

Financial Instruments Business (formerly – Securities Business)

Accompanying the enforcement of the Financial Instruments and Exchange Act (September 30, 2007), the concept of the securities business under the former Securities Exchange Act was abrogated and so-called securities companies came to be regulated under the law as financial instruments business operators. A financial instruments business means engaging in, as a business, any of the acts set forth in Article 2, Paragraph 8 of the Financial Instruments and Exchange Act. The financial instruments business includes, compared to the former Securities Exchange Act, a broader range of acts relating to investment service. Based on the details of operations, the business is divided into the following types (Financial Instruments Act, Article 28) : (1) Type I Financial Instruments Business (activities such as the sale / solicitation of securities with high liquidity and client asset management, etc.), (2) Type II Financial Instruments Business (activities such as the sale / solicitation of securities with low liquidity), (3) Investment Management Business and (4) Investment Advisory and Agency Business. From the perspective of the protection of investors, the activities of these four types differ respectively in the kind and degree of the business regulations imposed on an operator as a cornerstone of control to entry (Financial Instruments Act, Article 29 and below).

Financial Instruments Business					
Type I Financial Instruments Business			Investment Management Business	Type II Financial Instruments Business	Investment Advisory and Agency Business
Stock Company			Stock Company	Judicial Person or Individual	Judicial Person or Individual
PTS	Securities Underwriting	Securities Companies / Financial Futures Companies (Over-the-Counter Futures)	Investment Trust Operators / Discretionary Investment Operators	Sale of Trust Beneficial Rights Business / Sale of Commodity Investment Business / Real Estate Specified Joint Enterprises / Exchange Financial Futures Trading	Advisory based on investment advisory contract / Agency - intermediary services of conclusion of investment advisory contract or discretionary investment contract
		Authorization	Registration	Registration	Registration
				10,000,000 yen (only individual operator)	5,000,000 yen (only when engaging in investment advisory / agency services)
300 million yen	Lead manager 3 billion yen, other 500 million yen	50,000,000 yen	50,000,000 yen	10,000,000 yen	None
Yes (same as above)			Yes (same as above)		
Yes			Yes		
Ancillary businesses, delivery services, approval services					
120% or more					

So-called securities companies fall within Type I Financial Instruments Business. Currently, companies who are able to use the word “securities” in their trade names are any special securities company (meaning “a deemed registered Type I Operator”. A company which was registered as a securities firm pursuant to Article 28 of the former Securities Act at the time of the enforcement of the Financial Instruments Act and a company which is deemed to be a Type I registered operator through the enforcement of the Financial Instruments Act) and companies that engage in securities related activities (Financial Instruments Act, Article 28, Paragraph 8) having registered as Type I financial instruments business operators.

Among the primary laws and regulations relating to business regulations of the financial instruments business are the Financial Instruments and Exchange Act (Act No. 25, 1950), Order for the Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No. 321, 1965), the Cabinet Office Ordinance regarding Definitions under Article 2 of the Financial Instruments and Exchange Act (Ministry of Finance Ordinance No. 14, 1993), the Cabinet Order on Financial Instruments Business Operators (Cabinet Office Order No. 52, 2007), and the Financial Instruments Business Operator’s Deposit for Operations Regulations (Cabinet Office / Ministry of Justice Order No. 3, 2007). In addition to financial instruments activities, Type I Financial Instruments Business Operators and Investment Management Business Operators may engage in ancillary businesses, delivery services and approval services. Additionally, Type II Financial Instruments Business Operators and persons engaged only in Investment Advisory and Agency Businesses will generally be approved to engage in other side businesses, but, when engaging in these businesses, they will also obey the regulatory laws and regulations relating to said businesses. Registered financial organizations engaged in certain securities related businesses of course shall also obey the operