporate bonds to be published**

Corporate bonds to be published must be covered by an issue rated at AA or higher, except for those subject to a measure to suspend publication as separately provided by the JSDA.

(ii) **Transactions to be published**

Transactions to be published are those traded at a volume of not less than 100 million yen at face value.

(iii) **Matters to be published**

Matters to be published are as set forth below:

- (a) Execution date;
- (b) Issue code;
- (c) Issue name;
- (d) Maturity date;
- (e) Yield;
- (f) Trading volume (recognized based on the face value);
- (g) Execution price per unit;
- (h) Whether the transaction is sale or purchase; and
- (i) Other matters separately specified by the JSDA.

(4) **Ensuring Fairness of Transactions**

Association Members, in executing Over-the-Counter transactions of public and corporate bonds with customers, must ensure the fairness of the transaction by acting at a proper price based on the current market price computed in reasonable manners (hereinafter referred to as “Internal Current Market Price”) (with respect to pre-auction government bond transactions among pre-issued government bond transactions, the proper compound interest rate calculated in accordance with the method used for the Internal Current Market Price). (Rules Concerning Publication of Over-the-Counter Trading Reference Prices, Etc. and Trading Prices of Bonds, art. 12, para. 1).

Furthermore, Internal Current Market Price shall be made in consideration of maintenance of method of acquisition and computation (art. 12, para. 2).

Additionally, in Over-the-Counter trades with customers who initiate bond transactions worth less than JPY10 million face value (excluding qualified institutional investors set forth in Article 2, Paragraph 3, Item 1 of the FIEA, or certain business entities, etc.; hereinafter referred to as “small investors” in these Rules), Association Members must make special efforts to disclose
price information and provide education and raise awareness regarding Over-the-Counter transactions of bonds to further increase the fairness of transactions in these securities. An Association Member also has the duty to explain the differences between transactions on a financial instruments exchange market and Over-the-Counter trades, etc. to small investors who trades in listed bond certificates for the first time (art. 14 and art. 15).

In addition to the above, Association Members must provide customers who are entering into a pre-issued government bond transaction with a prior explanation of the fact that such trades are subject to a condition precedent and of the treatment in the event that the condition precedent is not satisfied (art. 13).

(5) Prohibition of Extraordinary Transactions

Association Members must not effect the acts set forth in each of the following items and any other acts with the aim of compensating for the customer’s loss or adding to his/her profit (hereinafter referred to as “Extraordinary Transactions” in these Rules) (art. 16, para. 1):

(i) Over-the-Counter transactions in same-bond issues in which sales and purchases are effected simultaneously at prices favorable to customers or the third parties, but unfavorable to the Association Members (the price differential that corresponds to a proper interest based on a difference in the delivery date and the price differential which corresponds to the differential in delivery terms between the cash bonds and registered bonds are excluded);

(ii) The act of repurchasing or selling at prices favorable to customers performed in purchasing bonds from or selling bonds to customers, or transactions effected on the basis of prior promises that contracts will be cancelled (Gensaki Transactions are excluded); and

(iii) A transaction to be conducted in collusion with a third party promising in advance on the occasion of selling a bond to a customer or purchasing it from a customer that the customer will be sure to gain profits by selling the bond to, or purchasing it from, the third party.

Furthermore, an Association Member must, when a short-term transaction conducted with a customer has produced a substantial amount of profits for the customer, be mindful of the possibility that such a transaction may fall under the Extraordinary Transaction, and must endeavor to further strengthen internal control of matters concerning the contract with the customer, confirmation of such a contract, and keeping of records, etc. (art. 16, para. 2).

(6) Administration of the Execution Process, Etc.

When conducting Over-the-Counter transactions in bonds, an Association Member must promptly prepare, file and keep an order slip, etc. pertaining to the said order stating the time, etc. of the contract, and manage these in an appropriate manner. Furthermore, Association Members must establish internal rules concerning the administration of the execution process in order to
control the work of processing contracts properly (art. 17 and art. 18).

4 Foreign Instruments and Transactions Related Matters

1 Rules Concerning Foreign Securities Transactions

These are rules that Association Members must observe for the purpose of protecting investors with respect to transactions of foreign securities conducted between an Association Member and its customer or another Association Member or in underwriting, etc., a public offering of foreign shares, etc., in Japan.

However, derivatives transactions and transactions on domestic financial instruments exchange markets are not subject to these Rules (art. 1).

(1) Conclusion of Contract and Processing Under the Agreement

When an Association Member receives an order for a foreign securities transaction from a customer or another Association Member (including handling of public offering or secondary distribution or the handling of private placements), the Association Member must enter into a contract with the customer or other Association Member for the foreign securities transaction. When an Association Member purports to enter into such contract with a customer (excluding professional investors in the case where the sale of foreign securities is made by handling of a private placement), it must deliver the agreement on foreign securities trading account (hereinafter “Agreement” in these Rules) to the customer (in cases where the Association Member has already delivered the Agreement and the customer has not applied for the delivery of the Agreement again, it is unnecessary to deliver the Agreement) and receive an application form describing that they apply for the establishment of a trading account pursuant to the Agreement submitted by the customer.

When an Association Member receives the application, it must establish a system to confirm that it has received the application from the customer by the method of accepting the application form describing that the customers apply for the establishment of a trading account pursuant to the Agreement or by other methods it prescribed. Moreover, when an Association Member opens the account upon approval of the application, it must notify the customer to such effect (art. 3).

The Agreement controls the execution of trades in foreign securities based on the customer’s order, the settlement of trade monies, the custody of securities, and the processing of rights such as for dividends and share options. Transactions in foreign securities with customers take place according to the Agreement except for brokering sales in response to a tender offer (art. 4).

(2) Compliance Matters

In the case of foreign securities, except in the case of public offering and secondary distribution, no disclosure of confidential corporate information, etc. under the FIEA is made, which limits the information that investors can obtain. Therefore, in view of the fact that the
member’s responsibility as a broker is immense, an Association Member shall, in soliciting a
customer for an investment in foreign securities, take due care so that the investment may be
made in a manner suitable to the intention, investment experience, and financial resources, etc. of
the customer (art. 5).

(3) Offering of Materials, Etc.

When receiving an order for a transaction in foreign securities for which domestic disclosure
is not conducted from a customer, the Association Member must explain to the customer to that
effect and call the customer’s attention in advance (art. 6, para. 4).

In addition, the Association Member must keep the notices and other information materials
provided by the issuer of the foreign securities which the Association Member is entrusted with
the custody of, and allow the customer to access these, and must deliver notices and materials, etc.
delivered by the issuer at the customer’s request (art. 6, para. 1 and para. 3).

Furthermore, the Association Member must endeavor to make important materials that have
been made public by the issuer of the foreign securities which contribute to the relevant
customer’s investment decision available to the customer (art. 6, para. 2).

(4) Solicitation, Etc. of Already-Issued Foreign Securities

(i) Eligible Securities

From the standpoint of investor protection, concerning foreign share, etc., foreign share
option certificates, foreign investment equity subscription right certificates and foreign bonds
that already have been issued, those for which an Association Member is permitted to solicit
(excluding “foreign securities distribution ” and “private secondary distribution” provided for
in the FIEA and foreign securities to be delivered in connection with the settlement of foreign
securities futures transactions, etc.) orders from customers (except for institutional investors
and certain business entities, etc.; hereinafter the same shall apply in (4)(i) and (ii)) are limited
to the following foreign securities (art. 7, para. 1):

(a) Foreign share, etc., foreign share option certificates, foreign investment equity
subscription right certificates and foreign bonds that are traded in a Qualified Foreign
Financial Instruments Market (foreign financial instruments exchange markets and
over-the-counter markets that Association Members determine adequately protect
investors and satisfy the regulatory requirements contained in these Rules; hereinafter
the same shall apply in these Rules), foreign share, etc., foreign share option
certificates, foreign investment equity subscription right certificates and foreign
bonds (limited to those meeting both of the following requirements) that are expected
to be traded in a Qualified Foreign Financial Instruments Market and the foreign
bonds issued by the issuer of these securities:

i) that the transaction is scheduled on such Qualified Foreign Financial Instruments
Market is publicly disclosed or approved by such Qualified Foreign Financial
Instruments Market or a competent authority or a similar organization that
supervises such Qualified Foreign Instruments Market; and
ii) that the price in the public offering or the secondary distribution of such securities
has already been determined, or the price that is a basis for the transaction of such
securities is publicly disclosed by such Qualified Foreign Financial Instruments
Market.

(b) Those foreign government bonds, etc. and those bonds which were issued by an
international organization of which Japan is a member;

(c) Those foreign bonds and foreign preferred subscription securities (limited to those
prescribed in FSA Notification No. 19 dated on March 27, 2006 and similar ones) of
which disclosure is conducted pursuant to the FIEA;

(d) Those foreign shares, etc., foreign share option certificates, foreign investment equity
subscription right certificates and foreign bonds traded at a financial instruments
exchange market in Japan;

(e) Those foreign share option certificates, foreign investment equity subscription right
certificates and foreign bonds that are issued by the issuer of securities that are listed
on the markets described in (d) above;

In addition, concerning foreign shares, etc., foreign share option certificates, foreign
investment equity subscription right certificates and foreign bonds that have already been
issued, those for which Association Members are permitted to solicit orders from
customers by a “private secondary distribution” are limited to the following foreign
securities (art. 7, para. 2 and para. 3);

(f) Foreign shares, etc., foreign share option certificates and foreign investment equity
subscription right certificates falling under (a) above; and

(g) Foreign bonds falling under (a), (b) and (e) above and those issued pursuant to the
laws and regulations of the country or territory meeting the requirements under each
Item of Article 7, paragraph 3 of these Rules.

(ii) Case of Selling Without Solicitation

An Association Member must, when selling (including the case of entrustment) or
conducting an intermediary service of a sell order (including intermediary service of entrusted
sell order) in connection with foreign shares, etc., foreign share option certificates, foreign
investment equity subscription right certificates and foreign bonds other than the eligible
securities prescribed in (i) above without soliciting a customer, properly manage it by preparing
a document stating that the order is based on the customer’s intention, and keeping and
maintaining the document except for the cases prescribed in the rules (art. 8).

(iii) Transaction Forms

The transaction forms for already-issued foreign securities are generally classified into
transactions on a financial instruments exchange market in Japan (hereinafter “domestic
entrustment transactions” in these Rules), foreign transactions, and domestic OTC transactions,
but because domestic entrustment transactions are regulated by the various exchange
regulations, they are not subject to these Rules.

(a) Foreign Transaction

Foreign transaction means a transaction that is a sale and purchase order for foreign
securities (excluding foreign investment trust securities) executed by method of intermediating, brokering, or acting as agent on a foreign financial instruments market (including OTC markets) as well as the brokering of sales for tender offers of foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds (art. 2, para. 1, item 18).

(b) Domestic OTC Transaction

Domestic OTC transaction means a domestic OTC transaction for a foreign security (excluding foreign investment trust securities) (art. 2, para. 1, item 19).

(5) Domestic Over-the-Counter Transactions

(i) Settlement

Settlement of securities in domestic over-the-counter transactions is processed by an account transfer (art. 10).

(ii) Ensuring Fairness in Transactions

In order for an Association Member to carry out a domestic over-the-counter trade with a customer for foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, the trade must take place at an appropriate price based on the “Internal Market Price (market price computed in a reasonable manner)” (art. 11, para. 1).

The duty of best execution as prescribed in the FIEA will apply if an Association Member enters into a domestic over-the-counter transaction with a customer for foreign shares, etc. that are listed on a domestic financial instruments exchange market.

In addition, the Internal Market Price must be fixed taking into account the continuity of the methods used for acquisition and computation. If the Internal Market Price is difficult to obtain or if the Internal Market Price of an issue was not calculated on an ongoing basis, then the Internal Market Price shall be calculated in accordance with a reasonable and appropriate price (art. 11, para. 2 and para. 3).

Furthermore, at the customer’s request, an Association Member must explain to the customer a summary of the computation method, etc. from which the trading price was derived, either verbally or in writing (art. 11, para. 4).

(iii) Ensuring Fairness in Transactions with Small Investors

If an Association Member will conduct a domestic over-the-counter trade with a customer (other than a qualified institutional investor prescribed in Article 2, Paragraph 3, Item 1 of the FIEA and certain business entities, etc.), i.e., small investors, who will engage in a transaction in foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds under a contract of less than JPY10 million when converted into Japanese yen, the Association Member must give sufficient heed to the following items in order to provide greater fairness in trading (art. 12):

(a) Notification of price information

In general, it is difficult for small investors to obtain price information as compared to qualified institutional investors. Therefore, when price information is requested by small
investors, an Association Member must notify these investors of the trading prices at its offices in a prompt manner, as well as present other reference information such as the closing price of foreign securities on the foreign financial instruments exchange market to the small investors when requested (art. 12, item 1).

(b) Raising awareness of domestic over-the-counter transaction

An Association Member shall endeavor to raise awareness among small investors with respect to domestic Over-the-Counter transactions in foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, by keeping at a counter leaf lets, etc. (art. 12, item 2).

(iv) Prohibition of Extraordinary Transactions

(a) With respect to domestic Over-the-Counter transaction in foreign bonds to be conducted by an Association Member with a customer or another Association Member, the Association Member must not effect the transactions set forth in these Rules and any other acts of providing financial returns to customers or the third parties with the aim of compensating for the customer’s loss or adding to the profit (art. 13, para. 1).

(b) An Association Member must, when a short-term transaction conducted with a customer has produced a substantial amount of profits for the customer, be mindful of the possibility that such a transaction may fall under an “Extraordinary Transaction,” and must endeavor to strengthen further internal control of matters concerning the contract with the customer, confirmation of such a contract, keeping of records, etc. (art. 13, para. 2).

The phrase “short-term” refers to trades where the buy and sell occur within two business days based on the contract date or the delivery date. “Substantial amount of profit” means one percent or more per face value (art. 13, para. 3 and para. 4).

(v) Preparing and Keeping of Transaction Records

When an Association Member has effected domestic Over-the-Counter transaction of foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, it must properly manage by immediately preparing an order slip and other related documents that state such matters as the contracting time, and must keep and maintain those documents in a proper manner. (art. 14, para. 1).

In addition, an Association Member must keep and maintain Internal Market Price on a daily basis; provided, however, that, if Internal Market Price is calculated in accordance with a certain rule, it is enough for them to keep and maintain the basis for such rule (art. 14, para. 2).

Where obtaining the Internal Market Price is difficult, or where a transactions is conducted in an issue for which calculations are not made on a continuing bases, such Association Member must retain (i) the quotations of foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds related to such transaction which are acquired through a market information service, (ii) the price or quotations of such foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds at their principal trading markets, and/or other
information which was referred to in conducting the transaction. (art. 14, para. 3).

(6) Sale, Etc. of Foreign Investment Trust Securities

Some kinds of foreign investment trust securities (meaning the beneficiary certificates of an open-end type foreign investment trust (excluding foreign ETFs) and open-end type investment securities (excluding foreign ETFs); hereinafter the same in these Rules) are not seen in Japan, and there are countless different types of such investment trust securities. Therefore, provisions are included concerning the selection criteria, disclosure of materials, marketing methods, etc. for those foreign investment trust securities sold in Japan, geared particularly towards the protection of investors:

(i) Eligible Securities

The foreign investment trust securities for which an Association Member is allowed to solicit (excluding “foreign securities distribution”) and sell to customers (excluding qualified institutional investors) are those foreign investment trust securities established in accordance with the laws and regulations of the countries or regions that satisfy the requirements set forth in these Rules, and, in case of falling under a public offering or a secondary distribution, those meet the “selection criteria” separately prescribed for foreign investment trust beneficiary certificates (limited to open-end; excluding foreign ETFs; hereinafter the same in these Rules) and foreign investment securities (limited to open-end foreign investment securities; excluding foreign ETFs; hereinafter the same in these Rules), and confirmed by the Association Member that such securities present no problems on investor protection (art. 15).

(ii) Selection Criteria

In these Rules, the selection criteria for foreign investment trust securities differ depending on whether the securities are foreign investment trust beneficiary securities or foreign investment securities (art. 16 and art. 17).

(iii) Notification, Etc. of Commencement of Sale

Upon the handling of a public offering or secondary distribution (excluding “foreign securities distribution” provided for in the FIEA; hereinafter the same in these Rules) of foreign investment trust securities, an Agent Association Member must be appointed. An Agent Association Member is an Association Member that is the designated firm with respect to the said foreign investment trust securities and engages in delivery of informational material pertaining to the said foreign investment trust securities and publication of the net asset value, etc., on behalf of the issuer under a contract it enters into with the issuer or local underwriter.

The Agent Association Member must submit a “Statement of Notification of Handling of Foreign Investment Trust Securities”, a “Confirmation Letter” that relates to the conformity to the selection criteria, a copy of the contract related to the Agent Association Member and other documents prescribed by the JSDA upon commencing sales of the foreign investment trust securities (art. 18, para. 1).

Also, when an Agent Association Member intends to discontinue such agent functions, it must notify the JSDA to that effect (art. 18, para. 2).
(iv) **Obligation to Repurchase**

An Association Member must, even when the foreign investment trust securities have become unable to meet the selection criteria, accept an order from a customer for brokerage for the repurchase or cancellation of the securities (art. 19).

(v) **Disclosure of Materials**

An Association Member must send to the customer to whom the Association Member sold foreign investment trust securities the financial statement and all other documents (hereinafter referred to as the “financial statement, etc.” in these Rules) with respect to the foreign investment trust securities.

However, this shall not apply in the case where the issuer sends the financial statement, etc. to the customer, or where an Agent Association Member or another Association Member (who sold the relevant foreign investment trust to the customer) has delivered the financial statement, etc. to the customer by electromagnetic methods.

Furthermore, if the foreign investment trust securities the Association Member itself sold to a customer no longer comply with the selection criteria, that Association Member must notify the customer of that effect without delay (art. 22).

(7) **Underwriting, Etc. of Public Offering of Foreign Shares, Etc. in Japan**

(i) **Eligible Securities**

The foreign share certificates, etc. (excluding the foreign preferred subscription securities provided for in the FSA Notification No.19 dated on March 27, 2006, and similar instruments) that an Association Member can conduct underwriting, etc. of Public Offering in Japan (meaning the underwriting (limited to that carried out in a public offering), secondary distribution, or the handling of public offering or a secondary distribution, exclusive offer to sell, etc. to professional investors or the handling of exclusive offer to sell, etc. to professional investors of foreign share certificates, etc. by an Association Member; hereinafter the same in these Rules) are limited to the following certificates (art. 24):

- (a) Securities traded or scheduled to be traded on the Qualified Foreign Financial Instruments Market; and
- (b) Securities traded or scheduled to be traded on a Financial Instruments Exchange Market in Japan.

(ii) **Smooth Conclusion, Etc. of Sale and Purchase**

An Association Member who conducts Underwriting, etc. of Public Offering in Japan of foreign shares, etc. which are not listed on a financial instruments exchange market in Japan shall endeavor to smoothly execute sell or purchase orders of customers through foreign transactions or domestic Over-the-Counter transactions (art. 26).

(iii) **Notification of Underwriting, Etc. of Domestic Public Offering**

When underwriting, etc. a domestic public offering of foreign share certificates, etc. that are not listed on a domestic financial instruments market of an exchange, an Association
Member must submit in advance to the JSDA notification of the underwriting, etc. of domestic public offering of foreign share certificates, etc. and other materials deemed necessary by the JSDA (art. 27, para. 1).

(iv) Submission, Etc. of Materials, Etc.

An Association Member must promptly receive or collect materials helpful to investors’ investment decisions that are published by the issuer and materials or information deemed especially necessary by the JSDA received from such issuer (including the Japanese agent thereof), and is obligated to submit these to customers and make them available to the public in accordance with this rule. However, this shall not apply to cases where the materials, etc. published by the issuer can be easily and continuously acquired in Japan by using the Internet or by any other means (art. 28, para. 1).

When an Association Member receives or collects materials, etc. from issuers, it must secure the reliability in the delivery of information by entering into a contract, etc., with the issuer and submit in advance to the JSDA copies of documents related to the said contract, etc., and a document that states the operating procedure for collecting information, etc. (business rules for information collection) (art. 28, para. 2).

(v) Publication of the Name, Etc. of the Issuer

The JSDA shall publicize the name of the issuer and the name, etc. of the main qualified foreign financial instruments market among the matters notified by an Association Member pursuant to (iii) and (iv) above (art. 29).

(vi) How to Respond in case Materials, Etc. cannot be Received or Collected from the Issuer

In cases where a problem occurs that prevents an Association Member from receiving or collecting materials, etc. immediately from an issuer, the Association Member must promptly collect materials, etc. in connection with the issuer that has publicly disclosed to the main qualified foreign financial instruments market, the authority that supervises such qualified foreign financial instruments market, or a self-regulatory organization equivalent in status to the JSDA, and furnish these to customers and make them available to the public in accordance with these Rules.

In cases where it is difficult to promptly receive or collect the materials, etc. from the issuer, or where such circumstances have been resolved, the Association Member shall immediately notify to that effect to the JSDA and announce such facts publicly (art. 28, para. 3).
fully understand the importance of their duties as an intermediary function in the capital market that is entrusted by society, always maintain a sound social common sense and ethical sense for the purpose of obtaining the trust of the people, take measures that are necessary to establish the required professionalism and maintain the high sense of ethics among its officers and employees, and ensure that an Association Member should prevent any action that causes doubt or disbelief from society regarding the fair execution of business by an Association Member, thus developing trust in the capital market by maintaining and improving self-discipline in its social mission and the roles they assume (art. 1).

(1) Maintenance and Submission of the Ethical Code
An Association Member shall, with respect to the sale and purchase or other transactions of securities, etc. that are prescribed in the provision of Article 3, Item 8 of the Articles of Association, maintain an ethical code containing the matters specified separately by the JSDA* or rules that have the same purport (hereinafter referred to as the “Ethical Code”) (art. 2).

An Association Member must submit the Ethical Codes they maintain to the JSDA (art. 3, para. 1) and if it amend part of its Ethical Codes that corresponds to any of the matters specified separately by the JSDA, it must also submit the amended codes to the JSDA (art. 3, para. 2).

* For details of these matters, see the “Model Ethical Code” (Volume 2, Chapter 5, “2.5 Code of Ethics”).

(2) Obligation for Reporting and Explanation
An Association Member shall voluntarily report to the JSDA matters that the Association Member determines inappropriate or that may develop to be inappropriate in light of the Ethical Code even though these are not directly provided by laws, regulations, and rules (art. 4, para. 1).

When the JSDA is aware of the occurrence or existence of matters about actions or practices by an Association Member (including cases where the JSDA receives a report as in the preceding Paragraph), and the JSDA determines it inappropriate or it may develop to be inappropriate in light of the Ethical Code even though these are not directly provided by laws, regulations, and rules, the JSDA may request the Association Member concerned to explain such matters (hereinafter referred to as “Material Matters”) (art. 4, para. 2).

When an Association Member is requested by the JSDA to explain the Material Matters pursuant to the provision of these Rules, Article 4, Paragraph 2, the Association Member must immediately explain it to the extent that is not in violation of laws, regulations, and orders, etc. by a competent administrative agency or other public agency (art. 4, para. 3).

(3) Explanation of Ethics, Etc. by an Entity Which Intends to Join the JSDA
The JSDA shall request an entity which intends to join the JSDA to submit the Ethical Code it maintains, and seek explanation with regard to the details of the Ethical Code and the establishment of internal systems from a person who is to be the representative of the said entity in relation to the JSDA’s activities, before the said entity receives approval for joining the JSDA (art. 5).
(4) Establishment of Internal Systems

An Association Member shall establish internal systems that are deemed necessary for the Association Member for the purpose of ensuring the effectiveness of the Ethical Code, including the assignment of a person in charge of operation and control, providing education and training to officers and employees, and how to respond in the case where a violation is found (art. 6).

Other Rules

(1) Uniform Practice Rules

The Uniform Practice Rules have been established to unify the practice concerning sale and purchase or other transactions, etc. of securities by Association Members and actions related thereto, improving the efficiency of the processing of transactions and eliminating disputes arising from the ambiguity or disunity thereof.

(2) Rules for Handling Disputes

The Rules for Handling Disputes have been established to contribute to the resolution of complaints from customers regarding the business operations conducted by Association Members and the mediation for resolution of disputes between customers and Association Members and the prompt and fair resolution of disputes between Association Members concerning the sale and purchase or other transactions, etc. of securities.

As of February 2010, the mediation services for processing complaints from customers of Association Members and resolving disputes between customers and Association Members have been entrusted from the JSDA to the Financial Instruments Mediation Assistance Center (FINMAC).

[Reference] Flows of Procedures for Dispute Resolution at FINMAC

The Financial Instruments Mediation Assistance Center (FINMAC) is a financial ADR (alternative dispute resolution) organization certified by the FSA and the Ministry of Justice to accept requests for consultation, complaints and motions for mediation from users with regard to transactions in shares, investment trusts, and foreign exchange margin trading, in order to resolve complaints or disputes from a fair and neutral standpoint.

Association Members are required to cooperate with FINMAC for promoting resolution of complaints or disputes involving their customers.

The main services of FINMAC include responding to “requests for consultation” and “complaints” brought thereto by users, and conducting the “mediation procedure” (dispute resolution),

1. Requests for consultation

FINMAC staff provides consultation and advice to users in response to their requests and questions regarding transactions in financial instruments.
2. Procedure for dispute resolution

FINMAC notifies Association Members of the details of the complaints it has confirmed with users, aiming to resolve the disputes between the users and the Association Members.

<Procedural flow>

1. Confirm the details of the complaint
   FINMAC accepts a complaint (a user’s manifestation of his/her dissatisfaction with the services provided by an Association Member, demanding that the Association Members and a financial instruments intermediary service provider act in accordance with their responsibilities and duties, or seeking compensation or improvement for the loss that may arise; the same shall apply hereinafter) from a user.

2. Notify the Association Member of the complaint
   FINMAC notifies the Association Member of the complaint filed against it by the user and requests investigation.

3. Report the investigation results to the user
   The Association Member and FINMAC report the investigation results to the complaining user.

3. Mediation procedure (initiated if the dispute is unable to be resolved by the procedure in 2)

A mediator, who is a lawyer, positions him/herself between the disputing user and Association Member, aiming to resolve their dispute.

<Procedural flow>

1. Accept a motion for mediation
   If a user seeks dispute resolution by the mediation procedure, FINMAC receives a motion for mediation from the user and accepts it after confirming its content.

2. Receive the mediation motion fee
   The user is required to pay a mediation motion fee (the amount of the fee depends on the amount of damages claimed) within 10 days from the day on which the notice of acceptance of the motion for mediation arrives at the user.

3. Conduct the mediation procedure
   The mediator, who is a lawyer, hears the circumstances of the dispute from both the user and the Association Member, and indicates a settlement proposal to solve the dispute.
   If both the user and the Association Member are satisfied with the settlement proposal, they sign a settlement agreement.
   The mediation procedure may be called off if both the user and the Association Member are dissatisfied with the settlement proposal, or the mediator judges that a settlement cannot be reached. In this case, the parties to the dispute may go to court to solve their dispute in civil action if they wish to do so.
Chapter 5

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Introduction

A financial instruments exchange is a juridical person (either a financial instruments membership corporation or stock company) that establishes and operates a marketplace on which sale and purchase in securities or market derivatives transactions (hereinafter “securities trading, etc.”) take place (“financial instruments market”) (Financial Instruments and Exchange Act, hereinafter “FIEA,” art. 2, para. 16).

Because establishing a financial instrument market is imbued with a strong public character, license by the Prime Minister is required (FIEA, art. 80, para. 1). The application for a license is examined to ensure, inter alia, that the articles of incorporation, business regulations and brokerage agreement standards—which are the important regulations of the financial instruments exchanges—conform to the law and regulations and are sufficient for achieving the fair and smoothly functioning securities trading, etc. on the financial instruments markets operated by financial instruments exchanges (hereinafter referred to as “financial instruments exchange markets”), and for protecting investors (FIEA, art. 82, para. 1). If thereafter a change occurs, the approval of the Prime Minister must be received with respect to each such change (FIEA, art. 149, para. 1).

The major regulations of the financial instruments exchanges are the articles of incorporation, which provide for fundamental matters of the organization and operation of the financial instruments exchange; the business regulations, which prescribe the methods, etc. for transactions conducted on the market at the financial instruments exchange; the trading participant regulations, which prescribe matters concerning trading participants; the clearing and settlement regulations, which prescribe matters concerning the clearing and settlement of transactions conducted on the financial instruments exchange market; the listing regulations, which prescribe for the listing, de-listing, and timely disclosure, etc. of securities; and the brokerage agreement standards, which prescribe the terms and conditions concerning the agreement between the customer and the financial instruments business operator which is trading participant.

An outline of the major items among the various regulations of the Tokyo Stock Exchange Incorporated (hereinafter referred as the “TSE”) and Osaka Exchange Incorporated (hereinafter referred to as the “OSE”; the TSE and the OSE are hereinafter collectively referred to as the “Exchange”) is described below.

Foundation of Japan Exchange Group, Inc.

Tokyo Stock Exchange Group, Inc. and Osaka Securities Exchange, Inc. effected a merger as of January 1, 2013, and Japan Exchange Group, Inc. (hereinafter referred to as “JPX”) was founded as an organization that owns Tokyo Stock Exchange, Inc. (hereinafter referred to as the “TSE”), Osaka Securities Exchange, Inc. (renamed Osaka Exchange, Inc. in March 2014; hereinafter referred to as the “OSE”; the TSE and the OSE are hereinafter collectively referred to as the “Exchange”) and others as its affiliates.

Following this, the OSE’s spot markets were integrated into the TSE’s spot markets as of July 16, 2013, and the TSE’s derivatives markets were integrated into the OSE’s derivatives markets as of March 24, 2014. Thus, the markets previously operated by the
respective exchanges were integrated according to the characteristics of the products traded on the markets.

With regard to clearing after transactions, the OSE’s clearing function for market derivatives transactions was integrated into the Japan Securities Clearing Corporation as of July 16, 2013, as in the case of the TSE’s clearing function.

**Self-Regulation Organization**

The Exchange must perform self-regulation related services in an appropriate manner in order to ensure the fair purchase and sale of securities on the financial instruments exchange market, as well as to protect investors (FIEA, art. 84, para. 1).

The “self-regulation related services” are the following services conducted in respect of a financial instruments exchange: (i) services related to the listing and delisting of financial instruments, etc.; (ii) the investigation of whether the members or trading participants (hereinafter referred to as the “members, etc.”) comply with laws and regulations, dispositions by government agencies which are based on laws and regulations, with the articles of incorporation and other rules, and with the equitable principle of trade; and (iii) services related to an examination of the contents of purchase and sale of securities which are conducted by the members, etc. on a financial instruments exchange market (FIEA, art. 84, para. 2; Cabinet Office Ordinance on Financial Instruments Exchanges, art. 7).

With the authorization of the Prime Minister (the Commissioner of the Financial Services Agency), the Exchange may entrust the whole or part of these self-regulation services to a self-regulation organization (FIEA, art. 85, para. 1).

It is not permissible for a person other than the Exchange, etc. to incorporate a self-regulation organization (FIEA, art. 102-3). A self-regulation organization must obtain the authorization of the Prime Minister (the Commissioner of the Financial Services Agency) if it seeks to perform self-regulation services. In order to obtain the authorization, the applicant for authorization must undergo an examination regarding whether the application conforms to the criteria including: (i) the provisions of the articles of incorporation and the operational rules of the self-regulation organization conform to laws and regulations, and are sufficient to allow the proper operation of self-regulation services; and (ii) the applicant has a sufficient personnel structure to operate self-regulation services in an appropriate manner (FIEA, art. 102-16).

In order to perform self-regulation services properly, a self-regulation organization needs to have in place an organizational structure which allows it to maintain a high-level of autonomy and manage and operate its services from a neutral stance, and also needs to be well-versed in the functions and characteristics of financial markets.

Within the framework under the FIEA as described above, in October 2007, the Tokyo Stock Exchange Group established a self-regulation organization, Tokyo Stock Exchange Regulation, as its group member organization which was independent from the TSE, a market operating organization.

In November 2007, Tokyo Stock Exchange Regulation began operation as an
organization specialized in performing self-regulation services upon entrustment by the TSE.

Following the inauguration of the JPX in January 2013, the self-regulation functions of the OSE were transferred to Tokyo Stock Exchange Regulation in July 2013, and then Tokyo Stock Exchange Regulation was renamed Japan Exchange Regulation in April 2014.

Based on the JPX’s self-regulation structure developed in this manner, Japan Exchange Regulation performs self-regulation services effectively in a position that is neutral and independent from the TSE and the OSE, while exerting a high level of expertise in close coordination with both exchanges.

1 Articles of Incorporation

The articles of incorporation contain the fundamental rules governing a juridical person.

The Exchange is a stock company under the Companies Act, and the articles of incorporation of the Exchange contain provisions concerning its trade name, purposes, location of principal office, manner of public notices, matters concerning shares, matters concerning the shareholders meeting, matters concerning directors and the board of directors, matters concerning auditors and the board of auditors, and matters concerning accounting, similar to an ordinary stock company.

In addition, since the Exchange operates a financial instruments market as a financial instruments exchange, in addition to the above matters, the articles of incorporation provide for the following matters.

11 Matters Concerning the Financial Instruments Exchange Market

The articles of incorporation provide that the types of transactions conducted on the financial instruments exchange market (hereinafter the “exchange market”) are sale and purchase in securities on the TSE or market derivatives transactions on the OSE (TSE Articles of Incorporation, art. 2, para. 1, art. 42; OSE Articles of Incorporation, art. 2, para. 1, art. 42). It also provides that the OSE may establish standardized instruments to be referenced in market derivatives transactions (OSE Articles of Incorporation, art. 43).

Moreover, in view of the importance and the public nature of the exchange for the national economy, the articles of incorporation include a statement that the exchange market must conduct its operations, placing the highest value on making securities trading, etc. executed in a fair and smooth manner in order to contribute to the public interest and the protection of investors (TSE Articles of Incorporation, art. 2, para. 2; OSE Articles of Incorporation, art. 2, para. 2).
Matters Concerning Rule-Making

The articles of incorporation of the Exchange provide that: (i) matters necessary for securities trading, etc. on the exchange market shall be provided by the business regulations; (ii) any agreement pertaining to the acceptance of brokerage by a trading participant for securities trading, etc. on the exchange market shall be provided by the brokerage agreement standards; and (iii) in addition to above, the Exchange may establish other rules as necessary in the operations of the exchange market (TSE Articles of Incorporation, art. 44; OSE Articles of Incorporation, art. 44).

Furthermore, among necessary matters concerning securities trading, etc., the business regulations delegate matters concerning trading participants, matters concerning clearance and settlement, and the matters concerning the listing, etc. of securities to the trading participant regulations, clearance and settlement regulations, and listing regulations, respectively (TSE Business Regulations, rule 1-3; OSE Business Regulations, rule 2).

Matters Concerning Compliance with the Laws/Regulations and Various Rules by Trading Participants, Examinations, and Disciplinary Actions

When securities trading, etc. proceeds in a fair and smooth manner, exchange markets can play an important and public role in the national economy. To this end, trading participants must be persons who are sufficiently trustworthy to become market players.

As such, in order to regulate these trading participants, the articles of incorporation provide that trading participants must comply with the FIEA, the regulations of the exchanges and the just and equitable principles of trade, etc. (TSE Articles of Incorporation, art. 45; OSE Articles of Incorporation, art. 45). Moreover, to realize this goal and to duly perform its role as market operator, the Exchange may conduct any necessary investigations in order to examine the status of the compliance of trading participants with the FIEA, the regulations of the exchanges and the just and equitable principles of trade, or any other cases prescribed by the business regulations. In addition, when a trading participant violates the laws and regulations, dispositions taken by administrative authorities under the laws and regulations, the rules and regulations of the Exchange, takes any action in violation of the just and equitable principles of trade, or falls under any other causes for a disciplinary action set forth in the business regulations, the Exchange may take disciplinary actions against the trading participant such as imposition of fines, suspension from or restriction on securities trading, etc. by the offending trading participant on the exchange market, revocation of the trading qualifications, or any other dispositions (TSE Articles of Incorporation, art. 46 and art. 47; OSE Articles of Incorporation, art. 46 and art. 47).
Matters Concerning Advisory Committees

Since it is important that the Exchange, which plays an important and public role in the national economy, is managed properly, the Exchange provides for the establishment of advisory committees to deliberate on important matters concerning the operations of its markets (TSE Articles of Incorporation, art. 41; OSE Articles of Incorporation, art. 41).

Currently, there is the market management committee as an advisory committee.

Trading Participant Regulations

General Provisions

The TSE Trading Participant Regulations and the OSE Trading Participant Regulations provide for necessary matters concerning the trading participants of the TSE and the OSE, pursuant to Rule 1-3, Paragraph 1 of the TSE Business Regulations and Rule 2, Paragraph 1 of the OSE Business Regulations, respectively.

There is only one type of trading participants on the TSE: general trading participants who are qualified to conduct the sale and purchase of securities (TSE Trading Participant Regulations, rule 2, para. 1 and para. 2).

The training participants on the OSE are categorized into three types: (i) futures, etc. trading participants who are qualified to conduct government bond futures transactions, index futures transactions, securities options transactions, government bond futures options transactions, and index options transactions; (ii) government bond futures, etc. trading participants who are qualified to conduct government bond futures transactions and government bond futures options transactions; and (iii) foreign exchange margin trading participants (FX trading participants)* who are qualified to conduct exchange foreign exchange (FX) margin transactions (OSE Trading Participant Regulations, rule 2, para. 1 through para. 4).

Trading participants are required to endeavor to ensure fair price formation and efficient distribution in the exchange markets, thereby maintaining and enhancing its functions as a financial instruments exchange market. Moreover, they must be persons who conduct securities trading, etc. on the exchange markets as their important business (TSE Trading Participant Regulations, rule 3, para. 1 and para. 2; OSE Trading Participant Regulations, rule 4, para. 1 and para. 2).

* The OSE’s exchange FX margin transactions market had seen a constant growth in the trading volume since its opening. However, trading on this market was suspended temporarily in October 2014, partly due to the shift of transactions from exchange markets to over-the-counter
markets accompanying the increased transparency, reliability and convenience of over-the-counter FX margin transactions market resulting from the tightened regulations and tax system reforms.

2 Acquisition of Trading Qualifications

Persons desiring to acquire trading qualifications must make an application to the Exchange to acquire trading qualifications (TSE Trading Participant Regulations, rule 4, para. 1; OSE Trading Participant Regulations, rule 30, para. 1). Financial instruments business operators (limited to those registered for the business concerning acts provided for in FIEA, art. 28, para. 1, item 1) or exchange trading authorized firms can become general trading participants and futures, etc. trading participants. Financial instruments business operators (limited to those registered for the business concerning acts provided for in FIEA, art. 28, para. 1, item 1), exchange trading authorized firms or registered financial institutions can become government bond futures, etc. trading participants. Financial instruments business operators (limited to those registered for type II financial instrument business) or registered financial institutions can become FX trading participants (TSE Trading Participant Regulations, rule 4, para. 2; OSE Trading Participant Regulations, rule 32, para. 1).

When the Exchange approves the application, once the applicant takes the necessary procedures to obtain trading qualifications (TSE Trading Participant Regulations, rule 5, para. 1; OSE Trading Participant Regulations, rule 32, para. 2), pays admission fees (TSE) or trading participation fee (OSE) and enters into a trading participation agreement by the day immediately prior to the date designated by the Exchange (the date of acquisition of trading qualification), takes the necessary procedures to obtain clearing qualifications (where the applicant does not obtain clearing qualifications, it must enter into a clearing entrustment contract and designate a designated clearing participant) under the clearance and settlement regulations (see “Section 5. Clearing and Settlement Regulations” of this Chapter for details), deposits the guarantee fee, and deposits the trading participant guarantee, the applicant will obtain trading qualifications on the date prescribed by the Exchange (TSE Trading Participant Regulations, rule 6, para. 1: OSE Trading Participant Regulations, rule 33).

However, the applicant does not have to pay admission fee where it succeeds to the trading participant rights in an assignment, merger or company split (TSE Trading Participant Regulations, rule 5, para. 3).
Duties, Etc. of the Trading Participant

Trading participants must enter into an agreement with the Exchange whereby they assent to comply with the regulations, etc. of the Exchange (TSE Trading Participant Regulations, rule 7; OSE Trading Participant Regulations, rule 31). Also, trading participants must register one person as its trading participant representative with the Exchange, who is appropriate for representing such trading participant at the Exchange (TSE Trading Participant Regulations, rule 8, para. 1; OSE Trading Participant Regulations, rule 6, para. 1), and must register one office as a liaison office at which it receives notifications from the Exchange (TSE Trading Participant Regulations, rule 10; OSE Trading Participant Regulations, rule 8).

When the Exchange finds that the cooperative or control relationship of the officers of a trading participant and other person is inappropriate in the light of operation of the Exchange markets, after holding a hearing with such trading participant, the Exchange may demand the alteration thereof by giving the reason therefore (TSE Trading Participant Regulations, rule 9, para. 1; OSE Trading Participant Regulations, rule 5, para. 1).

Trading participants must pay trading participant fees (TSE Trading Participant Regulations, rule 11; OSE Trading Participant Regulations, rule 9) and deposit the participant bond and trading participant security money with the Exchange (TSE Trading Participant Regulations, rule 12, para. 1; rule 13, para. 1; OSE Trading Participant Regulations, rule 11, para. 1, and rule 11-2, para. 1). The participation bond secures the claims of the entrustors of transactions on the financial instruments markets, and the other trading participants, as well as financial instruments exchanges and financial instruments clearing organizations. Entrustors of transactions on financial instruments exchanges are given first priority to be satisfied out of the participation bond prior to the other trading participants (FIEA, art. 114, para. 4 and art. 115). The Exchange sets the required amount of participation bond as JPY3 million (TSE Trading Participant Regulations, a rule. 12, para. 2; OSE Trading Participant Regulations, rule 11, para. 1). Furthermore, securities can be deposited in lieu of cash with respect to participation bond and trading participant security money, in principle (TSE Trading Participant Regulations, rule 12, para. 3, rule 13, para. 2; OSE Trading Participant Regulations, rule 11, para. 2, and rule 11-2, para. 2; FIEA, art. 114, para. 2).

In addition, the Exchange ascertains the actual state of management of the trading participants by requiring trading participants to obtain the approval of the Exchange in cases of a merger, etc., or to file a notice with the Exchange where it changes its officers, and imposes reporting duties with respect to various other matters to aid in the management of the exchange market (TSE Trading Participant Regulations, rule 16 through rule 18; OSE Trading Participant Regulations, rule 14 through rule 16).

It is needless to say that there are an innumerable number of investors behind the backdrop of securities trading, etc. and the settlement thereof on the exchange market. To protect these investors and maintain order, the Exchange shall conduct investigations of trading participants (TSE Trading Participant Regulations, rule 19; OSE Trading Participant Regulations, rule 17), and can impose a variety of restrictions on trading participants with respect to the securities
trading, etc. they are entrusted from customers.

First, as regards the examination of trading participants, where the Exchange conducts an examination of the trading participant’s compliance with laws and regulations, etc., the Exchange can demand the submission of reports and materials to be used as a reference concerning the operations or property of the trading participant, or investigate the status of the trading participant’s operations, property or books, documents or other items.

In addition, in order to eliminate exaggerated advertisements or prevent obstacles to fair competition, the trading participant must conduct its advertising activities in accordance with the rules prescribed by the Exchange (TSE Trading Participant Regulations, rule 20).

Next, with a view to preventing incidents, etc. when a trading participant accepts the trade, etc. of securities to be conducted on the exchange market, it must carry out prior inquiries as to the address, full name, and other matters concerning the customer (TSE Trading Participant Regulations, rule 21; OSE Trading Participant Regulations, rule 19).

In addition, a trading participant must develop a trading management system designed to prevent unfair trading (TSE Trading Participant Regulations, rule 22-2; OSE Trading Participant Regulations, rule 21), as well as an order management system designed to prevent accepting and placing erroneous orders (TSE Trading Participant Regulations, rule 22-3; OSE Trading Participant Regulations, rule 21-2). Furthermore, a trading participant must properly develop the system for examining the listing eligibility of companies applying for listing of its securities as the managing trading participant and a risk management system regarding the positions in market derivatives transactions (TSE Trading Participant Regulations, rule 22-4: OSE Trading Participant Regulations, rule 21-3), and it must also develop a corporate information management system that is deemed necessary and appropriate in light of the operations of the exchange markets in order to prevent unfair transactions using corporate information (TSE Trading Participant Regulations, rule 22-5: OSE Trading Participant Regulations, rule 21-4).

In addition to the various operating regulations described above, when the Exchange finds it urgently necessary in the light of operations of the exchange market, the Exchange may implement necessary and proper restrictions concerning the operations of all or part of trading participants (TSE Trading Participant Regulations, rule 24; OSE Trading Participant Regulations, rule 23).

2.4 Loss of Trading Qualification

There are two ways to lose trading qualification: voluntary loss and mandatory loss. In the case of the former, the approval of the Exchange is necessary. In the case of the latter, however, notwithstanding the intent of the trading participant, if it falls within certain legally prescribed circumstances, which are (i) loss of trading qualifications by the trading participant; (ii) dissolution; and (iii) where trading qualification is automatically lost due to the revocation of the trading qualification, then the approval of the Exchange or procedures to apply to renounce
trading qualification are unnecessary (FIEA, art. 94 and 95 applied mutatis mutandis to FIEA, art. 113, para. 3).

Upon losing its trading qualification, there is an issue concerning which method shall be in place to process the remaining unsettled transactions of the trading participant.

In the case of voluntary loss of trading qualification, the Exchange shall suspend securities trading, etc. on the exchange market pertaining to the trading qualification of the trading participant from the day after the date it accepts the application to renounce trading qualification from trading participants (TSE Trading Participant Regulations, rule 26; OSE Trading Participant Regulations, rule 35), and must process the unsettled transactions of the trading participant by having another trading participant succeed to such obligations (TSE Clearing and Settlement Regulations, rule 56; OSE Clearing and Settlement Regulations, rule 34). The Exchange grants its approval with respect to the loss of trading qualification on a certain date in the future (TSE Trading Participant Regulations, rule 28, para. 1; OSE Trading Participant Regulations, rule 37, para. 1).

Furthermore, where the trading participant who applied to renounce trading qualification loses such qualification simultaneously upon a merger, etc. with another person possessing a trading qualification similar to the original trading qualification, since the rights and obligations of the applicant will by operation of law be succeeded to by the person, there is no special need to process the unsettled transactions of the applicant by globally suspending its securities trading, etc., and in this case, the securities trading, etc. of the applicant is generally not suspended (TSE Trading Participant Regulations, rule 27; OSE Trading Participant Regulations, rule 36).

On the other hand, in the case of a mandatory loss, the trading participant will lose its trading qualification when the prescribed events occur, and the unsettled securities trading, etc. is carried over after such loss. Moreover, even in the case of a voluntary loss, there could be cases where unsettled securities trading, etc. is carried over. As such, when the person who lost his/her trading qualification has unsettled securities trades, etc. which relate to his/her lost trading qualification, such person or a general successor may trade securities, etc. for the purpose of settlement thereof, and under the management of the Exchange (TSE Trading Participant Regulations, rule 31; OSE Trading Participant Regulations, rule 40).

When the trading participant loses its trading qualification, the Exchange shall immediately give public notice of the fact that the participant has lost its trading qualification. Moreover, when the trading participant conducts acceptance of securities trading, etc., the Exchange shall give public notice regarding the return of the trading participant’s participation bond (TSE Trading Participant Regulations, rule 29, para. 1; OSE Trading Participant Regulations, rule 38, para. 1). The trading participant cannot request the return of its participation bond until six months after the date of the aforementioned public notice (TSE Trading Participant Regulations, rule 29, para. 2; OSE Trading Participant Regulations, rule 38, para. 3).

Persons who lost their trading qualification must allot all cash and securities to be returned from the Exchange towards the satisfaction of all claims such persons owe to the Exchange as a trading participant (TSE Trading Participant Regulations, rule 30; OSE Trading Participant Regulations, rule 39).
A trading participant of TSE can, with the approval of the TSE, assign its trading participation rights simultaneously upon renouncing them to a person whose acquisition of such trading participation rights is subject to the loss thereof (TSE Trading Participant Regulations, rule 33, para. 1 and para. 2).

Further, persons who acquire trading participation rights through an assignment do not need to pay an admission fee (TSE Trading Participant Regulations, rule 5, para. 3).

**Disciplinary Actions and Measures Towards Trading Participants**

In order to secure its market management, the Exchange can take disciplinary actions or measures towards trading participants that disturb the maintenance of order on the exchange markets, under strict rules.

First, Rule 34 of the TSE Trading Participant Regulations and Rule 42 of the OSE Trading Participant Regulations set forth the cases where the Exchange will take disciplinary actions towards trading participants. These are broadly classified into cases: (i) where such participants are unfit as trading participants; (ii) where the trading participant encounters difficulties in their assets or business such as insolvency or breach of contract; and (iii) where the trading participant violates its duties. After conducting an examination of the trading participant who falls under any of these circumstances, the Exchange can impose fines, warnings, suspension or restriction of securities trading, etc. by the trading participant, suspension or restriction of its clearing brokerage entrustment, revocation of its trading qualification.

When the trading participant has objections to the disciplinary actions, relief measures such as the filing of a protest can be taken (TSE Trading Participant Regulations, rule 38; OSE Trading Participant Regulations, rule 46).

Next, when the trading participant is subject to sanction under the laws and regulations, the Exchange will implement measures such as suspending or restricting the trading participant’s trades, etc. of securities, suspending or restricting the entrustment of clearing brokerage or revoke its trading qualification, depending on the content of such sanction (TSE Trading Participant Regulations, rule 39; OSE Trading Participant Regulations, rule 45).

In addition to these disciplinary action and measures, when the Exchange finds that the officers or control relationship, etc. of the trading participant is improper in view of the market management, in order to urge the improvement thereof, it may suspend or restrict the securities trading, etc. of the trading participant, suspend or restrict its clearing brokerage entrustment, or implement any other appropriate measures (TSE Trading Participant Regulations, rule 35, para. 1; OSE Trading Participant Regulations, rule 43, para. 1). Moreover, if the trading participant encounters financial difficulties, the Exchange can suspend or restrict its securities trading, etc. or suspend or restrict entrustment of its clearing (TSE Trading Participant Regulations, rule 35, para. 2; OSE Trading Participant Regulations, rule 43, para. 2); and when the trading participant becomes insolvent or is likely to become insolvent, the Exchange may suspend its securities...
trading, etc., suspend its clearing brokerage entrustment (TSE Trading Participant Regulations, rule 35, para. 3; OSE Trading Participant Regulations, rule 43, para. 3), and cause it to process any unsettled transactions remaining in an attempt to return the situation to normal.

Finally, the Exchange lists the acts that violate the duty of good faith in transactions (e.g., acceptance of an order for cornering of shares from persons having the purpose of selling such shares to the related persons of the issuer), and take any administrative measures for such cases (TSE Trading Participant Regulations, rule 34, para. 1, item 8, rule 42; OSE Trading Participant Regulations, rule 42, para. 1, item 9, and rule 51).

2 6 Mediation

The Exchange establishes a system to autonomously resolve a dispute between trading participants concerning the trade, etc. of securities, a loan of securities or other transaction (TSE Trading Participant Regulations, rule 44; OSE Trading Participant Regulations, rule 55).

2 7 Remote Trading Participant System

Against the increase of trades by overseas investors in the recent years, and in response to the needs for direct participation to the exchange market from overseas, the remote trading participant system which allows foreign securities dealers that do not have branch offices, etc. in Japan to directly participate in the exchange market as a trading participant was introduced in February 2009. In principle, regulations similar to “2.1 General Provisions” through “2.6 Mediation” above have been established with respect to remote trading participants.
Securities for trading in the exchange market are the securities that are listed on that financial instruments exchange. Securities that are not listed cannot be traded on financial instruments exchanges.

Listing on a financial instruments exchange means that a financial instruments exchange admits the securities issued by corporations and others as securities for trading in the market that are operated by that financial instruments exchange.

The securities to be listed are limited to securities as defined under the FIEA. Specifically, these include share certificates, government bonds, municipal bonds, corporate bonds and convertible type bonds with share options.

By listing securities, the issuer or investors of the securities enjoy a variety of benefits. Generally, because listed securities are broadly available to the public and the market price is publicly announced every day through the media, etc., the issuer can benefit from the increase in the power to procure funds, the modernization and streamlining of management, the improvement of social trustworthiness and company awareness. On the other hand, because setting fair prices and the appropriate circulation are secured through transactions on the exchange, investors can benefit from the increased ease of trading (liquidity) as well as the increase in the asset and collateral value of the securities invested.

Thus, the listing of securities serves the important function of connecting issuers of securities and investors through the financial instruments exchange market.

The listing system of securities of the TSE can be divided largely into the listing examination system of securities and the management system of listed securities. The TSE Listing Regulations cover the application for listing securities with respect to the former, and timely disclosure of company information of the issuer, ensuring of the effectiveness of listing management, and delisting of listed securities, etc. with regard to the latter, and the system is managed pursuant to respective guidelines.

Furthermore, the TSE has established a listing system pertaining to the securities of new enterprises to effectuate the funds procurement of new enterprises which have the potential for high growth, thereby contributing to the development of new industries and providing diversified investments to investors (the market concerning share certificates, etc. listed under this listing system is called “Mothers”). For listing on the Mothers, the TSE has established separate criteria in addition to the criteria for listing on the Main Markets (the markets pertaining to stocks, etc. listed on the TSE, except for those listed on Mothers and JASDAQ, or more specifically, stocks listed on the First Section Market and the Second Section Market), and conducts examinations, etc. thereunder. In addition, in view of the change of environment surrounding Mothers, efforts are taken to promote the listing of growing companies such as by reestablishing the market concept as “the market for growing companies eyeing a step-up to the listing on the market 1st section in the near future” as well as upgrading the handling concerning listing examinations.

The TSE has also established a listing system pertaining to the securities of growing companies...
companies engaged in diverse businesses, with the aim of providing these companies with more opportunities for listing and fund-raising, thereby contributing to the cultivation of a wide range of industries, while providing investors with a variety of investment options (the market concerning share certificates, etc. listed under this system is called “JASDAQ”). For listing on JASDAQ, the TSE has also established separate criteria under which it conducts examinations, etc. JASDAQ consists of two sub-divisions: a sub-division for companies which have a certain business scale and performance and whose business is expected to expand (“Standard”), and a sub-division for companies which have unique technologies or business models and have abundant future growth potential (“Growth”).

In addition to this, the TSE is operating the TOKYO PRO Market, a market for share certificates, etc., and the TOKYO PRO-BOND Market, a market for bonds, both of which have been established based on the “professional market system” introduced pursuant to the amendments to the FIEA in 2008. While the TOKYO PRO Market is a market aimed at providing an opportunity to procure funds to Japanese and Asian growing companies which are at the early stage unsupported by general exchange markets, the TOKYO PRO-BOND Market is a market aimed at realizing expeditious and flexible issuance of bonds in response to the market environment by greatly simplifying the documents required to be disclosed upon issuance of bonds without damaging the quality of the information provision service to investors and thereby making the procedures more efficient. Please note that these markets have adopted systems largely different from that of general exchange markets such that persons other than professional investors (meaning the persons other than the professional investors as prescribed in Article 117-2, Paragraph 1 of the FIEA) cannot purchase the securities listed on such markets. The general system for listing securities which are adopted at markets except for professional markets shall be explained below.

### 3 1 Procedures for New Listing of Shares, Etc.

Except for government bonds, etc., the TSE does not list shares, etc. unless the issuer files a listing application for such shares, etc. (TSE Listing Regulations, rule 201). On the face of the law, as long as a the TSE makes a registration with the Prime Minister, it could theoretically list an issue of shares, etc. regardless of the intent of the issuer; however, the intent of this provision is to ensure that listing proceeds based on the actual application made by the issuer.

When an issuer intends to list its shares, etc., it must submit documents including a new listing application prescribed by the TSE and a written confirmation regarding compliance with exchange rules and regulations prescribed by the TSE (TSE Listing Regulations, rule 204).

Upon receipt of the application for listing, the TSE shall examine the appropriateness of the listing based on the Listing Requirements (TSE Listing Regulations, rule 205-207, rule 212-214, etc.), and shall file the listing notification with the Prime Minister when it decides to list the shares, etc. (FIEA, art. 121, Cabinet Office Ordinance on Financial Instruments Exchanges, art.
When the TSE newly lists an issue of shares, etc., the TSE shall require the issuer to submit the listing agreement specified by the TSE, and shall enter the required items such as the issue name of the subject shares, etc., the volume, etc. in the original register of listed shares, etc. on the effective date of the listing agreement (TSE Listing Regulations, rule 203).

### Listing Requirements of Shares, Etc.

With regard to the listing examination of shares, etc., the examination is conducted with the emphasis on whether the listing of the shares, etc. on the TSE would be necessary and appropriate for setting a fair price and to facilitate the maintenance of adequate circulation, as well as benefit the public and protect investors, as described below.

This listing examination is conducted for companies that meet all of the following formal requirements (TSE Listing Regulations, rule 205):

- **i)** The number of shareholders;
- **ii)** Shares in circulation;
- **iii)** Market capitalization;
- **iv)** The number of continued years of business;
- **v)** The amount of net assets;
- **vi)** The amount of profits or market capitalization;
- **vii)** False statements or adverse opinions, etc.;
- **viii)** Audit by the listed company audit firm;
- **ix)** The appointment of a transfer agent;
- **x)** The number of shares in a unit;
- **xi)** The types of the share certificate;
- **xii)** Restriction on transfer of shares;
- **xiii)** The handling by designated book-entry transfer institutions; and
- **xiv)** Outlook for conducting mergers, etc.

Applications meeting the formal requirements are examined substantially in terms of the following factors (TSE Listing Regulations, rule 207, para. 1):

- **i)** Corporate continuity and profitability (operates business continuously, and has a stable revenue base);
- **ii)** Healthiness of corporate management (performs operations fairly and faithfully);
- **iii)** Effectiveness of corporate governance and internal management systems (the corporate governance and internal management systems have been prepared...
appropriately and are functioning);
(iv) Appropriateness of corporate disclosure, etc. (can disclose corporate details appropriately); and
(v) Other matters considered necessary by the TSE from the viewpoint of public interest or investor protection, with respect to the issuer.

The foregoing is the overview of the listing examination for domestic shares, etc. (other than shares listed on Mothers and JASDAQ; hereinafter the same). As for the listing examination for foreign shares, etc. (other than shares listed on Mothers and JASDAQ; hereinafter the same), the examination is conducted based on the listing examination system for domestic shares, etc., taking into consideration characteristics that are unique to foreign shares, etc.

Specifically, a substantive examination is conducted for companies that can meet the criteria of deposit agreements, etc., in addition to satisfying all of items (i) through (vii) and (xii) through (xiv) for domestic shares, etc. (TSE Listing Regulations, rule 206, para. 1). This substantive examination takes into consideration the laws, business practices, etc. of the issuer’s domicile.

Meanwhile, if an issuer of share certificates, etc. that have already been listed on the TSE (hereinafter called the “listed company”) newly issues the same type of share certificates, etc., the listing shall, as a rule, be approved (TSE Listing Regulations, rule 302).

Following the series of public stock offerings that resulted in the significant share dilution, rapid progress has been made in the development of systems for increasing capital by allotting share options without contribution (generally referred to as “rights offering”), and case examples are being accumulated one by one. However, there is an argument that some companies which would have been unqualified to raise capital by the conventional capital increase methods use the rights offering scheme and issue a large number of shares without going through a third party’s review on whether their share issues are reasonable, giving rise to a concern that shareholders may suffer disadvantage from such share issues. Under such circumstances, the TSE revised its listing criteria for share option certificates (meaning the securities set forth in Article 2, Paragraph 1, Item 9 of the FIEA or the securities set forth in Item 17 of the said paragraph that have the nature of share option certificates set forth in Item 9 of the said paragraph) in October 2014.

Specifically, a listing of share option certificates to be allotted through a generally-called non-commitment-type rights offering* must meet (i) the criteria regarding the procedure for assessment of reasonableness of the capital increase and (ii) the criteria regarding the issuing company’s business performance and financial conditions, in addition to the existing listing criteria.

*“Non-commitment-type rights offering” refers to a type of rights offering for which there is no underwriter who commits to exercise share options that remain unexercised.
Designation for the 1st Section, Re-designation, Change of Market and Choice of Market

Regarding the designation for the 1st Section market issues for listed shares, etc., the TSE has established certain formal standards regarding: (i) the number of shareholders; (ii) shares in circulation, etc.; (iii) trading volume; (iv) market capitalization; (v) the amount of net assets; (vi) the amount of profits or market capitalization; (vii) false statements or adverse opinions, etc.; and (viii) the number of share units (TSE Listing Regulations, rule 308). In addition, the TSE also conducts examinations on items that the TSE separately covers, including whether the profits and losses of the corporate group of the listed company and the forecast of earnings are in good condition based on documents submitted by the listed company as well as inquiries to the TSE. This is the method by which issues are designated to the 1st Section market (TSE Listing Regulations, rule 309).

On the other hand, regarding the re-designation to a 2nd Section market issue, the TSE provides formal standards with respect to: (i) the number of shareholders; (ii) shares in circulation; (iii) the volume of trading; (iv) market capitalization; and (v) insolvency. If an issue listed on the 1st Section market falls within any of these items, that issue will be re-designated to the 2nd Section market. Examinations regarding re-designation to the 2nd Section market concerning (i), (ii) and (v) are, in principle, conducted based on the status of a listed company at the end of each business year (TSE Listing Regulations, rule 311).

In addition, if the TSE receives an application for a change to the main market from a company listed on Mothers or JASDAQ, a change to the Mothers from a company listed on JASDAQ, or a change to JASDAQ from the company listed on the main market or Mothers, it shall conduct examinations in the same manner as the application for new listing described above.

A company listed on Mothers shall, at prescribed timing, such as ten years after listing, choose to either remain listed on Mothers or change its listing market to a Main Market (TSE Listing Regulations, rule 316).

Timely Disclosure, Etc. and Other Listing Management

For listed shares, etc. that have been listed after having gone through examinations in accordance with examination requirements, the TSE imposes a continual obligation on the issuers of the shares, etc. to ascertain and report any facts that may have material effects on their management as well as any important decisions that may affect rights concerning shares, etc.

In other words, the TSE imposes obligations such as: (i) disclosure concerning determinations made on material matters for making investment decisions concerning the issuance of shares, capital reductions, mergers, etc. (TSE Listing Regulations, rule 402, item 1); (ii) disclosure where facts arise which are material on making investment decisions, such as occurrence of damages, changes to the major shareholder, dishonoring of bills, etc. (TSE Listing Regulations, rule 403).
Regulations, rule 402, item 2); (iii) disclosure of facts concerning subsidiaries (TSE Listing Regulations, rule 403), etc. In addition, the TSE requires the issuer to agree to make the submitted documents available for public inspection (TSE Listing Regulations, rule 414, etc.). The issuer shall disclose corporate information timely using TDNet (the timely disclosure information transmission system of the TSE) (TSE Listing Regulations, rule 414).

In addition to the above, the TSE sets, as the charter of corporate behavior, “matters to be observed” setting forth matters that listed companies must observe at the minimum, such as matters to be observed concerning third party allotments (TSE Listing Regulations, rule 432), securing of independent officers (TSE Listing Regulations, rule 436-2), audits by listed company auditing firms, etc. (TSE Listing Regulations, rule 441-3), and prohibition of insider trading (TSE Listing Regulations, rule 442), and “desired matters” setting forth matters for which listed companies are requested to make efforts, such as maintenance of system for eliminating antisocial forces (TSE Listing Regulations, rule 450), etc.

In particular, with respect to third party allotments, the TSE has improved systems concerning third party allotments in 2009 such as (i) improvement of delisting criteria, (ii) new establishment of corporate code of conduct, (iii) establishment of provisions regarding timely disclosure, (iv) submission of a written confirmation stating that the person who receives an allocation does not have relationships with any antisocial forces, in order to ensure an environment in which investors can make investments securely.

In 2015, a new corporate governance system was introduced, requiring listed companies to implement the principles of the “Corporate Governance Code,” or, if they do not implement the principles, requiring them to explain the reasons in their corporate governance report (TSE Listing Regulations, rule 436-3). As such, listed companies must respect the objective and spirit of the “Corporate Governance Code” and make efforts to enhance their corporate governance (TSE Listing Regulations, rule 445-3), and also make efforts to retain at least one independent director among the members of the board of directors (TSE Listing Regulations, rule 445-4).

The “Corporate Governance Code” is a set of principles attached to the TSE Listing Regulations, which was prepared based on the “Corporate Governance Code [Final Proposal]” developed by the “Council of Experts Concerning the Corporate Governance Code” (finalized on March 5, 2015). The “Corporate Governance Code” establishes fundamental principles for effective corporate governance at listed companies in Japan. It is expected that the Code’s appropriate implementation will contribute to the development and success of companies, investors and the Japanese economy as a whole through individual companies’ self-motivated actions in order to achieve sustainable growth and increase corporate value over the mid- to long-term.
Ensuring Effectiveness

The TSE takes measures necessary for listing management in accordance with the timely disclosure, etc. of corporate information by the issuer or the charter of corporate behavior to contribute to investor protection.

Specifically, the TSE takes measures including the following: the designation for issues on special warning market (TSE Listing Regulations, rule 501) and submission of improvement reports (TSE Listing Regulations, rule 502 through rule 505) from the viewpoint of promoting improvement as measures to ensure effectiveness upon violation of rules such as the timely disclosure of corporate information, etc. and violation of the “matters to be observed” under the charter of corporate behavior; and public announcement (TSE Listing Regulations, rule 508) and imposition of listing contract penalty (TSE Listing Regulations, rule 509) from the viewpoint of imposing penalty.

In 2014, a new rule has been introduced to allow the TSE to give cautions to investors by publicizing the information on the matters mentioned above more speedily and flexibly (TSE Business Regulations, rule 30).

Delisting Requirements for Share Certificates, Etc.

A delisting of shares listed on the TSE shall be handled with great care since it may have a significant influence on stakeholders such as trade counterparties, financial institutions, investors, etc., not to mention the listed company itself.

The TSE has prescribed standards for delisting domestic share certificates, etc., and if a listed domestic share certificate, etc. falls under any of the following criteria, it will be delisted (TSE Listing Regulations, rule 601):

(i) Number of shareholders;
(ii) Shares in circulation;
(iii) Trading volume;
(iv) Market capitalization;
(v) Insolvency;
(vi) Suspension of banking transactions;
(vii) Bankruptcy, civil rehabilitation, or corporate reorganization proceedings;
(viii) Suspension of business activities;
(ix) Inappropriate mergers, etc.;
(x) Damaging the soundness of transactions with controlling shareholders;
(xi) Delayed submission of securities reports or quarterly reports;
(xii) False statements or adverse opinions, etc.;
(xiii) Disclosure-in-question securities; etc.;
(xiv) Violations of the listing agreement, etc.;
(xv) Entrustment to a transfer agent;
(xvi) Restrictions on stock transfers;
(xvii) The issuer becomes a wholly owned subsidiary company;
(xviii) The handling by designated book-entry transfer institutions;
(xix) Unfair restrictions on the rights of shareholders;
(xx) The acquisition of all shares by the listed company;
(xxi) The acquisition of shares, etc. in response to demand for a share, etc. cash-out;
(xxii) Involvement of antisocial forces; and
(xxiii) Other criteria.

For the delisting of foreign share certificates, etc., in addition to the above-mentioned criteria (i) through (xiv) and (xvi) through (xxiii), the following criteria have been established: (i) termination of deposit agreements, etc.; (ii) delisting, etc. on an overseas financial instruments exchange, etc.; and (iii) status of circulation, etc. (TSE Listing Regulations, rule 602).

Furthermore, if a listed share certificate, etc. has a possibility of meeting one of the delisting requirements or if the issuer of the listed share certificates, etc. requests delisting, the TSE may designate such share certificates, etc. as Securities Under Supervision so as to apprise investors of the facts (TSE Listing Regulations, rule 610, etc.). Furthermore, if the delisting of a listed share certificate, etc. has been determined, the TSE may designate such share certificates, etc. as Securities To Be Delisted until the day prior to the delisting date so as to apprise investors of the facts (TSE Listing Regulations, rule 611).

3 7 Listing of Non-participating Preferred Share and Tracking Share

While the application for listing non-participating preferred shares (class shares with preferred rights concerning the distribution of surplus which distribution will not be made from the amount available for distribution remaining after payment of preferred distributions) and tracking shares (classes of shares that provide for the payment of dividends based on the performance, or surplus, etc. of a consolidated subsidiary of the issuer; together with the non-participating preferred share, hereinafter “preferred shares”) is conducted using procedures very similar to “3.1 Procedures for New Listing of Shares, Etc.” above (TSE Listing Regulations, rules 801 to 803), in light of the uniqueness of preferred shares, etc., the listing examination and delisting are conducted in accordance with requirements and standards that are different from those for “3.2 Listing Requirements of Shares, Etc.” and “3.6 Delisting Requirements for Share Certificates, Etc.” above.

The listing examination is conducted for issues applying for new listing that can meet formal
requirements such as: (i) the issuer shall have listed common share (voting share); (ii) the number of shareholders; (iii) number of shares in circulation; (iv) market capitalization; (v) the ratio of shares in circulation; (vi) handling by designated book-entry transfer institutions; and (vii) restrictions on stock transfers (TSE Listing Regulations, rule 804), by a substantial examination in terms of: (i) outlook for booking profit sufficient for distributing surplus; (ii) situation in which the details of shares, corporate information, etc. may be disclosed properly; and (iii) not being deemed inappropriate in light of public interest or investor protection (TSE Listing Regulations, rule 805).

As regards the issuer of preferred share, etc., in addition to the timely disclosure applicable to the issuer of common share, the issuer is obligated to disclose information regarding the peculiarities of preferred share, etc., such as disclosing the contents of major decisions concerning the management, functions or property made by the business execution-determining organ of the subsidiary covered by the tracking share in the case of the issuer of tracking share (TSE Listing Regulations, rule 806).

Also, with respect to delisting, if the issuer meets either of the following criteria: (i) the issuer commits a material breach of the preferred share listing agreement or ceases to be a party to the preferred share listing agreement, or (ii) the issuer’s common share meets the delisting requirements for the common share, all issues of preferred shares, etc. issued shall be delisted. If the listed preferred share, etc. meets one of the following criteria: (i) the number of shareholders; (ii) shares in circulation; (iii) the preferred share, etc. term has been completed; (iv) trading volume; (v) absence of trade executions during a consecutive three-month period; (vi) market capitalization; (vii) exclusion from the scope of securities covered by the book-entry transfer business of designated book entry transfer institutions; (viii) restriction on the transfer of shares; (ix) the issuer acquiring all shares concerning the issue; or (x) other occasions where the TSE acknowledges delisting to be appropriate to the public interest and to protect investors, the listed issue shall be delisted (TSE Listing Regulations, rule 808).

Meanwhile, the preferred share, etc. shall be the same market category as the common stock issued by that issuer (TSE Listing Regulations, rule 802, para. 4).

### Listing of Bonds

As with shares, etc., listing procedures for bonds are based on applying for listing by the issuer and filing to the Prime Minister.

However, government bonds may be listed without applications for listing from issuers (TSE Listing Regulations, rule 901, para. 3).

Among the listing requirements for bonds, requirements for issuers and requirements for corporate bonds applying for listing are provided. Examinations are conducted for bonds that meet these requirements and then listings are determined (TSE Listing Regulations, rule 904). These requirements are as follows: First of all, the issuer must be a listed company on the TSE (TSE Listing Regulations, rule 904, para. 1, item 1), and the criteria for bonds applying for listing.
include: (i) the aggregate face amount of outstanding bonds; (ii) the number of the bonds
subscribed; (iii) par value; and (iv) that the bond is subject to handling by the book-entry transfer
business of a designated custody and book-entry transfer institution (TSE Listing Regulations,
rule 904, para. 1, item 2). Also, as for bonds other than corporate bonds, listing shall be
determined in light of the above-mentioned requirements for bonds applying for listing (TSE
Listing Regulations, rule 905, para. 1).

As with the listing requirements, for the delisting requirements for bonds, requirements for
issuers and requirements for listed bonds are provided. As with corporate bonds, if an issuer meets
either of the following criteria, all issues of bonds issued by the issuer will be delisted: (i)
significant violations concerning the listing agreement for the bonds or the issuer not becoming a
party to the listing agreement concerning the bonds (TSE Listing Regulations, rule 912, para. 1,
item 1); or (ii) the share, etc. (common share) issued by the issuer falls under (vi) through (xiv),
(xxii) or (xxiii) referred to in “3.6 Delisting Requirements for Share Certificates, Etc.” (TSE
Listing Regulations, rule 912, para. 1, item 2 a-(a)); and if the listed corporate bonds meet any of
the following criteria: (i) where the total nominal amount of outstanding bonds becomes less than
300 million yen by the day a month before the day on which the final redemption date arrives; (ii)
where the final redemption date arrives or where advanced redemption is carried out for the total
amount of bonds; or (iii) acceleration of payment; (iv) cases where the debts pertaining to the
listed issue are succeeded by another company in an absorption-type company split or
incorporation-type company split; (v) cases where the bonds are no longer subject to the book-
entry transfer business of a designated custody and book-entry transfer institutions; or (vi) cases
where delisting is deemed appropriate in order to protect the public interest or investors, the listed
issue shall be delisted (TSE Listing Regulations, rule 912, para. 2).

### Listing of Convertible Type Bonds with Share Options

As with other bonds, when a listing application is filed for convertible type bonds with share
options (referring to those bonds with share options which the object of the contribution made
upon the exercise of the share option is the bonds underlying such bonds with share options; same
hereinafter), a listing examination is conducted, and a determination will be made in accordance
with the listing requirements (TSE Listing Regulations, rule 917).

Listing requirements are comprised of requirements for issuers and requirements for issues
applying for listing. The former includes the requirement that the issuer is a listed company on the
TSE, and the latter includes criteria regarding the following: (i) the total issue amount; (ii) that the
terms for exercise of the share options are not terms that are recognized as being inappropriate;
(iii) the share options shall be subject to handling by designated book-entry transfer institutions;
and (iv) that the bond is not considered inappropriate in order to protect the public good or
investors, etc. (TSE Listing Regulations, rule 920, para. 1).

The delisting requirements also prescribe standards concerning the issuer and standards
concerning the listed issue. With respect to the former standards, if the issuer falls under any of
the following, all issues of the convertible type bonds with share options issued by the issuer will
be delisted: (i) if the issuer has materially violated the convertible type bonds with share options,
etc. listing agreement or ceases to be a party to the convertible type bonds with share options, etc.
listing agreement; (ii) if the share, etc. issued by the issuer meets one of items of various criteria
in Rule 601 to Rule 604-5 of the TSE Listing Regulations; and (iii) cases where the issuer will
become a wholly-owned subsidiary of another company through a stock swap or stock transfer,
and when such other company, etc. is a listed company or expects to list its shares promptly (TSE
Listing Regulations, rule 921, para. 1). Also, with respect to the latter standards, if the listed
convertible type bonds with share options meet any of the following criteria, the listed issue will
be delisted: (i) where the total listed nominal amount becomes less than 300 million yen by the
day a month before the day on which the final redemption date arrives; (ii) where the exercise
period for a share option reaches maturity; (including the completion of the exercise period due to
execution of the early redemption of the total amount of the convertible type bonds with share
options); (iii) acceleration of payment; (iv) cases where the liabilities pertaining to the bonds
concerning the listed issue are succeeded by another company pursuant to a merger or a
absorption-type company split or incorporation-type company split; (v) when the issue will not be
subject to handling by designated book-entry transfer institutions; or (vi) where the TSE finds
delisting proper in order to protect the public interest or investors, the listed issue shall be delisted
(TSE Listing Regulations, rule 921, para. 2).

Furthermore, the TSE provides separately in Rule 926 through Rule 940 of the TSE Listing
Regulations concerning the listing of Exchangeable Bonds (referring to bond certificates that may
be exchanged for share certificates of a company other than the issuer of such bond at the request
of the bondholder).

310 Listing of ETN

ETN (Exchange Traded Note) refers to securities issued in foreign countries which have the
nature of corporate bonds and whose redemption price is aimed at tracking specific indicators
such as share price index and commodity price. The TSE Rules provide for a listing system for
ETN trust beneficiary certificates (referring to securities trust beneficiary certificates whose
entrusted securities are ETN). The listing of an ETN trust beneficiary certificate shall be
determined based on an application by the issuer of the ETN which is the entrusted security, after
examination conducted under the criteria for listing examination (TSE Listing Regulations, rule
941).

The criteria for listing examination provide for the qualification requirements for the issuer
(e.g., registered financial institution, financial instruments business operator), and the
requirements for soundness of the issuer’s financial standing (in terms of the amount of net assets
or net worth, capital adequacy ratio, and credit rating). The criteria also specify the following
matters concerning the merchantability of the ETN to be issued: (i) the matters to be stated in the issuance agreement; (ii) indicator eligibility; (iii) expectations for efficient distribution; (iv) the period until the final redemption date; (v) the requirement that the sum of the total remaining redemption value and the scheduled issuance value of the ETN to be issued should not exceed a certain proportion of the amount of net assets of the issuer; (vi) the handling of the ETN at the designated book-entry transfer institution; (vii) concurrent listing on a foreign financial instruments exchange of the ETN which is the entrusted security; and (viii) the determination that the listing of the ETN is not deemed inappropriate from the viewpoint of the public interest or the protection of investors (TSE Listing Regulations, rule 945).

The criteria further specify the information to be disclosed: (a) information to be disclosed on a daily basis, including (i) the number of listed beneficiary right units, and the total remaining redemption value and redemption value per security of the ETN, which is an entrusted security, and (ii) the daily deviation rate between the redemption value per security and the specified indicator; (b) information to be disclosed on a timely basis, such as the decisions made by the issuer, etc. and the events that occur concerning the issuer, etc.; and (c) the settlement of accounts and credit status (TSE Listing Regulations, rule 947).

Similarly, the delisting criteria provide for the benchmarks for delisting in relation to the issuer’s status, soundness of the issuer’s financial standing, and nature of product of the ETN. (a) The benchmarks relating to the issuer’s status include (i) the issuer’s loss of status as a registered financial institution, etc.; and (ii) the issuer’s suspension of its business activities or dissolution. (b) The benchmarks relating to the soundness of the issuer’s financial standing include: (i) the amount of net assets or net worth; (ii) capital adequacy ratio; and (iii) credit rating. (c) The benchmarks relating to nature of product include: (i) the matters stated in the issuance agreement; (ii) the correlation coefficient between the redemption value per security and a specified indicator; (iii) the percentage of the total remaining redemption value of the ETN to the amount of net assets of the issuer; (iv) the arrival of the final redemption date; (v) acceleration of payment; (vi) material breach of the listing agreement; (vii) exclusion from the scope of securities covered by the book-entry transfer business of the designated book-entry transfer institution; (viii) delisting from a foreign financial instruments exchange; (ix) termination of the trust agreement; and (x) the determination that the delisting of the ETN is appropriate from the viewpoint of the public interest or the protection of investors. An ETN shall be delisted if it falls under any of the above cases (TSE Listing Regulations, rule 951).

3 11 Listing of ETF

ETF (Exchange Traded Fund = investment trusts traded on an exchange) collectively refers to beneficiary certificates targeting investment performance tracking a specified index (meaning the price and other index in a financial instruments market) or the price of specified commodities. Under the TSE regulations, listing systems for ETFs are categorized into 6 types in accordance
with the country of incorporation of the issuer or the law governing the issuance of ETFs: domestic ETFs, foreign ETFs, foreign ETF trust beneficiary certificates, domestic spot commodity ETFs, foreign spot commodity ETFs and foreign spot commodity ETF trust beneficiary certificates. Hereafter, we will explain the listing system of ETFs with domestic ETFs as an example.

The listing of domestic ETF (the beneficiary certificates of the investment trusts enumerated in Article 2, Paragraph 1, Item 10 of the FIEA managed to match the fluctuation rate of the amount of net assets of the investment trust property, etc. per unit with the fluctuation rate of a specified index) is determined when the investment trust management company, etc. (hereinafter referred to as “management company”) and trust company, etc. (hereinafter referred to as “trustee”), acting as trustee files a listing application and the TSE conducts an examination based on the listing requirements (TSE Listing Regulations, rule 1101).

The listing requirements prescribe that the management company must be a member of the Investment Trust Association, Japan and that it gives an undertaking with respect to timely disclosure, etc., as well as the following as the formal standards pertaining to listed issues: (i) the domestic ETF falls within the category of beneficiary certificates of securities investment trusts other than bond investment trusts or the category of beneficiary certificates of investment trusts set forth in Article 12, Item 1 or Item 2 of the Enforcement Order for the Act on Investment Trusts and Investment Corporations (hereinafter the “ITAEO”); (ii) matters to be stated in indentures; (iii) eligibility, etc. of the juridical person specified in the securities registration statement regarding the domestic ETF as a person handling the public offering of the domestic ETF (hereinafter referred to as the “Designated Participant”); (iv) adequacy of the index; (iv) issues comprising the trust property, etc.; (vi) prospect for smooth circulation, etc.; (vii) false statements or adverse opinions, etc.; (viii) handling by designated book-entry transfer institutions; and (ix) the issues are not deemed inappropriate from the perspective of the public interest or investor protection (TSE Listing Regulations, rule 1104).

With respect to timely disclosure, the following matters are prescribed as the information to be disclosed: (i) details determined with respect to the securities portfolio necessary for acquiring beneficiary certificates under additional entrustment in the future; (ii) number of listed beneficiary interests, net asset value and net asset value per unit; (iii) the divergence ratio between the net asset value per unit and the index; (iv) facts determined by the management company and the trustee; and (v) matters occurred with respect to the management company and the trustee (TSE Listing Regulations, rule 1107).

As delisting requirements concerning the person who entered into the listing agreement, the Listing Regulations provide the following criteria: (i) where the registration of the financial instruments trading business of the management company is invalidated or revoked; (ii) where the authorization, etc. of the trustee is revoked; (iii) the appropriateness of the management company; and (iv) violation of the listing agreement, etc. The delisting requirements contain the following standards concerning the individual issue: (i) the certificates do not fall within beneficiary certificates of securities investment trusts other than bond investment trusts or the certificates are not those of investment trusts specified in Article 12, Item 1 or Item 2 of the ITAEO; (ii) change
of matters to be stated in indentures; (iii) the appropriateness of the Designated Participant, etc.;
(iv) the linkage between the net asset value per unit and the index; (v) late submission of the
securities reports, etc.; (vi) false statements or adverse opinions, etc.; (vi) expiration of the
investment trust indenture; (viii) the issue does not become subject to handling by designated
book-entry transfer institutions; or (ix) cases where delisting is deemed appropriate in order to
protect the public interest or investors. The beneficiary certificates of the issuer will be delisted
where any of these standards are met (TSE Listing Regulations, rule 1112).

### Expansion of the ETF Market

The world’s first ETF is said to be “TIPS-35 (Toronto-35 Index Participation Units)”
listed on the Toronto Stock Exchange of Canada in 1990. Thereafter, in the 2000s, the ETF
market has rapidly grown particularly in Europe and the US supported by a wide variety of
investors from individual investors to institutional investors, and currently approximately
6,000 issues of ETFs (including issues of ETN) are listed in more than 40 exchanges around
the world.

Meanwhile, in Japan, the “Nikkei 300 Index Fund” was listed as Japan’s first ETF in
1995, and other types of ETF aimed at tracking major share price indices such as “Nikkei
225 ETF” and “TOPIX ETF” were listed in 2001. However, both the number of issues and
trading volume in ETFs were growing at a sluggish pace.

In response to such circumstances, the government put together the “Better Market
Initiative” at the end of 2007 and focused on the diversification of ETF which is a means of
investment that enables investors to make easy and effective diversified investments at a low
cost. In addition, the TSE declared in its 3 year mid-term management plan announced in
2008 to target 100 listed ETF issues which was 3 times more compared to the number as of
the end of fiscal year 2007.

Subsequently, the TSE has made various improvements in the system, leading to the
diversification of listed ETF issues including those linked with the commodity indexes (e.g.
gold, crude oil) and those linked with foreign stock indexes (e.g. Chinese and Brazilian
stocks), and in March 2011, the number of listed ETF issues exceeded the target number of
100.

In April 2011, a system for trading ETN (Exchange Traded Note), a type of financial
instruments linked with certain indexes as in the case of ETF, was introduced. The ETN and
ETF markets have expanded as a result of the subsequent movements including the
integration between the TSE and the OSE in July 2013. As of the end of September 2018,
223 ETF issues and 23 ETN issues, totaling 246 issues, were listed on the TSE.
Real estate investment trust securities refer to beneficiary certificates of an investment trust enumerated in Article 2, Paragraph 1, Item 10 of the FIEA, or investment securities enumerated in Item 11 of the same Paragraph, which have as their purpose the management of the investors’ funds as investments principally in real estate, etc. The TSE rules provide for listing systems respectively for three categories, namely, investment securities, beneficiary certificates for investment trusts managed under instructions from the settlor, and beneficiary certificates for investment trusts managed without instructions from the settlor. The listing of real estate investment trust securities is determined based upon a listing application filed by the persons specified for the respective categories, i.e., the investment corporation and the asset management company in the case of investment securities, and the settlor company of an investment trust and the trust company in the case of a beneficiary certificate of an investment trust (hereinafter referred to as the “issuer, etc.”), after an examination conducted under the listing requirements (TSE Listing Regulations, rule 1201-2).

The listing requirements provide that the asset management company, the settlor company of an investment trust or the trust company, etc. must be a member of the Investment Trust Association, Japan, as well as the following standards pertaining to the product characteristics of the listed issue: (i) ratio of the amount of real estate, etc. among the managed assets, etc.; (ii) setting the ratio of the total amount of real estate, etc., real estate related assets and current assets, etc., among the managed assets, etc.; (iii) commitment to execute an advisory agreement concerning timely disclosure with a financial instruments business operator (except cases of submitting a recommendation letter from the managing trading participant); (iv) number of units listed; (v) total net asset value per unit; (vi) total net asset value; (vii) ratio of the number of investment units held by large investors plus the number of investment units held by the issuer or the ratio of the number of investment units of beneficiary interests held by large beneficiaries; (viii) number of investors excluding large investors and the issuer who holds its own investment units and has applied for listing of its issue or number of beneficiaries excluding large beneficiaries; (ix) false statements or adverse opinions, etc.; (x) matters to be stated in indentures or by-laws; (xi) handling by designated book-entry transfer institutions; (xii) transfer agent, etc. as formal criteria (TSE Listing Regulations, rule 1205). For issues meeting the formal criteria, a substantial examination is held from the following viewpoints: (i) to be in a status to appropriately disclose information concerning the real estate investment trust certificates; (ii) to be in a status to manage, etc. the assets in a healthy manner; (iii) to have a prospect for distributing profit or cash continuously after listing; and (iv) the issue is not found inappropriate from the perspective of the public interest or investor protection (TSE Listing Regulations, rule 1206).

The timely disclosure provisions provide the following matters as information to be disclosed in the following broad categories: (i) information concerning the issuer, etc.; (ii) information concerning the managed assets; (iii) information concerning account settlement, including information concerning the price of the assets; and (iv) other information (TSE Listing Regulations, rule 1210).
Regulations, rule 1213).

Regarding delisting, in addition to criteria relating to the issuer, etc. such as the investment corporation becomes subject to dissolution causes or the registration of the financial instruments business of the asset management company expires, etc., the delisting requirements contain the following standards concerning the individual issue: (i) ratio of the total amount of real estate, etc., real estate related assets and current assets, etc., among the managed assets, etc.; (ii) ratio of the amount of real estate, etc., among the managed assets; (iii) distribution of profit or cash; (iv) net asset value; (v) asset scale; (vi) number of units listed; (vii) trading volume; (viii) late submission of the securities reports, etc.; (ix) false statements or adverse opinions, etc.; (x) violation of listing agreements; (xi) matters to be stated in indentures; (xii) handling by designated book-entry transfer institutions; (xiii) termination of the investment trust agreement where the listed security is a beneficiary certificate of an investment trust; (xiv) involvement of antisocial forces; or (xv) cases where delisting is deemed appropriate in order to protect the public interest or investors (TSE Listing Regulations, rule 1218). Real estate investment trust securities will be delisted where any of these standards are met.
The Business Regulations include detailed provisions governing securities trading in the TSE market. In addition, the TSE has also prescribed the Margin/Loans for Margin Trading Regulations, which have the force equivalent to that of the Business Regulations. The discussion below will describe the broad outline of these regulations.

Government bond futures transactions, index futures transactions, securities option transactions, government bond futures option transactions and index option transactions on the OSE markets will be mentioned only when necessary. The general issues concerning these transactions will be discussed in “Section 7. Market Derivatives Transactions” below.

4 Structure of Securities Trading

1 Types of Securities Trading

Securities trading conducted on the TSE market can be categorized into securities trading on auction market and securities trading on markets other than the auction market (ToSTNeT market) (Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, rule 1). With respect to the securities trading on auction market, there are (i) cash transactions; (ii) regular transactions; (iii) when-issued transactions (TSE Business Regulations, rule 9, para. 1) as transactions during trading session, and as transactions other than those during trading session, there are (i) transactions for the correcting errors, etc. (TSE Business Regulations, rule 41); and (ii) off-auction distribution (TSE Business Regulations, rule 42), etc.

The trading of securities on the ToSTNeT market (ToSTNet transactions) can be categorized into (i) single issue transactions, (ii) basket transactions; (iii) closing price transactions; and (iv) off-auction own share repurchase transaction (Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, rule 2 and Chapter 2).

Transactions in bonds (excluding convertible type bonds with share options and exchangeable bonds; hereinafter the same) are categorized into two types: (i) cash transactions; and (ii) regular transactions (TSE Business Regulations, rule 9, para. 1); however, the trading of government bonds is conducted by regular transactions only (TSE Business Regulations, rule 9, para. 4).

Transactions during Trading Session on Auction Market

Cash transactions are transactions that are settled on the day the trading contract is concluded (TSE Business Regulations, rule 9, para. 2).

Regular transactions are settled on the third day (to be shortened to the “second day” from July 16, 2019) following the day that the trading contract was concluded (excluding holidays; the same shall apply hereinafter in counting the number of days) (TSE Business Regulations, rule 9, para. 3). The settlement on a regular transaction must be made on the
fourth day (to be shortened to the “third day” from July 16, 2019) following the day the trading contract was concluded if the trade was concluded on the date prescribed as the date of amendment of exercise conditions with respect to convertible type bonds with share options and the date prescribed as the date of amendment of exchange conditions with respect to exchangeable bonds, ex-rights date for the right to request early redemption with respect to convertible type bonds with share options and exchangeable bonds, or the day that is four days (to be shortened to “three days” from July 16, 2019) prior to the interest payment date on interest bearing convertible type bonds with share options (excluding interest bearing convertible type bonds with share options that are not handled by the JASDEC in its book-entry transfer business) and interest bearing exchangeable bonds. The purpose behind extending settlement in these cases is to prevent the double payment of rights, etc. (TSE Business Regulations, rule 9, para. 3, para. 5 and para. 6). In the case of government bonds transactions, settlement shall be made on the day following the day of conclusion of the trading contract (TSE Business Regulations, rule 9, para. 4).

**When-issued transactions** are transactions that relate to shareholder allotment with consideration of domestic share certificates and preferred equity investor allotment with consideration of preferred equity investment certificates prescribed in the Act on Preferred Equity Investment by Cooperative Structured Financial Institution. As a rule, the transaction is carried out during the period from an ex-rights day to the day three days (to be shortened to “two days” from July 16, 2019) prior to the new registration date concerning the new share certificates, and all settlements are made on the new registration date concerning the new share certificates (TSE Business Regulations, rule 9, para. 7; TSE Business Regulations Enforcement Rules, rule 5).

The term of a when-issued transaction ranges from one month to three months. For this reason, the financial instruments exchange clearing organization requires the clearing participants to deposit a trade margin from the perspective of ensuring settlement, and receive and pay for the profit and loss account arising from daily fluctuations (this is called the mark-to-market system) (the business method manual issued by Japan Securities Clearing Corporation).

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**Discussion on Shortening of Stock Settlement Cycle**

In July 2015, the Working Group on Shortening Stock Settlement Cycle (organized by JSDA, TSE, and Japan Securities Clearing Corporation) was set up to discuss issues toward shortening the stock settlement cycle (from “T+3” to “T+2,” which means reducing the number of days after the contract date until the settlement date from three days to two days).

As a result of the discussion at the Working Group, a final report was published in June 2016. Through deliberation at the Council on Securities Delivery and Clearing/Settlement Systems Reform, which is the upper body of the Working Group, it was decided in May 2018 that the scheduled implementation date of the T+2 settlement cycle would be July 16, 2019 (trade date basis).
Transactions Other than Those during Trading Session on Auction Market

Transactions for correcting errors, etc. are expedient trades executed on exchange market, in which a participant becomes its own counterparty under a certain conditions. These are for orders from customers the transaction for which was unable to be conducted on exchange based on a purport of consignment by, due to a mistake.

Such conditions required are: (i) for an error caused by an inevitable circumstance; (ii) with prior approval of the exchange; and (iii) at a price approved by the exchange as an adequate price (TSE Business Regulations, rule 41, para. 1). These strict conditions are reasonable considering that execution method outside trading session is allowed for the convenience of participants.

Settlement for transactions for correcting errors, etc. will be made on the original settlement day that the transaction would have been executed based on a purport of entrustment (TSE Business Regulations, rule 41, para. 2).

Off auction distribution is made when a sale of a significantly large entrustment is ordered by a customer and is executed after the TSE announces the conditions for distribution for the purpose of securing liquidity of the bulk order by encouraging the participation of many ordinary investors, thereby avoiding abrupt market fluctuations. Recently, the method has been utilized to distribute a major shareholder’s shares to ordinary investors for the purpose of improving share distributions among investors.

A trading participant wishing to execute an off auction distribution (hereinafter called a “handling trading participant”) must collect not only the commission pertaining to the distribution but also a commission for accepting of off auction distribution from the customer who placed the bulk order (hereinafter the “distributor”) (TSE Brokerage Agreement Standards, rule 51, para. 1). The reason for the commission for accepting off auction distribution arises from the fact that the handling trading participant may need to make considerable efforts for the sale depending on the marketability of the issues offered for sale.

The handling trading participant forwards the commission for handling the off auction distribution to the trading participants who acquired the issues by participating in the off auction distribution (TSE Business Regulations, rule 47, para. 1).

Once notification from the handling trading participant is accepted (notification must be submitted after the trading session is closed), the TSE confirms that the volume of the sale exceeds the volume predetermined and announces the methods used in such distribution and other necessary matters (TSE Business Regulations, rule 42, para. 3); provided, however, that off auction distribution may not be executed in cases deemed inappropriate in light of trade management by the TSE (TSE Business Regulations, rule 42, para. 1).

Off auction distribution must be made at the price designated by the distributor and approved by the TSE, within the range of the closing price on the day the TSE accepts the notification and the price derived by subtracting an amount equivalent to 10% of the closing price (TSE Business Regulations, rule 43).

In an off auction distribution, all purchase applications are submitted between 8:00 a.m. and 8:45 a.m. on the day following the day the TSE accepts the notification (TSE Business Regulations, rule 42).
Regulations, rule 44, para. 1). Following the period of purchase application, trade contracts are concluded in accordance with a certain set of requirements. Delivery takes place on the third day (to be shortened to the “second day” from July 16, 2019) following the date the contract is concluded (if the day falls on the date prescribed as the date of amendment of exercise conditions with respect to convertible type bonds with share options, etc., the fourth day (to be shortened to the “third day” from July 16, 2019)) following that date through the TSE (TSE Business Regulations, rule 42, para. 2).

The volume of shares per purchase application per customer may be limited if the off-auction distribution was intended to improve stock ownership distribution (TSE Business Regulations Enforcement Rules, rule 31).

(2) Ex-Dividend Trades and Ex-Rights Trades, Etc.

The TSE provides that in a regular transaction of share certificates (excluding equity contribution securities set forth in Article 2, Paragraph 1, Item 6 of the FIEA), trades commence at the ex-rights or ex-dividend two days prior (to be shortened to the “day prior” from July 16, 2019) to the record date for shareholders eligible for dividends (including interim dividends) or the record date for share options and other rights (TSE Business Regulations, rule 25; TSE Business Regulations Enforcement Rules, rule 18).

When the consideration for acquisition, conditions for exercise of rights or conditions for exchange are revised for convertible preferred share, convertible type bonds with share options or exchangeable bonds which provide that acquisition may be requested to the issuing company, etc., these are traded with the revised conditions starting two days prior (to be shortened to the “day prior” from July 16, 2019) to the effective date of revision of the consideration for acquisition or three days prior (to be shortened to “two days prior” from July 16, 2019) to the effective date of the revision of the exercise conditions or exchange conditions (TSE Business Regulations, rule 26, TSE Business Regulations Enforcement Rules, rule 19). Convertible type bonds with share options with a call provision are traded ex-rights starting three days prior (to be shortened to “two days prior” from July 16, 2019) to the last day of the call period (TSE Business Regulations, rule 26-2, TSE Business Regulations Enforcement Rules, rule 19-2).

(3) Margin Trading and Loans for Margin Trading

Trades of share certificates in an exchange transaction are treated as a spot transaction, and cash and share certificates are exchanged on the settlement day. However, implementation of mock supply and demand is necessary to further ensure smooth circulation and the formation of fair market prices. The margin trading system was implemented to serve such goals.

In this scheme, a customer deposits a margin at a certain rate to a financial instruments business operator and borrows the acquisition money or sale securities required for the settlement of the entrusted order from the financial instruments business operator (provision of credit). The financial instruments business operator then settles the transaction in the financial instruments exchange. After the settlement, the lending and borrowing relationship between the customer and the financial instruments business operator remains, thereby in reality deferring the settlement of
the trade. Settlement for the borrowing and lending relationship is made by repaying the borrowed money or securities. Such settlement can also be made with the acquired securities or sale money from a reverse transaction.

In that sense, margin trading is a type of deferred transaction made possible through financial operation. Therefore, a considerable amount of capital is required to support such a scheme. As a result, several securities finance companies were established as specialized securities financing institutions in order to support such capital needs. In a nation such as ours, where the stock lending market is rather primitive, these securities finance companies also serve the role of funding institutions.

The relationship between financial instruments business operators and securities finance companies plays an important role in the existence of margin trading. The lending of capital or share certificates (financing, lending of share certificates) established between a financial instruments business operator and a securities finance company is called loans for margin trading.

The major issues pertaining to margin trading, which concern the relationship between a trading participant and a customer, are set forth in the Brokerage Agreement Standards. Under margin/loans for margin trading regulations, (i) there is standardized margin trading in which the broker loan rate (when the share lending balance exceeds the loan balance for the relevant share issue in the Japan Securities Finance Co., Ltd., the broker loan fees are collected from the customers borrowing the shares and are paid to the customer borrowing the money at the same fees) and the possible deferral of the repayment term are regulated by the TSE and negotiable margin trading in which the broker loan rate and possible extension of repayment term are negotiable between the participant and a customer (Margin/Loans for Margin Trading Regulations of the TSE, rule 2 and rule 7); (ii) a participant shall not engage in margin trading in share options, equity contribution securities, or investment equity subscription right certificates prescribed in Article 2, Paragraph 18 of the Act on Investment Trusts and Investment Corporations, or in issues that have become subject to the criteria for delisting or other issues deemed inappropriate by the TSE (id. rule 3); (iii) a participant shall not engage in margin trading for its officers or employees (id. rule 5); (iv) a participant shall not provide credit for the trading of off auction distribution (id. rule 4); and (v) a participant shall, in principle, furnish monthly reports providing the matters determined by the TSE to the customers who have outstanding margin trading yet to be settled (id. rule 6). The TSE also requests that participants refrain from engaging in margin trading that involves convertible type bonds with share options for the time being.

The selection of issues that can be traded using standardized margin trading (hereinafter called “standardized margin issues”) is made pursuant to the “Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions” established by the TSE in order to comply with trade management strategy (id. rule 7, para. 2).

The lending standards of securities finance companies established the system for loans for margin trading. The issues that can be loaned are selected by the TSE from standardized margin trading issues, because issues for loans for margin trading with small circulation volumes or a small number of shareholders can cause inconvenience. The selection of issues is also made
pursuant to the “Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions” (*id.* rule 10).

In addition, the TSE makes various attempts to ensure the sound operation of loans for margin trading as demonstrated by its close contact and communication with securities finance companies.

## 4.2 Trading Session

### (1) Trading Hours and Holidays

The trading hours are shown in the table below (as of September 1, 2018).

The holidays of the Exchange are Sundays, national holidays, the earliest subsequent day that is not a national holiday if a national holiday falls on a Sunday, a day that is in-between two national holidays, Saturdays, the three days at the beginning of a year, and December 31 (TSE Business Regulations, rule 3, para. 1; OSE Business Regulations, rule 19, para. 1).

When it deems it necessary, the Exchange can implement a temporary closing for an entire day (TSE Business Regulations, rule 3, para. 2; OSE Business Regulations, rule 19, para. 2), or temporarily close all or part of a trading session. At the same time, the Exchange can open a trading session on a non-business day (TSE Business Regulations, rule 4, etc.; OSE Business Regulations, rule 20, etc.).

### (2) Bids and Offers and Trading (Transaction) Unit

Bids and offers for trading, etc. must be provided before a trade can be established in a trading session. The bids and offers for transactions, etc. executed using a trading system are the bids and offers based on the information entered into the trading participant’s terminals that are linked to the trading system (TSE Business Regulations, rule 14, para. 2; OSE Business Regulations, rule 26, para. 2). The units of bids and offers are shown in the table below.

With a view to increasing the convenience for a wide range of investors, the TSE streamlined the units for bids and offers for share certificates with high liquidity (those constituting TOPIX100) in three phases, on January 14 and July 22, 2014, and September 24, 2015.

Bids and offers for share certificates must be made on a cum-dividend basis (with-income distribution basis for beneficiary certificates), while bids and offers are made flat quotation for interest-bearing bonds, interest-bearing convertible corporate bonds with share options and interest-bearing exchangeable bonds. Bids and offers for bonds other than interest-bearing bonds, convertible type bonds with share options other than interest-bearing types, and exchangeable bonds other than interest-bearing exchangeable bonds are made cum-interest (TSE Business Regulations, rule 14, para. 4).

The trading (transaction) units are shown in the table below.
<table>
<thead>
<tr>
<th>Share Certificates</th>
<th>Trading session hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic share certificates</td>
<td>(Auction trading)</td>
</tr>
<tr>
<td>• Morning trading session (9:00 – 11:30)</td>
<td></td>
</tr>
<tr>
<td>• Afternoon trading session (12:30 – 15:00) (ToSTNeT)</td>
<td></td>
</tr>
<tr>
<td>• Single issue transactions and basket transactions: 8:20 – 17:30 .... A</td>
<td></td>
</tr>
<tr>
<td>• Closing price transactions: 8:20 – 8:45, 11:30 – 12:15, 15:00 – 16:00 .. B</td>
<td></td>
</tr>
<tr>
<td>• Off-auction own share repurchase transactions: 8:45 (orders for sale accepted from 8:00 – 8:45)</td>
<td></td>
</tr>
<tr>
<td>Equity investment securities, preferred equity investment certificates, investment trust beneficiary certificates, investment securities, investment equity subscription right certificates</td>
<td></td>
</tr>
<tr>
<td>Foreign share certificates</td>
<td></td>
</tr>
<tr>
<td>TSE</td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td></td>
</tr>
<tr>
<td>Government bonds</td>
<td>12:30 – 14:00</td>
</tr>
<tr>
<td>JPY-denominated foreign bonds</td>
<td></td>
</tr>
<tr>
<td>Bonds other than government bonds and foreign bonds (municipal bonds, specialized bonds, bank debentures, corporate bonds)</td>
<td>12:30 – 15:00</td>
</tr>
<tr>
<td>Convertible Type Bonds with Share Options</td>
<td>JPY-denominated</td>
</tr>
<tr>
<td>(Auction trading)</td>
<td></td>
</tr>
<tr>
<td>• Morning trading session (9:00 – 11:30)</td>
<td></td>
</tr>
<tr>
<td>• Afternoon trading session (12:30 – 15:00) (ToSTNeT)</td>
<td></td>
</tr>
<tr>
<td>• Single issue transactions and basket transactions: (same as A above)</td>
<td></td>
</tr>
<tr>
<td>• Closing price transactions: (same as B above)</td>
<td></td>
</tr>
<tr>
<td>Exchangeable Bonds</td>
<td></td>
</tr>
<tr>
<td>• Morning trading session (9:00 – 11:30)</td>
<td></td>
</tr>
<tr>
<td>• Afternoon trading session (12:30 – 15:00)</td>
<td></td>
</tr>
</tbody>
</table>

Chapter 5. Articles of Incorporation and Various Regulations of the Exchanges

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<table>
<thead>
<tr>
<th>Price per share (lot)</th>
<th>Trading (transaction) unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPY 3,000 or less</td>
<td>JPY 1</td>
</tr>
<tr>
<td>Over JPY 3,000</td>
<td>JPY 5</td>
</tr>
<tr>
<td>Over JPY 5,000</td>
<td>JPY 10</td>
</tr>
<tr>
<td>Over JPY 20,000</td>
<td>JPY 50</td>
</tr>
<tr>
<td>Over JPY 50,000</td>
<td>JPY 100</td>
</tr>
<tr>
<td>Over JPY 500,000</td>
<td>JPY 1,000</td>
</tr>
<tr>
<td>Over JPY 30 million</td>
<td>JPY 50,000</td>
</tr>
<tr>
<td>Over JPY 50 million</td>
<td>JPY 100,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Price per share (lot) in TOPIX 100</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>JPY 1,000 or less</td>
<td>JPY 0.1</td>
</tr>
<tr>
<td>Over JPY 1,000</td>
<td>JPY 0.5</td>
</tr>
<tr>
<td>Over JPY 3,000</td>
<td>JPY 1</td>
</tr>
<tr>
<td>Over JPY 10,000</td>
<td>JPY 5</td>
</tr>
<tr>
<td>Over JPY 30,000</td>
<td>JPY 10</td>
</tr>
<tr>
<td>Over JPY 100,000</td>
<td>JPY 50</td>
</tr>
<tr>
<td>Over JPY 300,000</td>
<td>JPY 100</td>
</tr>
<tr>
<td>Over JPY 1 million</td>
<td>JPY 500</td>
</tr>
<tr>
<td>Over JPY 3 million</td>
<td>JPY 1,000</td>
</tr>
<tr>
<td>Over JPY 10 million</td>
<td>JPY 5,000</td>
</tr>
<tr>
<td>Over JPY 30 million</td>
<td>JPY 10,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>1 Japanese Sen per face value of JPY100</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Japanese Sen per face value of JPY100</td>
<td>Face value of JPY50,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5 Japanese Sen per face value of JPY100</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Japanese Sen per face value of JPY100</td>
<td>Face value of JPY10,000, face value of JPY100,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>One security</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>One security</td>
<td>One unit. Provided, for issues specifically identified by the exchange, the number of units specified in each instance by the exchange</td>
</tr>
<tr>
<td>Trading session hours</td>
<td></td>
</tr>
<tr>
<td>-----------------------</td>
<td></td>
</tr>
<tr>
<td>Government Bond Futures Transactions, Government Bond Futures Options Transactions</td>
<td></td>
</tr>
<tr>
<td>• Morning trading session (8:45 – 11:00, 11:02)</td>
<td></td>
</tr>
<tr>
<td>• Afternoon trading session (12:30 – 15:00, 15:02)</td>
<td></td>
</tr>
<tr>
<td>• Evening trading session (15:30 – 5:25, 5:30)</td>
<td></td>
</tr>
<tr>
<td>(J-NET)</td>
<td></td>
</tr>
<tr>
<td>• 8:20 – 15:15; 15:25 – 5:30</td>
<td></td>
</tr>
</tbody>
</table>

| Index Futures Transactions, Index Options Transactions |
| OSE |
| TAIEX futures are traded only during the daytime trading session. |
| • Daytime trading session (excluding Nikkei 225 VI futures) (8:45 – 15:10, 15:15) |
| • Evening trading session (excluding Nikkei 225 VI futures) (16:30 – 5:25, 5:30) |
| • Daytime trading session (Nikkei 225 VI futures) (9:00 – 15:10, 15:15) |
| • Evening trading session (Nikkei 225 VI futures) (16:30 – 18:55, 19:00) |
| (J-NET [excluding Nikkei 225 VI futures and trading with a flexible contract month]) |
| • 8:20 – 16:00; 16:15 – 5:30 |
| (J-NET [Nikkei 225 VI futures]) |
| • 8:20 – 16:00; 16:15 – 19:00 |
| (J-NET [Trading with a flexible contract month]) |
| • 8:20 – 20:00 |

| Securities Options Transactions |
| • Morning trading session (9:00 – 11:30, 11:35) |
| • Afternoon trading session (12:30 – 15:10, 15:15) |
| (J-NET [excluding trading with a flexible contract month]) |
| • 8:20 – 16:00 |
| (J-NET [Trading with a flexible contract month]) |
| • 8:20 – 17:30 |
### Unit of Bids and Offers vs. Trading (transaction) unit

<table>
<thead>
<tr>
<th>Description</th>
<th>Trading (transaction) unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Japanese Sen (5 Japanese Rin for a Mini contract) per face value of JPY100</td>
<td>Face value of JPY 100 million (or for a Mini contract, the amount derived by multiplying the price of the standardized long-term government bonds by JPY 100,000)</td>
</tr>
<tr>
<td>1 Japanese Sen per face value of JPY 100 of the underlying issue of the government bond futures transaction to be executed by the exercise of the options</td>
<td>One unit of a government bond futures put option or government bond futures call option (one unit of option the exercise of which can execute a sale or purchase of government bond futures with a face value of 100 million yen at an exercise price for the underlying government bond futures contract month)</td>
</tr>
<tr>
<td>Nikkei 225 Futures (Large)</td>
<td>Nikkei 225 Futures (Large)</td>
</tr>
<tr>
<td>Nikkei 225 Futures (Mini)</td>
<td>Nikkei 225 Futures (Mini)</td>
</tr>
<tr>
<td>TOPIX Futures (Large)</td>
<td>TOPIX Futures (Large)</td>
</tr>
<tr>
<td>TOPIX Futures (Mini)</td>
<td>TOPIX Futures (Mini)</td>
</tr>
<tr>
<td>JPX-Nikkei Index 400, FTSE China 50 Index Futures</td>
<td>JPX-Nikkei Index 400, FTSE China 50 Index Futures</td>
</tr>
<tr>
<td>RN Prime Index Futures</td>
<td>RN Prime Index Futures</td>
</tr>
<tr>
<td>TOPIX Core30 Futures, TSE REIT Index Futures</td>
<td>TSE Mothers Index Futures, TOPIX Core30 Futures, TSE REIT Index Futures</td>
</tr>
<tr>
<td>TSE Banks Index Futures</td>
<td>TSE Banks Index Futures</td>
</tr>
<tr>
<td>TSE Mothers Index Futures, DJIA Futures, TAIEX Futures</td>
<td>DJIA Futures, TAIEX Futures</td>
</tr>
<tr>
<td>Nikkei 225 VI Futures</td>
<td>Nikkei 225 VI Futures</td>
</tr>
<tr>
<td>Nikkei 225 Dividend Index Futures</td>
<td>Nikkei 225 Dividend Index Futures</td>
</tr>
<tr>
<td>TOPIX Dividend Index Futures, TOPIX Core30 Dividend Index Futures</td>
<td>TOPIX Dividend Index Futures, TOPIX Core30 Dividend Index Futures</td>
</tr>
<tr>
<td><strong>(Nikkei 225 Options)</strong></td>
<td></td>
</tr>
<tr>
<td>Unit of bids and offers</td>
<td></td>
</tr>
<tr>
<td>JPY 100 or less</td>
<td>JPY 100 or less</td>
</tr>
<tr>
<td>Over JPY 100 – JPY 1,000 or less</td>
<td>Over JPY 1,000</td>
</tr>
<tr>
<td>Over JPY 1,000</td>
<td>JPY 100</td>
</tr>
<tr>
<td><strong>(TOPIX Options)</strong></td>
<td></td>
</tr>
<tr>
<td>20 points or less</td>
<td>20 points or less</td>
</tr>
<tr>
<td>Over 20 points</td>
<td>Over 20 points</td>
</tr>
<tr>
<td>(1 point = JPY 10,000)</td>
<td>(1 point = JPY 10,000)</td>
</tr>
<tr>
<td><strong>(JPX-Nikkei Index 400 Options)</strong></td>
<td></td>
</tr>
<tr>
<td>50 points or less</td>
<td>50 points or less</td>
</tr>
<tr>
<td>Over 50 points</td>
<td>Over 50 points</td>
</tr>
<tr>
<td>(1 point = JPY 1,000)</td>
<td>(1 point = JPY 1,000)</td>
</tr>
<tr>
<td>When the minimum of the bids and offers for a securities option transaction is:</td>
<td></td>
</tr>
<tr>
<td>JPY 50</td>
<td>JPY 50</td>
</tr>
<tr>
<td>– Below JPY 50</td>
<td>– Below JPY 50</td>
</tr>
<tr>
<td>JPY 1,000</td>
<td>JPY 1,000</td>
</tr>
<tr>
<td>– Below JPY 1,000</td>
<td>– Below JPY 1,000</td>
</tr>
<tr>
<td>Amount in ( ) for is when the trading unit is an odd number.</td>
<td>Amount in ( ) for is when the trading unit is an odd number.</td>
</tr>
<tr>
<td>JPY 1,000</td>
<td>JPY 1,000</td>
</tr>
<tr>
<td>– Below JPY 3,000</td>
<td>– Below JPY 3,000</td>
</tr>
<tr>
<td>JPY 3,000</td>
<td>JPY 3,000</td>
</tr>
<tr>
<td>– Below JPY 30,00</td>
<td>– Below JPY 30,00</td>
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<tr>
<td>JPY 30,000</td>
<td>JPY 30,000</td>
</tr>
<tr>
<td>– Below JPY 50,00</td>
<td>– Below JPY 50,00</td>
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<tr>
<td>JPY 50,000</td>
<td>JPY 50,000</td>
</tr>
<tr>
<td>– Below JPY 100,00</td>
<td>– Below JPY 100,00</td>
</tr>
<tr>
<td>JPY 100,000</td>
<td>JPY 100,000</td>
</tr>
<tr>
<td>– Below JPY 1,000,00</td>
<td>– Below JPY 1,000,00</td>
</tr>
<tr>
<td>JPY 1,000,000</td>
<td>JPY 1,000,000</td>
</tr>
<tr>
<td>Over JPY 1 million</td>
<td>Over JPY 1 million</td>
</tr>
<tr>
<td>JPY 5,000</td>
<td>JPY 5,000</td>
</tr>
</tbody>
</table>

* When the exchange determines that it is necessary to lower the unit of bids and offers and designates such issues, the unit of bids and offers that falls below the bids and offers in question.

* Flexible contract months are applicable to TSE Banks Index Futures and TSE REIT Index Futures, in addition to Nikkei 225 Options, TOPIX Options, and JPX-Nikkei Index 400 Options.

(Source) As of September 1, 2018
Conclusion of Trading Contracts

The transactions during trading session of the TSE’s market shall be effected by auction where the buying orders and selling orders are concentrated on the market respectively and placed according to the rules of price priority and timing priority (TSE Business Regulations, rule 10, para. 1 and para. 2, etc.).

The rule of price priority is the rule under which a lower offer shall have priority to higher offers and a higher bid shall have priority to lower bids (TSE Business Regulations, rule 10, para. 2, item 1, etc.).

The seller selling the goods at a lower price and the buyer buying the goods at a higher price always receive higher priority in any market, and such practice is the principle of price competition. What happens when two or more quotations for a same price are given? The rule of timing priority applies in such a case.

The rule of timing priority is the rule giving priority to the bids or offers made earlier when two or more bids or offers are made at the same price (TSE Business Regulations, rule 10, para. 2, item 2(a), etc.).

The Enforcement Regulations of the Business Regulations set forth the rules for cases where two or more bids or offers for the same price are made at the same time or for cases where the timing of bids or offers with the same price is not clear. In any case, the basic principle is to prioritize the bids or offers in order of the person with the greater quantity of bids or offers to the smaller quantity of bids or offers (TSE Business Regulations, rule 10, para. 2, item 2(b); TSE Business Regulation Enforcements Rules, rule 6, etc.).

Market orders always have price priority over other order. When there are more than two market orders, such market orders hold the same priority and all volumes are executed at the same time (TSE Business Regulations, rule 10, para. 2, item 3, etc.). However, when a closing price for an afternoon trading session is determined at a price limit as mentioned below, all remaining market orders shall be deemed to be limit orders to buy or sell at the said price and in this instance, all bids and offers at the said price shall be deemed to have been made simultaneously (TSE Business Regulations, rule 10, para. 4). (See “4.3 (1) Price Limit of Quotations” of this Chapter for details)

The priorities of trade contract prices are formed through the competition among bids and offers, respectively. How is a contract price determined? The individual auction is the method that determines the contract price (TSE Business Regulations, rule 12, para. 1, etc.).

In the individual auction, price of transaction is established when the lowest sell quote among many quotes and the highest buy quote among many quotes match. Then, transactions shall be effected according to the order of priority described above (TSE Business Regulations, rule 10, para. 2 and rule 12, para. 2, etc.).

Another method of determining a transaction price is the Itayose. In this method, if a certain volume (total volume of buy quotes and sell quotes listed in (i) through (iii) — (i) total volume of the market orders; (ii) total volume of sell quotes that does not reach the price in question and the total volume of buy quotes that exceeds the price in question; and (iii) total volume of the either buy quotes or sell quotes(for bonds only, the volume more than the buy and sell unit for opposing
orders) of bids and offers at the price in question) of the buy quote and sell quote matches at a certain price, a trade is established by using the price as a contract price between corresponding quotes according to the order of priority (TSE Business Regulations, rule 12, para. 3, etc.). This method is used when (i) determining the opening price for a trading session; (ii) determining the first contract price following the suspension of trading of a certain issue, etc.; (iii) determining the closing price for a trading session; and (iv) in addition to (i) through (iii) above, determining the contract price while the quotations are being posted as prescribed by the TSE.

JGB futures transactions, index futures transactions, securities options transactions, government bond securities futures option transactions and index options transactions are traded generally in the same way as securities trades.

(i) *Itayose* (see Chart 5-1)

a. A sell quote for market order/15,000 shares (a) and a buy quote for market order/20,000 shares (A) are matched. A buy quote for market order/5,000 shares remains as a result.

b. The remaining 5,000 shares of the buy quote are matched with the lowest sell quote of JPY495/5,000 shares (b). At this point, the entire volume of buy quote
(A) is executed. However, the buy orders at rates of (B), (C), (D), and (E), which are higher than JPY495, are not executed.

c. Among the remaining quotes, the highest buy quote of JPY499/3,000 shares (B) is matched with the lowest sell quote of JPY496/5,000 shares (c). The remaining 2,000 shares of order (c) are then matched with the buy quote of JPY498/5,000 shares (C). The remaining 3,000 shares of (C) are matched with the sell quote of JPY497/2,000 shares (d).

d. At this point, 1,000 shares of the buy quote of JPY498/5,000 shares (C) remain. This is then matched with the sell quote of JPY498/3,000 shares (e). Then the conditions for determining a contract price through itayose method are established at the matching buy and sell at JPY498. As a result, the opening price is determined at JPY498 and all quotes matched in the matching process are traded at the uniform price of JPY498.

![Chart 5-2](chart52.png)

<table>
<thead>
<tr>
<th>(Section to enter the sell-market quotes)</th>
<th>(ISSUE)</th>
<th>(Section to enter the buy-market quotes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>501</td>
<td>2,000</td>
<td>500</td>
</tr>
<tr>
<td>(g)</td>
<td>3,000</td>
<td>(f)</td>
</tr>
<tr>
<td>499</td>
<td>2,000</td>
<td>(e)</td>
</tr>
<tr>
<td></td>
<td>497</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>486</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>495</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>484</td>
<td>6,000</td>
</tr>
</tbody>
</table>

(ii) Zaraba (see Chart 5-2)

a. A sell order of JPY497/3,000 shares (h) is placed after the opening price was determined. The 3,000 shares are matched with a highest buy quote of JPY497/5,000 shares (D). 3,000 shares are matched at JPY497 and 2,000 shares remain.

b. Next, a buy quote of JPY498/5,000 shares (H) is placed. The 5,000 shares are matched with the lowest sell quote of JPY498/2,000 shares (e). 2,000 shares are matched at JPY498 and 3,000 shares remain.

c. Next, a sell order of 6,000 shares (i) by the market order is placed. First, 6,000 shares are matched with the highest buy quote of JPY498/3,000 shares (H). Then the remaining shares are matched with the next highest buy quote of JPY498/3,000 shares (H).
quote of JPY497/2,000 shares (D). Finally the remaining 1,000 shares are matched with a buy quote of JPY496/4,000 shares (E). The contract price for each order is JPY498, JPY497 and JPY496, respectively.

Measures for the Rationalization of Securities Trading, Etc.

The core functions of the Exchange lie in its management of trades conducted in the market. The management of trades conducted in the market can be categorized into two main aspects: (i) daily management of the market to ensure the systematic and methodical execution and operation of trades and (ii) the management of rationalization measures that have been established to eliminate unfair trading and to prevent the occurrence of abnormal situations.

The most notable rules among the securities trade rationalization measures that have been established by the Exchange are described below:

(1) Price Limit of Quotations

Volatile fluctuations in securities prices lead to unexpected losses for investors. In order to prevent this, the TSE limits the daily price fluctuation to a certain proportion of the previous day’s closing price (TSE Business Regulations, rule 14, para. 5). The price limits for trading share certificates are categorized into 34 levels according to the price of the securities (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 2) (see Chart 5-3).

In addition, the price limit of a convertible bond-type bond with share option is computed by multiplying the price limit for the listed share certificates of the issuer underlying the convertible bond by the Conversion Ratio (Issuance price per face value of JPY100/Issue price of the stocks to be issued upon exercise of the share options). The daily price limit for exchangeable bonds where the underlying share certificates are listed on a financial instruments exchange is the daily price limit of such listed share certificates multiplied by exchange ratio (face value per JPY100/exchange price). Where the underlying share certificates are listed on other domestic financial instruments exchange, the daily price limit figured by multiplying the latest final price on such other domestic financial instruments exchange by the exchange price (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 3). In addition, the price limit on bonds is one yen (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 2-2).

The TSE may modify the allowed price limits for all or part of issues when it finds abnormal conditions in trades or when it finds or suspects that abnormal trading conditions (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 5).

The OSE applies price limits on bids and offers with regard to government bonds futures transactions, index futures transactions, securities options transactions, government bond futures options transactions and index options transactions.
Pursuant to Rule 65 of the TSE Business Regulations, the TSE has the right to implement the following regulatory measures concerning securities trading and the entrustment of such securities trading in the TSE markets when it finds or suspects abnormal conditions in trading (TSE Rules on Regulatory Measures Concerning Securities Trading or Its Brokerage, rule 1):

(i) Limiting the increase of the rate of margin for margin sells or margin buys, or increase of the rate of margin for when-issued transactions, and limiting the use of margin securities in lieu of the margin;

(ii) Reducing the ratio to be multiplied by the market value where margin securities are deposited in lieu of a cash margin in a margin sale or margin buy or a when-issued transaction;

(iii) Where limits are imposed on the use of margin securities in a margin sale or margin buy, requiring trading participants to deposit in cash all or a portion of the margin that cannot be substituted with securities with the TSE;

(iv) Limiting or prohibiting margin sales or margin buys (including margin sales or margin buys conducted by trading participants);

(v) Limiting the total number of shares sold or purchased in when-issued transactions;

(vi) The following enumerated actions regarding the trading margin deposited by trading participants for when-issued transactions:
   a. Moving up the trading margin deposit date;
   b. Increase the amount of trading margin, and limit substitution of trading margin with securities; and
   c. Progressively increase the trading margin where the total number of issues sold or purchased exceeds a certain level;

(vii) Accepting the deposits of the sold securities or purchase prices on the basis of the entrustment of customers, before the settlement date of the transaction;

(viii) Limiting or prohibiting trading participants from conducting sales or purchases for their own account (including sales and purchases based on discretionary trading agreements); and

(ix) Daily publication of margin trading balance.

The OSE also implements regulatory measures for the brokerage of government bonds futures transactions, index futures transactions, securities options transactions, government bond futures options transactions and index options transactions.

The margin trading balance will be published daily if an issue available for margin trading is designated as a stock on alert (TSE Rules on Regulatory Measures Concerning Securities Trading, Etc. or Its Brokerage, rule 2).

Necessary measures regulating trading or the entrustment of trades in connection with issues under trade monitoring (TSE Rules Concerning an Issue under Trade Monitoring, rule 4, para. 1). Furthermore, if the issue under trade monitoring is an issue to which margin trading is available, the margin trading balance will be disclosed daily (TSE Rules Concerning an Issue under Trade Monitoring, rule 4, para. 2).
### Chart 5-3  Price Limits in Trades in Share Certificates

<table>
<thead>
<tr>
<th>Base Price</th>
<th>Daily Price Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than</td>
<td>Upward/Downward</td>
</tr>
<tr>
<td>JPY 100</td>
<td>JPY 100</td>
</tr>
<tr>
<td></td>
<td>JPY 200</td>
</tr>
<tr>
<td>JPY 200</td>
<td>JPY 500</td>
</tr>
<tr>
<td>JPY 500</td>
<td>JPY 700</td>
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<tr>
<td>JPY 700</td>
<td>JPY 1,000</td>
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<tr>
<td>JPY 1,000</td>
<td>JPY 1,500</td>
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<td>JPY 1,500</td>
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<td>JPY 15,000</td>
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<td>JPY 15,000</td>
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<tr>
<td>JPY 30,000,000</td>
<td>JPY 50,000,000</td>
</tr>
<tr>
<td>JPY 50,000,000—or more</td>
<td>JPY 10,000,000</td>
</tr>
<tr>
<td>Upward/Downward</td>
<td>JPY 30</td>
</tr>
</tbody>
</table>

### Cancellation of Securities Trading, Etc.

In financial instruments trading, it is the basic premise that contracts that are once effected shall not be cancelled and shall be settled, and the certainty of settlement is one of the bases of reliability of the financial instruments market. However, in cases a contract in a scale which cannot be normally assumed is effected due to errors and the settlement cannot be conducted for a
long term, etc., the functions of a financial instruments market will be paralyzed and could cause a massive uproar.

Accordingly, if a trade, etc. is effected based on an erroneous order and the Exchange determines that the settlement thereof is extremely difficult and could cause confusion in the exchange market, etc., the Exchange may, as prescribed by the Exchange, cancel a trade, etc. (TSE Business Regulations, rule 13, para. 1 and para. 2; OSE Business Regulations, rule 25, para. 1 and para. 2).

### Development of Systemization of Trades

In the past, the Exchange has conducted all trades in share certificates on the trading floor by manpower, but after the operation of the computer-based trading system targeting a part of the TSE second section issues in January 1982, the systemization has developed, and trading on the trading system has become mainstream (trading on the trading floor was completely abolished in April 1999 on the TSE and in July 1999 on the OSE).

The Exchange has renewed and improved the trading system from time to time such as by responding to the increase of transactions due to the spread of the Internet, and in recent years in particular, the widespread use of algorithm transactions (a transaction method of automatically repeating orders by computer programs using mathematical models) through IT development has required the trading system to respond to the speeding up of market order and contract processing or the rapid increase of transactions.

As a result, the TSE has been operating trading systems with high speed, reliability and expandability such as the Tdex+System (targeting options transactions; futures transactions added in November 2011) since October 2009, and arrowhead (targeting stocks, etc.) since January 2010. On the OSE, a derivatives trading system called J-GATE was put into operation in February 2011. The replacement of arrowhead made in 2015 has further increased the system’s reliability, usability and performance, and replacement was also made for J-GATE on July 19, 2016.

In addition, the Exchange provides services to respond to the needs for faster transactions by market participants such as the collocation service (a service collocating the servers of the exchange and trading participants which minimizes the physical distance between the servers and contributes to the shortening and speeding up of time required for communication).

### System Development by Exchanges for Persons Engaged in Low Latency Trading

In order to respond to the low latency trading on financial instruments markets in Japan, the FIEA was amended in 2017 to introduce the registration system for persons engaged in low latency trading(*), effective as of April 2018, and to develop a framework of regulations including system development, risk management, and provision of information to the regulatory authorities.

Following this legal amendment, exchanges have also developed various systems for persons engaged in low latency trading.
Specifically, in order to enable the exchange to understand the trading strategy according to which orders in low latency trading are placed, a trading participant that is to make a bid or order in low latency trading is required to disclose to the exchange that the bid or order is made for low latency trading, while indicating the classification of the trading strategy for low latency trading (TSE Business Regulations, rule 14, para. 1, item 7, etc.; OSE Business Regulations, rule 26, para. 1, item 2, etc.). Whenever a customer entrusts the sale and purchase of securities in low latency trading to a trading participant, the customer must give instructions to the trading participant regarding the fact that the entrusted transaction is low latency trading and the classification of the trading strategy for low latency trading (TSE Brokerage Agreement Standards, rule 6, para. 1, item 13 and para. 5; OSE Brokerage Agreement Standards, rule 9, para. 1, item 10 and para. 4).

Furthermore, when a self-regulation organization examines the details of the sale and purchase of securities in low latency trading on a financial instruments exchange market and requests the customer who conducts low latency trading to submit necessary documents and provide a factual explanation, the customer must do as requested (TSE Brokerage Agreement Standards, rule 56; OSE Brokerage Agreement Standards, rule 36), and the trading participant entrusted by the customer with the sale and purchase must implement appropriate measures to ensure that the customer responds to the self-regulation organization’s request (TSE Trading Participant Regulations, rule 21-2; OSE Trading Participant Regulations, rule 19-2).

* The term “low latency trading” means (i) an act for which the determination on performance of the act is automatically made by an electronic data processing system, (ii) the provision of information necessary for conducting the purchase and sale of securities, etc. based on that determination to a financial instruments exchange, etc. is made by means of information and (iii) communications technology that is specified by Cabinet Office Order as a method for shortening the time normally required for the provision of information (FIEA, art. 2, para. 41).

## 5 Clearing and Settlement Regulations

The Clearing and Settlement Regulations of the Exchange provide the rules for clearance and settlement of securities trading, etc. on exchange markets pursuant to the provision in the Business Regulations which states “matters concerning the clearance and settlement or trades, etc. of securities conducted on the Exchange shall be provided for by the Clearing and Settlement Regulations” (TSE Business Regulations, rule 1-3, para. 2; OSE Business Regulations, rule 2, para. 2).

Under amendments to the Securities and Exchange Act made by the “Act Concerning the
Coordination, Etc. of Laws Related to the Coordination of the Securities Markets Pursuant to the Reform of the Securities Settlement System, Etc.” (the so-called “Securities Settlement System Reform Act”) implemented in January 2003, the Japan Securities Dealers Association and the exchanges jointly established a central securities transaction clearing organization (hereinafter referred to as the “clearing organization”) in order to clear transactions conducted on each exchange in a more uniform manner. (the clearing organization is the Japan Securities Clearing Corporation (hereinafter simply referred to as the “JSCC”), which commenced operations in January 2003 and merged with Japan Government Bond Clearing Corporation on October 1, 2013).

The TSE Clearing and Settlement Regulations appoint the JSCC as the designated clearing organization (TSE Clearing and Settlement Regulations, rule 3), and the details of the clearance or settlement of securities transactions are prescribed by the clearing organization’s business method manual (TSE Clearing and Settlement Regulations, rule 4).

Meanwhile, as of July 16, 2013, the OSE’s clearing function for market derivatives transactions was integrated into the JSCC through the organizational conversion upon the business integration between the TSE and the OSE.

Accordingly, the OSE Clearing and Settlement Regulations appoint the JSCC as the designated clearing organization (OSE Clearing and Settlement Regulations, rule 3), and the details of the clearance or settlement of market derivatives transactions are prescribed by the clearing organization’s business method manual (OSE Clearing and Settlement Regulations, rule 4).

In this Section, the outline of the clearing and settlement system is explained. For additional details, please refer to the business method manual of the clearing organization.

5 1 Clearing Organization System

The framework of the clearing and settlement system consists of the following interrelated components: (i) settlement conducted between clearing participants (participants of the clearing organization) and the clearing organization (the clearing organization system); (ii) the realization of DVP (Delivery Versus Payment: a settlement method which eliminates principal risk (referring to the risk that the purchaser does not pay the price for the securities upon the delivery of the securities by the seller, or the risk that the purchaser, who has paid the price for the securities, is unable to acquire the securities or take back the principal of the payment in whole when the seller does not deliver the securities) by making the settlement of securities mutually conditional upon the receipt of funds) by interposing the clearing organization; and (iii) the realization of effective netting among multiple parties (multilateral netting) in settlement by interposing the clearing organization.

The trading of securities in financial instruments markets is a contract (promise) for the sale and purchase (exchange) of securities and funds, and is completed through physical transfer of those securities and funds, i.e., “settlement.” The agency that effectuates the transfer of rights to
securities or funds is known as a “settlement facility.” For the settlement of securities, it is settlement facility such as the Japan Securities Depository Center, Inc., and for the settlement of funds, it is the fund settlement banks, or the Bank of Japan that handle the transfer of rights (settlement) that is completed by an account transfer. “Clearing” is a necessary function to complete this settlement in an efficient and safe manner, and providing such function is the raison d’être of the “clearing organization.”

In financial instruments markets, various market participants are continuously engaged in trading activities. If the transaction is settled directly with the counterparty to such transaction (the gross method), the volume of securities and funds necessary for settlement could be substantial, thereby imposing significant costs on the parties to the settlement (deliverer of securities and payer of funds).

To address this problem, in the trading of share certificates, etc., the multilateral trading relationship of these market participants is transformed into a bilateral relationship between each of them and the clearing organization by having the clearing organization act as counter party when exchanging the securities and funds to settle a trade. In other words, the clearing organization becomes the counterparty to the settlement in lieu of the actual party to the trade, and conducts the exchange with market participants by simultaneously assuming the obligations of one party to the trade (delivery of securities or payment of funds) and acquiring the corresponding rights of the other party (receipt of securities or funds).

Also, to achieve efficient delivery and receipt of securities and funds, the clearing organization conducts netting, in which it offsets corresponding volumes of securities and amounts of funds in transactions conducted by clearing participants the settlement dates of which are the same. After conducting the netting and based on the results of such netting, the clearing organization provides transfer directions to the settlement facility.

In this manner, substantial netting among a large number of participants (multilateral netting) is realized by transforming buy-sell relationships created by a large number of market participants into the bilateral relationships between clearing house and then conducting netting.

Further, the clearing organization provides a mechanism which guarantees the performance of the settlement by using the initial margin deposit.

These are the fundamental functions of the clearing organization.

5 2 Development of the Legal System

In January 2003, the Securities and Exchange Law was amended by the Securities Settlement System Reform Act and the legal basis for the clearing organization was clarified. Following the enactment of the Financial Instruments and Exchange Act in September 2007, the act now defines the business of assuming obligations arising from securities transactions from financial instruments business operators and registered financial institutions as the “financial instruments obligation assumption service” (FIEA, art. 2, para. 28), and stock companies that receive a license
or approval to conduct the financial instruments obligation assumption service are positioned as “financial instruments clearing organizations” (FIEA, art. 2, para. 29).

In addition, the business of brokering transactions conducted by another person to the clearing organization, or “brokerage for clearing of securities, etc. (FIEA, art. 2, para. 27)” has been provided as a form of the financial instruments business (FIEA, art. 2, para. 8, item 5), thereby enabling persons other than trading participants on an exchange to similarly become clearing participants with the clearing organization regarding the brokerage for clearing of securities, etc. in exchange transactions.

Further, the FIEA prescribes that, in cases where a clearing participant defaults on its settlement obligations and causes losses to the clearing organization, the clearing organization has the right to receive satisfaction ahead of other creditors out of the clearing deposit such as the initial margin deposit, etc. of the clearing participant (FIEA, art. 156-11). Additionally, to protect itself against losses in conducting the financial instruments obligations assumption service, the clearing organization must implement certain measures, such as stating in the business method manual that the clearing participant will ultimately be responsible for the entire amount of the loss (the mutual guarantee system by clearing participants) (FIEA, art. 156-10). If the default of settlement obligations by an insolvent clearing participant causes the clearing organization itself to fail, it could spark a systemic risk that could have a major impact on the entire settlement of securities trading, etc. The relevant laws were coordinated to see to it that this kind of situation does not occur.

5 3 Clearing Participants System

A person who possesses clearing qualifications is called a clearing participant. Qualifications for engaging in clearing of securities trading on the exchange market are classified into the following categories based on the type of transaction:

(i) Spot Clearing Qualifications
  Clearing qualifications for securities transactions
(ii) Government Bond Futures, Etc. Clearing Qualifications
  Clearing qualifications for government bond futures transactions and government bond options transactions
(iii) Index Futures, Etc. Clearing Qualifications
  Clearing qualification for index futures transactions, index options transactions and securities option transactions
(iv) FX Clearing Qualifications*
  Clearing qualification for exchange FX transactions

Clearing qualifications in each category are subdivided into clearing qualifications that do not
allow the brokerage of securities, etc. clearing ("internal clearing qualifications"), and clearing qualifications that do allow the brokerage for clearing of securities, etc. ("external clearing qualifications").

In order to acquire a clearing qualification, it is necessary to file an application with the clearing organization and be approved. The clearing organization will conduct an examination as to the applicant’s administrative organization, financial base and business execution system regarding its application for clearing qualifications.

Clearing participants are required to deposit clearing deposits, etc. such as the initial margin deposit, required by the clearing organization under the Clearing Participant Agreement and other rules and regulations in order to secure the performance of the clearing participant’s obligations vis-à-vis the clearing organization. Clearing participants are required to submit periodic reports to the clearing organization containing financial information, etc. in order to allow the clearing organization monitor the status of their finances.

In addition, a clearing participant must notify the clearing organization in advance in the event that it will discontinue the financial instruments business, or dissolve in a merger or transfer its operations, etc. Further, a clearing participant must report to the clearing organization if the participant is likely to become insolvent or if it fails to meet certain prescribed financial criteria.

Moreover, the clearing organization may request clearing participants to submit a report or materials when the clearing organization investigates the status of the financial condition of clearing participants or the status of their compliance with the regulations. Additionally, the clearing organization may inspect the status of the business and finances of clearing participants and their books and records.

*Following the temporary suspension of trading on the OSE’s exchange FX margin transactions market, there is no clearing participant qualified for FX clearing (see page 2.1 “General Provisions” in this Chapter).

### Brokerage for Clearing of Securities, Etc.

“Brokerage for clearing of securities, etc.” means transactions conducted, pursuant to the provisions in the business method manual of the clearing organization, by a clearing participant upon an entrustment from a customer (a non-clearing participant that is a trading participant on an exchange) and for the customer’s account, under which the customer acts as the agent of the clearing participant to consummate the transaction on the condition that the clearing organization will assume the obligations pertaining to the transaction (FIEA, art. 2, para. 27).

In other words, brokerage for clearing of securities, etc. is, in substance, a sale or purchase, etc. of securities by the non-clearing participant who entrusts the clearing participant with an act to execute a sale or purchase, etc. in the name of clearing participant in order to have the clearing participant conduct clearing between the clearing participant and the clearing organization. This differs from general brokerage activities in that the clearing participant is not expected to play a
role in introducing the parties or adjusting the price of the trading, etc.; the non-clearing participant entrusting the transaction will have already determined the substantive details of the transaction.

When a quotation by a trading participant who is a non-clearing participant satisfies the Exchange regulations, the non-clearing participant may entrust the brokerage for clearing of securities, etc. to a clearing participant, and if the clearing participant accepted it, the transaction will be completed in the name of such clearing participant but for the account of the non-clearing participant (such a clearing participant is referred to as an “external clearing participant”).

Clearing Brokerage Contract

A non-clearing participant, when entrusting brokerage for clearing of securities, etc., must enter into a clearing entrustment contract with a clearing participant (TSE Trading Participant Regulations, rule 24-3; OSE Trading Participant Regulations, rule 25).

The clearing entrustment contract uses the template prescribed by the clearing organization pursuant to its regulations. The items to be listed in this contract include the fact that when a non-clearing participant purports to act as agent of the clearing participant to consummate a clearing-eligible transaction, the non-clearing participant applies for the brokerage for clearing of securities, etc. and such application was accepted by the clearing participant.

Furthermore, a non-clearing participant may enter into multiple clearing entrustment contracts with several external clearing participants, but the Exchange requires trading participants who are non-clearing participants to designate one firm (the designated clearing participant) from among those several clearing participants as a standing entrustee for the brokerage for clearing of securities, etc. (TSE Trading Participant Regulations, rule 24-4, para. 1; OSE Trading Participant Regulations, rule 27, para. 1). Also, in order to obtain the trading qualifications, the Exchange requires an applicant to either acquire clearing qualifications from the clearing organization, or if such applicant does not acquire clearing qualifications, to enter into a clearing entrustment contract and appoint a designated clearing participant (TSE Trading Participant Regulations, rule 5, para. 1; OSE Trading Participant Regulations, rule 32, para. 2).

Settlement Performance Guarantee System

The clearing organization conducts risk management relating to clearing participants by collecting collateral (initial margin deposit, etc.) sufficient to cover the risk of each clearing participant based on its transactional performance and by reviewing that amount on a periodic basis.

In the event that a clearing participant become insolvent, the losses caused by the failure of
such clearing participant are indemnified in the following order: (i) initial margin deposit of the defaulting participant; (ii) in cases where a third party, such as the entities that operate each market, provides an indemnity for damages, the amount thereof; (iii) surplus of the clearing organization; and (iv) mutual guarantee among clearing participants (clearing participants other than defaulting participants compensate the rest of the losses).

6 Brokerage Agreement Standards

6 1 General Rules

When trading participants accept the entrustment of the securities trading, etc. on the exchange market, they must follow the brokerage agreement standards prescribed by the Exchange.

This is in response to the legal provision (FIEA, art. 133, para. 1), and the points are (i) the contracts for entrustment between trading participants and their customers for transactions at-exchange must be concluded according to the brokerage agreement standards; and (ii) the brokerage agreement standards shall be prescribed by the financial instruments exchanges and must be approved by the Prime Minister (the Commissioner of the Financial Services Agency) (FIEA, art. 149, para. 1; art. 194-7, para. 1). In other words, trading participants and customers must conclude the agreement on an equal footing, and the brokerage agreement standards standardize the contents of the agreement with a view to standardizing transactions on the exchange and to protect investors.

Therefore, not only trading participants but also customers, as co-equal parties to the brokerage agreement standards, are obligated to understand and comply with the standards.

However, in reality there are few customers who fully understand the contents of the brokerage agreement standards, so trading participants must actively encourage customers to conduct transactions only after they fully understand the brokerage agreement standards.

Below we will give an explanation focused on major points of the brokerage agreement standards.

6 2 Accepting the Entrustment of Transactions

When customers entrust trading, etc. of securities to a trading participant, they are obligated to provide their addresses, full names, etc. (TSE Brokerage Agreement Standards, rule 3; OSE Brokerage Agreement Standards, rule 4). This corresponds to the duty of the trading participant to
conduct an examination into certain matters when it accepts entrustment of transactions under the provisions of Rule 21 of the TSE Trading Participant Regulations and Rule 19 of the OSE Trading Participant Regulations and is important from the perspective of the prevention of incidents.

In addition, at the time of the entrustment of securities transactions, a customer must give a clear instruction to a trading participant regarding the type of trading, the issue, the distinction between sales and purchases, the quantity, the price limit, the timing of the sale or purchase in the trading session, the effective term of the contracted order and whether or not it is a short sale or margin trading (TSE Brokerage Agreement Standards, rule 6, para. 1).

Upon entrusting a transaction in government bonds, the customer must give an instruction to the trading participant concerning the issue, the distinction between sales and purchases, the quantity, the price limit, the timing of the sale or purchase in the trading session, the effective term of the contracted order (TSE Brokerage Agreement Standards, rule 7).

Government bond futures transactions: the issue; the contract month; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, a.).

Index futures transactions: the underlying index; the contract month; if the transaction concerned is based on the Nikkei Stock Average or TOPIX, whether the transaction is a large contract or mini contract; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, b.).

Securities options transactions: the underlying security; the quantity of an underlying security for one trading unit of the security option; whether the option concerned is a security put option or security call option; the contract month; the exercise price; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, c.).

Government bond futures options transactions: the underlying issue of the government bond futures contract effected by exercise; whether the option concerned is a government bond put option or government bond call option; the contract month; the exercise price; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, d.).

Index options transactions: the underlying index; whether the option concerned is an index put option or index call option; the contract month; the exercise price; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, e.).

In the case of accepting a market derivatives transaction entrusted by a customer as mentioned above, the trading participant must obtain from the customer a written agreement for setting up futures/options trading account prepared in the form designated by the OSE (OSE Brokerage Agreement Standards, rule 5, para. 2).

*1 “Other required matters” as referred to above include: whether the transaction concerned is for a new sale or new purchase, or resale or repurchase; in the case of strategy trading,*2 an instruction to that effect; the quantity; the limit of price (or limit of strategy price in the case of strategy trading); the conditions for validity or executed volume; when adding conditions to bids and offers, the conditions; the trading hours; and the validity period of customer’s order (OSE Brokerage Agreement Standards, rule 9, para. 1, item 2 through item 9).

*2 “Strategy trading” refers to a transaction conducted by a trading participant in the trading session, which is for simultaneous execution of sales or purchases in multiple contract months.
or of multiple issues pertaining to market derivatives transactions (limited to sales and purchases for the same customer’s account or its own account) (OSE Business Regulations, rule 17, para. 1).

### Delivery and Other Settlement Methods

**1) Cash Transactions**

When entrusting trading of securities pertaining to cash transactions, customers must provide the sold securities or the purchase price to trading participants by a certain time mutually agreed between the trading participants and customers on the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 10).

**2) Regular Transactions**

When entrusting trading of securities pertaining to regular transactions, customers must provide the sold securities or the purchase price to trading participants by 9:00 a.m. of the third day (to be shortened to the “second day” from July 16, 2019) following the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 11, para. 1).

As regards regular transactions concluded on the following days, customers must provide the sold securities or the purchase price to trading participants by 9:00 a.m. of the fourth day (to be shortened to the “third day” from July 16, 2019) following the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 11, para. 2):

(i) For convertible type bonds with share options or exchangeable bonds, the day prescribed by the TSE as the day for trading based on new exercise or exchange terms; and

(ii) For convertible type bonds with share options and exchangeable bonds with put options, the date prescribed by the TSE as the ex-rights date for the put option.

**3) When-Issued Transactions**

For the entrustment of trading of securities pertaining to when-issued transactions, customers must provide the sold securities or the purchase price to members by 9:00 a.m. on the settlement day determined by the TSE (TSE Brokerage Agreement Standards, rule 13).

**4) Trading of Government Bonds**

When customers initiate government bond transactions, they must deliver the government bonds to be sold or the purchase price to trading participants by the time and date designated by the trading participant (TSE Brokerage Agreement Standards, rule 14).

**5) Calculation of Daily Interest**

In principle, for trading of bonds, convertible-type bonds with share options and
exchangeable bonds, the daily interest up to the settlement date of such trading must be calculated
by multiplying the total amount of the face value by the interest rate of the security divided by the
number of days applied, and the accrued interest to the date of settlement must be added to the
trading value (TSE Brokerage Agreement Standards, rule 16).

(6) Market Derivatives Transactions

In cases where a customer makes a settlement of government bond futures transactions, in
the event that a customer incurs any loss, the customer shall pay the trading participant the amount
of money equivalent to the amount of such loss by the time specified herein according to the type
of settlement: if the customer makes the settlement by effecting resale or repurchase, by the time
and date designated by the trading participant but no later than the day following the day on which
the trading day on which the resale or repurchase is effected ends; if the customer makes the
settlement by delivery/payment for large contracts, by the time and date designated by the trading
participant but no later than the day following the day on which the last trading day of the relevant
contract month ends; and if the customer makes the final settlement for mini contracts, by the time
and date designated by the trading participant but no later than the final settlement date of the
relevant contract month (OSE Brokerage Agreement Standards, rule 14-2-2, para. 3). For the
settlement by delivery/payment for large contracts, a customer shall deliver the sold government
bonds or pay the purchase prices to the trading participant by the time and date designated by the
trading participant as necessary for the settlement by delivery/payment for large contracts (OSE
Brokerage Agreement Standards, rule 14-10).

In cases where a customer makes a settlement of index futures transactions, in the event that
a customer incurs any loss, the customer shall pay the trading participant the amount of money
equivalent to the amount of such loss by the time specified herein according to the type of
settlement: if the customer makes the settlement by effecting resale or repurchase, by the time
and date designated by the trading participant but no later than the day following the day on which
the trading day on which the resale or repurchase is effected ends; if the customer makes the final
settlement, by the time and date designated by the trading participant but no later than the final
settlement date of the relevant contract month (OSE Brokerage Agreement Standards, rule 15,
para. 2).

When a customer makes a settlement of securities option transactions, the customer shall pay
the trading participant the trading prices for the purchase or the amount of money payable for
receiving the assignment of the exercise of options (limited to the assignment of the exercise of
options in securities options transactions for which the exercise can execute a contract for
receiving an amount of money calculated based on the difference between the exercise price and
the actual value) by the date and time designated by the trading participant but no later than the
day following the contract date or the day following the exercise date (OSE Brokerage Agreement
Standards, rule 17, para. 1 and para. 2). When a customer makes a settlement of sale or purchase
of the underlying securities by exercising the securities options, the customer must deliver the
money or securities involved in the sale or purchase of the underlying securities executed by the
said exercise of the options to the trading participant no later than 9:00 a.m. on the fourth day (to
be shortened to the “third day” from July 16, 2019) following the exercise date (OSE Brokerage Agreement Standards, rule 19, para. 1).

When entrusting a purchase of government bond futures options, a customer shall pay the trading participant the transaction price for the purchase by the time and date designated by the trading participant but no later than the day following the day on which the trading day on which the purchase is executed ends (OSE Brokerage Agreement Standards, rule 26-2-3).

When a customer makes a settlement of index options transactions, the customer shall pay the trading participant the option premium for the purchase or the amount of money payable for receiving the assignment of the exercise of options by the date and time designated by the trading participant but no later than the day following the day on which the trading day on which the transaction is executed ends or the day following the exercise date (OSE Brokerage Agreement Standards, rule 28).

6 4 When-Issued Transactions

Customers entrusting the trading participant for trading of when-issued transactions must state certain matters in a written agreement prepared in the form prescribed by the TSE, sign or affix its seal and submit it to the trading participant (TSE Brokerage Agreement Standards, rule 4, para. 1). Upon agreement between the trading participant and the customer, the customer may notify to the effect that he/she has consented to the details of the said written agreement presented by the trading participant to the trading participant via the Internet, and such notice shall be in lieu of the submission of the written agreement (TSE Brokerage Agreement Standards, rule 4, para. 2).

When the sale or purchase of when-issued transactions is concluded, the customer must deposit an amount at least 30% of the contract price as a margin deposit by the date and time designated by the trading participant which would be no later than the “second day” (to be changed to “noon on the second day” from July 16, 2019) following the date when the trade was concluded (TSE Brokerage Agreement Standards, rule 31, para. 1).

However, when the sale and purchase positions of the same issue by the same customer are matched, the trading participant shall waive the right to require the customer to submit a margin in relation to the latter transaction (TSE Brokerage Agreement Standards, rule 31, para. 2), and must return the margin in relation to the former transaction at the request of the customer (rule 38, para. 1). In this case, if any computed loss arises due to offset trading, the customer must submit the loss amount (TSE Brokerage Agreement Standards, rule 38, para. 2).

The margin securities below may be used in lieu of a cash margin, and the substitute price thereof must be less than the amount obtained by multiplying the market price as of the day prior to the date contributed by a ratio (substitution ratio) enumerated below (mutatis mutandis application of TSE Brokerage Agreement Standards, rule 40 in rule 32).
<table>
<thead>
<tr>
<th>Margin Securities</th>
<th>Substitution Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Share certificates, etc. listed on domestic financial instruments exchanges</td>
<td>80%</td>
</tr>
<tr>
<td>(ii) Government bonds</td>
<td>95%</td>
</tr>
<tr>
<td>(iii) Municipal bonds</td>
<td>85%</td>
</tr>
<tr>
<td>(iv) Bonds issued by juridical person pursuant to special enabling legislation: Government guaranteed bonds</td>
<td>90%</td>
</tr>
<tr>
<td>Others</td>
<td>85%</td>
</tr>
<tr>
<td>(v) Corporate bonds of listed companies (other than foreign corporations) on domestic financial instruments exchanges (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator upon issuance)</td>
<td>85%</td>
</tr>
<tr>
<td>(vi) Bonds with share options of a company (other than a foreign corporation) listed on a domestic financial instruments exchange (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator upon issuance)</td>
<td>80%</td>
</tr>
<tr>
<td>(vii) Exchangeable bonds that are listed on a domestic financial instruments exchange (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator upon issuance)</td>
<td>80%</td>
</tr>
<tr>
<td>(viii) Foreign government bonds listed on domestic financial instruments exchanges</td>
<td>85%</td>
</tr>
<tr>
<td>(ix) Foreign municipal bonds listed on the domestic financial instruments exchanges</td>
<td>85%</td>
</tr>
<tr>
<td>(x) Yen-denominated bonds of the International Bank for Reconstruction and Development (World Bank bonds)</td>
<td>90%</td>
</tr>
<tr>
<td>(xi) Yen-denominated bonds of the Asian Development Bank</td>
<td>90%</td>
</tr>
<tr>
<td>(xii) Yen-denominated foreign bonds issued by foreign corporations (excluding issuers in (viii) through (x), above) and listed on the domestic financial instruments exchanges; and</td>
<td>85%</td>
</tr>
<tr>
<td>(xiii) Investment trust beneficiary certificates and investment securities (limited to those listed on a domestic financial instruments exchange and those for which the Investment Trust Association, Japan announces market prices of previous day); and</td>
<td>85%</td>
</tr>
<tr>
<td>Beneficiary certificates of bond investment trusts</td>
<td>85%</td>
</tr>
<tr>
<td>Others</td>
<td>80%</td>
</tr>
</tbody>
</table>

When the total amount of the margin deposits received which is calculated by subtracting a
computational loss amount (the computational loss amount obtained by subtracting the profit due to market fluctuations and the profit due to off-setting trading from the loss due to market fluctuations and the loss due to offsetting trading) and the amount to be paid by the customer for when-issued transactions from the total margin submitted by the customer exceeds 30% of the contract value of securities pertaining to the when-issued transactions, trading participants may allow customers to withdraw the surplus (TSE Brokerage Agreement Standards, rule 33, para. 1; rule 34).

Where a part of the securities pertaining to when-issued transactions is settled, when the total amount of the guarantee deposits received from the customer exceeds 30% of the contract value of the securities pertaining to when-issued transaction (excluding the securities pertaining to the when-issued transactions to be settled), trading participants may allow customers to withdraw the surplus margin to be used for the settlement (TSE Brokerage Agreement Standards, rule 33, para. 2, item 1).

Where a part of the securities pertaining to when-issued transactions is settled and withdrawal is allowed for the settlement under the condition that all of the securities purchased in the when-issued transaction or the sales proceeds for the securities sold are deposited as margin, trading participants may allow the customer to withdraw the margin only if the total amount of the guarantee deposits received is at least 30% of the contract value of the securities pertaining to when-issued transactions of the customer (TSE Brokerage Agreement Standards, rule 33, para. 2, item 2).

Where all securities pertaining to when-issued transactions are settled, trading participants may allow customer to withdraw all margin (TSE Brokerage Agreement Standards, rule 33, para. 2, item 3).

Where money or securities submitted as margin are replaced with other property, trading participants may allow customers to withdraw the margin within the range of the substituted amount (TSE Brokerage Agreement Standards, rule 33, para. 2, item 4).

Where trading participants newly conduct when-issued transactions for customers and when the total amount of guarantee deposits received exceeds 30% of the contract value of the securities pertaining to the when-issued transactions, the surplus can be allotted to the margin necessary for the new when-issued transactions (TSE Brokerage Agreement Standards, rule 33, para. 3).

When a computational profit is realized due to market fluctuations or offsetting trading, trading participants must not allow customers to withdraw the computational profit before the settlement of when-issued transactions or allot it to a margin to be newly submitted (TSE Brokerage Agreement Standards, rule 35).

When a computational loss has arisen due to market fluctuations or offset trading, trading participants may have customers additionally submit an amount equivalent to such loss as the margin (TSE Brokerage Agreement Standards, rule 36).

When a computational loss arises due to market fluctuations or offset trading and, as a result, the total amount of guarantee deposits received falls below 20% of the contract value of the securities pertaining to when-issued transactions, trading participants must require their customers to submit a variation margin so that the amount of margin is raised to equal at least 30% of the
contract value by the date and time designated by the trading participants which would be no later than the second day (to be changed to “noon on the second day” from July 16, 2019) following the date when the calculation loss is incurred (TSE Brokerage Agreement Standards, rule 37, para. 1).

### 6.5 Margin Trading

When customers wish to establish a margin trading account regarding the entrustment of trading of securities, they must file an application and be approved for margin trading by the trading participant (TSE Brokerage Agreement Standards, rule 5, para. 1).

When customers obtain approval from trading participants, the customers must enter certain items, sign or seal the margin account agreement prescribed by the TSE, and submit it to the trading participant (TSE Brokerage Agreement Standards, rule 5, para. 2). Upon agreement between the trading participant and the customer, the customer may notify the trading participant of the effect that he/she has consented to the details of the agreement presented by the trading participant via the Internet, and such notice shall be in lieu of the submission of the agreement (TSE Brokerage Agreement Standards, rule 4, para. 2 applied *mutatis mutandis* through rule 5, para. 3).

When customers who have a margin account do not specify that a transaction should be margin trading at the time of initiating the trade, trading participants cannot conduct such trade as margin trading (TSE Brokerage Agreement Standards, rule 6, para. 2). Furthermore, in such cases, offsetting transaction cannot be used for the settlement (Cabinet Office Ordinance Concerning Transactions under Article 161-2 of the Financial Instruments Exchange Act and Deposits Related Thereto, art. 10). Therefore, if customers wish to conduct margin trading, they must clearly state this to trading participants.

When a sale or purchase using margin trading is concluded, customers must submit an amount at least equal to the amount listed below in cash as a margin by the date and time designated by the trading participant which would be no later than the second day (to be changed to “noon on the second day” from July 16, 2019) following the date when trading is concluded (TSE Brokerage Agreement Standards, rule 39):

1. **If no other margin has been received at the time of submission:**
   - (i) If the amount obtained by multiplying 30% by the contract price (hereinafter “normal minimum amount”) is more than JPY300,000, the said amount; and
   - (ii) If the normal minimum amount would be an amount less than JPY300,000, JPY300,000;
2. **If margin has already been received at the time of submission:**
   - (i) If the sum of the margin received and the normal minimum amount for the new margin trading is more than JPY300,000, the normal minimum...
(ii) If the sum thereof is less than JPY300,000, the amount obtained by adding the difference to the normal minimum amount.

As regards the margin for margin trading, the same range of margin securities can be submitted in lieu of a cash margin for when-issued transactions, using the same substitution ratio (TSE Brokerage Agreement Standards, rule 40).

In addition, for margin trading as well as with when-issued transactions, there are rules related to the withdrawal of margin deposits and limits imposed on their withdrawal and allotment (it is, of course, necessary that the total amount of the margin is equal at least to JPY300,000, but a request for withdrawal cannot be accepted if it would reduce the margin to less than 30% of the contract amount), the prohibition regarding withdrawal of an amount equivalent to the computational profit due to market fluctuations, etc., additional submission of an amount equivalent to the computational loss due to market fluctuations, and the maintenance of margin (for margin trading, if the total of the deposit received falls below 20% of contract value of the securities pertaining to margin trading, trading participants must have customers submit an additional margin to keep the level at 20%.) (TSE Brokerage Agreement Standards, rule 44, rule 46, rule 47 and rule 48).

Lending of the sold securities or the purchase price, based on the sale price or the purchased securities and margin as collateral, shall be conducted on the settlement day of the sale or the purchase of such margin trading (TSE Brokerage Agreement Standards, rule 41, para. 1). The repayment deadline is the next day after the lending, and if there is no notice of repayment by the day that is three days prior (to be shortened to “two days prior” from July 16, 2019) to that date, the deadline date is deferred daily. However, it cannot be deferred beyond the third day (to be shortened to the “second day” from July 16, 2019) following the six-month corresponding date of the day when the sale or purchase is concluded using standardized margin trading (meaning margin trading that are conducted according to the rules prescribed by the TSE regarding broker loan rates and deadlines for deferred repayment; hereinafter the same) (TSE Brokerage Agreement Standards, rule 43).

If a trading participant lends the purchase price or the securities to be sold in a standardized margin trading, it will collect the broker loan rate from the customer to whom it lends the securities to be sold at the rate announced by the TSE for excess lending issues at Japan Securities Finance Co., Ltd., and deliver this broker loan rate to the customer to whom it loaned the purchase price (TSE Brokerage Agreement Standards, rule 41, para. 2).

The computation period for the broker loan rate for standardized margin trading is the period from the loan date until the date before the repayment date (TSE Brokerage Agreement Standards, rule 42).

If the repayment date pertaining to margin trading in securities with the right to receive stock due to a stock split, etc. occurs the next day after the date such rights, etc. are allotted, repayment is made with share certificates with ex-rights (TSE Brokerage Agreement Standards, rule 49). If trading participants continue to lend money using standardized margin trading to customers with
respect to the securities with such rights, etc., the amount shall be calculated by subtracting the price of such rights, etc. determined by the TSE from the purchased contract price (partial repayment of the loan). If the loan of securities using standardized margin trading is continued, the value of such rights, etc. determined by the TSE is subtracted from the sale price received as collateral (partial refund of collateral) (TSE Brokerage Agreement Standards, rule 50).

6 Delivery of Money in Foreign Currency

It is assumed that all deliveries of money (sale and purchase prices or transaction prices, consignment fees, etc.) between customers and trading participants with respect to the sale and purchase, etc. of securities are made in Japanese yen. However, if entrusted trading participants agree, the payment can be made in the foreign currency specified by the customer (TSE Brokerage Agreement Standards, rule 52; OSE Brokerage Agreement Standards, rule 32).

6 Default

In the event of default on the part of a customer (as shown in the following cases (1) and (2)), trading participants, at their discretion and using the customer’s account, can conclude a sale contract or purchase contract (including, resale, repurchase, final settlement or exercise of rights), and if any loss is incurred because of this, trading participants can appropriate the customer’s money or securities held for the customer or recorded in the account of the trading participant pursuant to the “Act on Transfer of Bonds, Shares, Etc.” to compensate for such damage, and if there still remains any shortfall, they can request the payment of the shortfall to customers:

(1) Sale and Purchase of Securities (TSE Brokerage Agreement Standards, rule 53):
(i) When customers fail to provide the sold securities or the purchase price by a prescribed deadline to trading participants;
(ii) When customers fail to deposit the requisite margin or money corresponding to the loss amount if a computational loss is incurred regarding when-issued transactions by a prescribed deadline;
(iii) When customers fail to deposit or pay the requisite customer margin or money to trading participants regarding margin trading by a prescribed deadline; and
(iv) When customers fail to repay or return to trading participants the purchase price or the sold securities that were loaned regarding margin trading by a prescribed deadline;

(2) Market Derivatives Transactions (OSE Brokerage Agreement Standards, rule 33):
(i) When customers fail to submit/deposit or pay the requisite margin or the requisite money or transaction price regarding the purchase to trading participants by a prescribed deadline; and
When customers fail to deliver the sold securities or the purchase price regarding the settlement by delivery/payment or deliver the settlement amount or the securities to be delivered regarding the exercise of the options by a prescribed deadline.

For when-issued transactions, margin trading, government bond futures transactions, index futures transactions, securities options transactions, government bond futures options transactions and index options transactions, detailed measures for self-help by trading participants are specifically supplemented in an agreement submitted by customers to the trading participants, in addition to the above.

### 7 Market Derivatives Transactions

Rules and systems for market derivatives transactions on the TSE and those on the OSE have been integrated upon the integration of the TSE derivatives market and the OSE derivatives market on March 24, 2014. This change has resulted in making a wide variety of derivatives products tradable on the single platform. Various other changes have been made, such as replacement for J-GATE on July 19, 2016, the introduction of new products (e.g. TSE Mothers Index Futures and JPX-Nikkei Index 400 Options), and extension of the time of the evening trading session, thus increasing convenience in accessing the derivatives market.

### 7.1 Government Bond Futures Transactions

A government bond futures transaction is a type of transaction on financial instruments market in which a party makes a contract in accordance with standards and methods as established by persons operating a financial instruments market for the delivery of standardized instruments of government bonds (benchmarks established by standardizing the interest rate, maturity and other terms to facilitate market derivatives transactions (FIEA, art. 2, para. 24, item 5)) and consideration for them at a specified time in the future. When a resale or repurchase of the standardized instruments of government bonds which are the subject of the transaction is carried out, settlement may take place in the form of paying or receiving the differences (FIEA, art. 2, para. 21, item 1).

With futures transactions, necessary trading systems were installed such as the collection of margin money to confirm the security of transactions and daily mark-to-market to confirm the status of profits and losses on a daily basis. This system is important in light of the fact that futures transactions allow net cash settlements and are speculative in nature.

The Exchange instituted long-term government bonds futures transactions in 1985 in response to the increased necessity for a means of hedging risks as related to fluctuations in bond prices which accompanied the vast expansion of the bond market, as well as the increasingly
liberalized and more internationalized financial markets in Japan. It was followed by securities futures trading in super-long-term government bonds in 1988 (suspended in September 2002) and mid-term government bonds in 1996. In March 2009, mini futures trading (FIEA, art. 2, para. 21, item 2) on the price of standardized long-term JGBs was instituted. In April 2014, securities futures trading in super-long-term government bonds were resumed.

### Index Futures Transactions

An index futures transaction is a form of transaction on financial instruments market in which a party makes a contract in accordance with standards and methods as established by persons operating a financial instruments market for the delivery of cash that is calculated based on the difference between the value of the index specified when executing the contract and its actual value at a specified time in the future (FIEA, art. 2, para. 21, item 2).

The Exchange instituted index futures transactions based on the Nikkei Stock Average (Nikkei 225) and index futures transactions based on the Tokyo Stock Exchange Stock Price Index (TOPIX) in 1988 in response to the increased necessity for a means of hedging risks related to stock price fluctuations as well as the need to establish a mechanism which would allow the Tokyo market to function more as a true international market. Later, it has begun futures transactions based on various indices as follows:

In November 2014, the Exchange instituted JPX-Nikkei Index 400 futures transactions, a new type of futures for which the underlying index is JPX-Nikkei Index 400 and which consist of stocks of companies with high appeal for investors, selected on the basis of ROE and operating profit. In July 2016, it further instituted TSE Mothers Index Futures transactions based on the TSE Mothers Index, a stock index of all issues of domestic common stocks listed on the TSE Mothers market.

### Securities Options Transactions

A securities option transaction is a form of transaction on financial instruments market in which one of the parties (optionor) promises, in accordance with the standards and methods as established by persons operating a financial instruments market, to provide a securities option to the other party (optionee) and the optionee promises to pay the consideration for the securities option (FIEA, art. 2, para. 21, item 3).

A securities option is essentially the right of the optionee (option holder) to execute between the parties, upon the manifestation of intention by the option holder, a sale and purchase of securities or a transaction in which the parties pay and receive an amount of money calculated based on the difference between the price predetermined as the price of the securities on the
assumption that the option holder would manifest the intention to execute the transaction (the exercise price) and the actual price of the securities as of the time when the option holder actually manifests such intention (OSE Business Regulations, rule 3, item 3).

The Exchange instituted securities options trading on domestic share certificates in 1997 in order to offer a means of hedging risks associated with price fluctuations in individual share issues as well as to provide efficient opportunities for investing funds through the diversified investment instruments, while at the same time strengthening the function of the spot market.

**Initiatives toward the Expansion of Securities Options Market**

In general share transactions, profit can be gained when the share price rises. An attractive feature of options transactions is that profit can also be gained regardless of the rise or fall of the share price, or even when there is no price movement. In addition, investors can make investment with only a small amount of funds by taking advantage of the leverage effect, and they can also choose investment methods that fit their needs by combining multiple options.

Since it started handling securities options transactions in 1997, the Exchange has taken various initiatives to provide a wide range of investors, from individuals to institutional investors, with more opportunities to conduct efficient fund management using a variety of investment tools.

Major achievements made by the Exchange include: (i) the expansion of the scope of securities handled (2008); (ii) the setting up of the market maker scheme (2009);* and changes to the tick sizes for some exercise prices (2016). As part of the measures to raise awareness of individual investors with regard to securities options, the Exchange makes available the data of settlement prices of securities options and the history data of implied volatilities (the latter data is available on the “Option Chart” page of the JPX website at: https://www.jpx.co.jp/markets/derivatives/option-chart/).

In June 2018, in addition to index options transactions, the Exchange introduced flexible contract months for options transactions for which the exercise date and exercise price can be flexibly set, while taking advantage of transactions in listed securities which are highly transparent and free of credit risk of the counterparty in over-the-counter transactions.

The volume of securities options transactions conducted on exchanges in Japan is still small as compared to that in the United States, but driven by these initiatives taken by the Exchange, the volume has been increasing. As of October 1, 2018, 229 issues were available as the underlying securities of securities options transactions.

**Status of Securities Options Transactions in the United States**

According to a report published by the OSE on July 29, 2016, titled “Research on Actual Use of Derivatives by Overseas Individual Investors” (by Nomura Research Institute, available at: https://www.jpx.co.jp/corporate/research-study/derivatives/index.html), individual investors are very active in trading securities options in the United States. In particular, option trading beginners take the covered call strategy, i.e. purchasing and holding
the underlying securities and selling call options, aiming to gain more yields from the underlying securities.

As mentioned above, the volume of securities options transactions conducted on exchanges in Japan is still small compared to that in the United States, but it has been increasing with regard to covered call trading by individual investors.

*Market maker: A system that creates a trading environment where market makers continually quote bids and offers for designated contracts so that investors can trade the contracts at any time.

### 7.4 Government Bond Futures Options Transactions

Government bond futures options transaction is a form of transaction on financial instruments market in which one of the parties (optionor) promises, in accordance with the standards and methods established by the person operating a financial instruments market, to grant the other party (optionee) the right for an option specified by the agreement and the optionee pay the consideration of that option (FIEA, art. 2, para. 21, item 3).

A government bond futures option is essentially the right of the optionee (option holder) to consummate a government bond futures transaction for the standardized government bonds between the parties upon the expression of intent of the optionee (OSE Business Regulations, rule 3, item 4).

The Exchange instituted trading in long-term government bond futures options in 1990 in response to diversified needs of investors, while at the same time responding to demands that Japan’s market function more effectively as an international market.

### 7.5 Index Options Transactions

Index options transaction is a form of transaction on financial instruments market under which two parties enter into an agreement in accordance with the standards and methods established by the entity operating a financial instruments market whereby one party (optionor) grants an index option the other (optionee) specified by the agreement and the optionee pays the consideration for it (FIEA, art. 2, para. 21, item 3).

An index option is the right on the part of the party to whom it has been vested (the holder of rights) to carry out a transaction between the parties at will in which paying or receiving of cash is made as calculated based on the difference between the index predetermined as the price at which the right is exercised (the exercise price) and the actual value of the index at the time the actual
transaction is carried out (the actual index) (OSE Business Regulations, rule 3, item 5).

The Exchange instituted trading in index options on the Nikkei Stock Average (Nikkei 225) and those on the Tokyo Stock Price Index (TOPIX) in 1989 following index futures transactions in order to respond to diversified needs of investors while at the same time responding to demands that Japan’s market function more effectively as an international market.

In May 2015, in response to the growing need for more precise hedging opportunities to manage risks from shorter term exposures (e.g., releases of economic indicators and contingent event), and with a view to enhancing convenience for market players, the Exchange introduced Weekly Options based on the Nikkei Stock Average (Nikkei 225). While the exercise day comes the second Friday for the regular monthly options, it comes each Friday (except for the second Friday) for the weekly options.

Furthermore, the Exchange instituted trading in JPX Nikkei Index 400 options in July 2016 and also instituted trading in TSE Banks Index Futures and TSE REIT Index Futures as the types of transactions to which flexible contract months are applicable in June 2018.

7 Give-Up System

From the viewpoint of improving the convenience of futures/options trading (collectively referring to trades in “7.1. Government Bond Futures Transactions” through “7.5. Index Options Transactions” above), the Exchange has introduced the Give Up System from 2007, which has enabled investors to have the clearing and settlement functions (management of positions, exchange of margins, etc.) consummated by orders performed by a trading participant (order executing trading participant) handled by another trading participant (clearing settlement trading participant).

Obligation of Centralized Clearing of OTC Derivatives Transactions

With the economic downturn precipitated by the Lehman Brothers bankruptcy in 2008, it was decided by the G20 that OTC derivatives transactions shall be cleared by a central clearing organization at least by the end of 2012, in order to reduce the counterparty’s credit risk and the systemic risk caused by the market participants’ failure to the whole market.

In Japan, the FIEA was amended in November 2012, and the obligation of centralized clearing was imposed on CDS (Credit Default Swap) transactions related to iTraxx Japan, which is an index issue of CDS, and interest rate swap (IRS) transactions pertaining to yen-denominated LIBOR (London Interbank Offered Rate).

In July 2014, the JSCC further imposed the obligation of concentration of clearing under the FIEA with regard to such IRS transactions pertaining to Euroyen TIBOR.

In addition, in December 2014, an amendment was made to the Cabinet Office Ordinance to include financial instruments business operators, etc. dealing in over-the-counter derivatives transactions of more than a certain amount in the scope of parties subject
to the obligation of concentration of clearing.

**JSCC’s Initiatives for Clearing of OTC Derivatives Transactions**

Amidst the movements toward the centralized clearing of OTC derivatives transactions following the Lehman Brothers bankruptcy as described above, the JSCC decided to conduct the clearing business of OTC derivatives transactions as a central clearing organization. Accordingly, prior to the amendment of the FIEA in November 2012, the JSCC commenced the clearing business of CDS transactions related to iTraxx Japan from July 19, 2011, and that of IRS transactions pertaining to yen-denominated LIBOR from October 9, 2012.

The JSCC further commenced the clearing business of IRS transactions pertaining to Euroyen TIBOR from February 25, 2013, and then launched the clearing services for single-name CDS transactions linked with single reference entities on December 15, 2014 and the clearing services for non-JPY IRS transactions (foreign currency-denominated interest rate swap transactions) on September 24, 2015.

The JSCC is considering expanding the scope of subject transactions of OTC derivatives transactions, while paying attention to the international trends in regulatory measures for clearing organizations.

Meanwhile, in February 2014, the JSCC introduced a client clearing system which enables persons (clients) other than those belonging to the same corporate group including the entrusted clearing participant to entrust clearing for IRS transactions. It also introduced a cross-margining system in September 2015 with the objective of enabling cross-margining, *i.e.*, offsetting of risks arising in different transactions to be cleared (IRS transaction and JGB futures transaction), thereby reducing the collateral required of IRS clearing participants and IRS clearing clients.

In January 2017, the JSCC additionally included clearing clients in the scope of eligible users of the cross-margining system, with a view to further enhancing the efficiency in the collateral required of IRS clearing participants, etc.
1. **What is the Sales Representative Qualification Examination?**

Persons who wish to engage in securities operations must pass a Sales Representative Qualification Examination described below (hereinafter called the “Examination”) and must be registered in the Original Registry of Sales Representatives before they become engaged in the conduct of duties of a Sales Representative.

A Sales Representative must possess a certain minimum level of basic knowledge concerning Japan’s financial instruments laws, including the Financial Instruments and Exchange Act, etc., and other laws and ordinances, as well as financial products and financial instruments transactions.

The Examination administered by the Japan Securities Dealers Association (hereinafter called the “JSDA”) tests the extent of acquisition of this knowledge, and is part of the self-regulatory system of the securities industry.

2. **Qualification**

With regard to the Class-1 Sales Representative Qualification Examination (hereinafter referred to as the “Class-1 Examination”) and Class-2 Sales Representative Qualification Examination (hereinafter referred to as the “Class-2 Examination”), the people for whom the Association Member finds it necessary to have him/her take the Examination, and who do not fall under any of the following persons are qualified to sit for the Examination:

- Class-1 perpetrator of an inappropriate act;
- A person for whom five years have yet to elapse from the day on which such person came to be treated as a Class-2 perpetrator of an inappropriate act;
- A person who is under a waiting period to take the next Examination due to failure (for details, see “7. Required Waiting Period for Repeat Examinations”); and
- A person who is under a period during which he/she is excluded from taking the Examination due to misconduct (for details, see “To All Examinees: Notes Upon Taking the Sales Representatives Qualification Examination”).

3. **Examination Procedures**

Each Association Member files an application with the JSDA on behalf of the persons who want to take the Examination.

The applications for officers and employees of a financial instruments intermediary service provider are handled by an Association Member with whom the financial instruments
intermediary service provider has executed entrustment agreement.

Procedures for applying to take the examination are handled exclusively by the relevant department at the Association Member. Individuals wishing to take the Examination cannot submit an application directly to the JSDA.

4. Date and Location of the Examination

(1) Examination Date

The JSDA holds, in principle, the Examinations on every business day (except Saturdays, Sundays, public holidays and during the New Year period). However, this will be different for each examination site.

(2) Examination Sites

The examination sites (test centers) are located in major cities all over Japan. Please check with the examination site at your desired location for the examination date via the respective department of the Association Member in advance.

After the application, the examination site, date and time of the Examination is assigned to each applicant individually. In addition, examinees cannot sit for the Examination other than at the location and time scheduled in advance.

5. Checklist for the Day of Examination

(1) Due to poor weather conditions such as typhoons, the holding of the examination may be cancelled at sites that could be affected.

Please access the JSDA website and check whether the examination will be held as scheduled before heading for the examination site.

[JSDA website]

(2) Arrival at the Examination Site

Examination instructions will be announced at the test site prior to the commencement of the Examination. Therefore, all applicants should arrive at the examination site by the appointed time (at least 15 minutes before the fixed start of the Examination). (If you don’t arrive at the examination site at least 15 minutes prior to the fixed examination time you will not be permitted to take the Examination regardless of the reason).

(3) Documents Necessary for Personal Identification

The identity of the examinee will be verified at the reception desk of the examination site. Examinees must bring one of the following identification documents (documents other than those listed below, such as a student’s ID card, are not acceptable):

(i) Driver’s license (temporary license, driver’s license issued in a country outside Japan and driver’s license with no indication stating “driver’s license” are not allowed);
(ii) Certificate of driving history (limited to those issued on or after April 1, 2012);
(iii) Individual Number Card (Notification Card issued to notify every resident of their Individual Number is not allowed);
(iv) Basic Resident Registration Card (with a photograph affixed thereto);
(v) Passport;
(vi) Resident card or special permanent resident certificate (“alien registration certificate” is acceptable only if it may be recognized as a “resident card” or “special permanent resident certificate”); or
(vii) If an examinee does not have any of the above, the examinee must bring either (a) or (b) below:
   (a) A photo bearing employee identification card (Note) and a health insurance card (substitute documents are not acceptable)

(Note) Not applicable in the case of IDs of financial instruments intermediary service providers or temporary agencies. The photo must either be split-sealed, embossed or laminated, or printed on a plastic card. The card must bear the first and last names of the examinee, the name of the Association Member and a corporate logo or the logo of the corporate group to which the Association Member belongs.

(b) Personal identification statement (which must bear a company seal and a personal seal is not acceptable) and health insurance card (substitute documents are not acceptable).

(Notes)
1. Persons not in possession of a form of personal identification upon taking the Examination will not be permitted to take the Examination under any circumstances.
2. The forms of personal identification mentioned above are acceptable only if they are the originals (copies are not acceptable).
3. The forms of personal identification referred to above must be valid. Those that have become invalid by reason of expiry or other reason are not acceptable.
4. A “photo bearing employee identification card” or an “identification card” shall only be valid if it has been issued by an Association Member.
5. An “identification card” is valid for a period of six months after issuance (except when there has been a change of content).

(4) Miscellaneous
   No reference material such as texts or notes may be used during the Examination. Examinees must check in their personal belongings at the test room as no personal belongings are allowed in the test room.
   Examinees may use the calculator function displayed on the PC in order to solve
calculation questions. If you need to make notes, please use the note pad and pen provided at the examination site. The note pad, etc. will be collected by the proctor at the examination site after the Examination has been completed.

6. Notification of Pass or Fail
Examination results (pass or fail) will be given by a notice from the JSDA to a person-in-charge of each Association Member, in principle two business days after the Examination. The JSDA will not respond to inquiries from individual examinees.

The results given will be whether you have passed or failed, and your total scores, and the JSDA will not respond to inquiries regarding the examination questions.

7. Required Waiting Period for Repeat Examinations
A person who has taken and failed the Examination may not take any Examination for a period of 30 days from the day following the date of the original Examination.

If an examinee is later discovered to have taken the Examination within the waiting period above, the examinee’s qualification will be nullified even if the examinee has passed.

8. Measures Against Examinees Using Fraudulent Means
If any person uses or attempts to use fraudulent means (cheating) in taking the Examination, the passing score shall be cancelled or the Examination shall be halted.

In such a case the examination fee shall be payable.

9. Subjects and Methods of Examination

<table>
<thead>
<tr>
<th>Subjects</th>
<th>Class-1 Examination</th>
<th>Class-2 Examination</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Laws Relating to Solicitation and Sales of Financial Instruments</td>
<td>• Laws Relating to Solicitation and Sales of Financial Instruments</td>
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<tr>
<td></td>
<td>• Articles of Association and Various Rules of the Association</td>
<td>• Articles of Association and Various Rules of the Association</td>
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<tr>
<td></td>
<td>• Articles of Incorporation and Various Regulations of the Exchanges</td>
<td>• Articles of Incorporation and Various Regulations of the Exchanges</td>
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<tr>
<td>[Product Business]</td>
<td>• Equity Business</td>
<td>• Investment Trusts and Investment Corporations Business*</td>
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<tr>
<td></td>
<td>• Bond Business</td>
<td>• Incidental Businesses</td>
</tr>
<tr>
<td></td>
<td>• Investment Trusts and Investment Corporations Business*</td>
<td>• Derivatives Transactions (Class-1 Examination Only)</td>
</tr>
<tr>
<td>[Related Subjects]</td>
<td>• Basic Knowledge Concerning Securities Markets</td>
<td>• Basic Knowledge Concerning Securities Markets</td>
</tr>
<tr>
<td></td>
<td>• Stock Company Law in General</td>
<td>• Stock Company Law in General</td>
</tr>
<tr>
<td></td>
<td>• Basic Knowledge of Economics, Finance and Fiscal Policy</td>
<td>• Basic Knowledge of Economics, Finance and Fiscal Policy</td>
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<tr>
<td></td>
<td>• Financial Statements and Company Analysis</td>
<td>• Financial Statements and Company Analysis</td>
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<td></td>
<td>• Taxation of Securities Transactions</td>
<td>• Taxation of Securities Transactions</td>
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<td></td>
<td>• Sales Operations</td>
<td>• Sales Operations</td>
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<tr>
<td>Class-1 Examination</td>
<td>Class-2 Examination</td>
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<td>---------------------</td>
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</tr>
<tr>
<td>(1) Practical and professional knowledge regarding the subjects listed above</td>
<td>(1) Basic knowledge regarding the subjects listed above (Questions regarding basic knowledge concerning items such as margin transactions and derivatives transactions, which are not included in the scope of activities a Class-2 Sales Representative may conduct, appear in the Class-2 Examination in connection with the covered subjects, such as “Equity Business” and “Bond Business.”)</td>
<td></td>
</tr>
<tr>
<td>(2) Fundamental and important compliance-related topics</td>
<td>(2) Same as the left</td>
<td></td>
</tr>
</tbody>
</table>

(Note) If there is a change to the related laws, ordinances or various regulations, the questions will test the new laws, etc.

<table>
<thead>
<tr>
<th>Format of Questions</th>
<th>True or false questions and multiple-choice questions (to be answered by choosing the right term or making a calculation) The questions should be answered by making entries on the computer.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Number of Questions</th>
<th>100 questions in total (70 true or false questions, and 30 multiple-choice questions (from five choices))</th>
</tr>
</thead>
</table>

For true or false questions, each correct answer corresponds to 2 points. For multiple-choice questions (from 5 choices), each correct answer corresponds to 10 points (each correct answer to multiple-choice questions (choose 2 answer choices) corresponds to 5 points).

<table>
<thead>
<tr>
<th>Examination Time</th>
<th>2 hours and 40 minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grading</td>
<td>A perfect score is 440 points. A score of 70% (308 points) or higher is a passing score.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Examination Time</th>
<th>2 hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grading</td>
<td>A perfect score is 300 points. A score of 70% (210 points) or higher is a passing score.</td>
</tr>
</tbody>
</table>

**10. Instructions for Taking Examination**

Pay attention to the following when taking the Examination:

(1) Follow the instructions of the proctors at the examination site and in your test room. Examinees who do not follow their instructions may be treated as cheating (for details, see “To All Examinees: Notes Upon Taking the Sales Representatives Qualification Examination”);

(2) Make sure you read the instructions and the questions carefully before proceeding to answer the individual questions; and

(3) Make sure you fully understand the question, and give your answer according to the directions.
To All Examinees
Notes for Taking the Sales Representatives Qualification Examination

1. Prohibition of and Measures Against Fraudulent Acts
   (1) The following acts are considered as fraudulent:
      (i) Bringing in memos into the test room or entering the test room with information written on parts of the body
          <Example>
          • Notes with information regarding the Examination
          • Textbooks and exercise books or copies thereof
          • Information regarding the Examination written on the palm of the hand, arm or other parts of the body.
          * Please note that bringing in memos or writing information on parts of the body shall be deemed to be fraudulent acts even if the information is irrelevant to the examinations
      
      (ii) Bringing in items other than those necessary for the examination (i.e. certificate for the examination with an identification number and personal identification document) into the test room
          <Example>
          • All kinds of watches or clocks (wristwatches, etc.)
          • Cellular devices (cellular phones, tablets, wearable devices, etc.)
          • Writing utensils such as pens (excluding those provided at the examination site)
          Planners, business card holders and other personal items
          * There are locked lockers at the examination site. Items other than those necessary for the Examination (certificate for the examination with an identification number and personal identification document) must be placed in the lockers prior to taking the Examination.
          * If you wish to bring in items such as handkerchiefs, tissues, or eye drops, please consult the staff of the examination site without fail before entering the test room.

      (iii) Writing information on the certificate for the examination with an identification number or any parts of the body or bringing out such items
          <Example>
          • Writing on the body such as on the palm of the hand or arm, or leaving the test room with such writing on the body
          • Writing on equipment in the test room (except the note board provided) or bringing them out
          * Writing information on equipment other than the note board or writing on any part
of the body or bringing the information out shall be deemed to be fraudulent acts even if the information is irrelevant to the Examination.

(iv) Other acts in the test room such as the following

<Example>

• Talking in the test room
• Sneaking a look at other seats
• Entering or leaving the test room without the proctor’s approval
• Failing to obey the proctor’s instructions

(2) Not only will persons who have conducted fraudulent acts fail the examination, but they will also be reported to the company/organization to which they belong regarding their fraudulent act, and they will be investigated and measures will be taken (suspension from taking the examination for up to one year). In addition, the name of the company/organization to which the said individual belongs will be disclosed to all member firms of the JSDA for one year.

(3) The test room will be patrolled by the proctors and monitored through surveillance cameras.

2. Points of Note Prior to the Start of the Examination

• You must arrive by the appointed time for examinees, since examination instructions will be given before the examination starts. (If you do not enter the venue before the appointed time for examinees, you will not be permitted to take the Examination regardless of the reason).

• You must bring the “personal identification documents” designated by the JSDA. (for details, see “Outline of the Qualification Examination System for Sales Representatives, Checklist for the Day of Examination”).
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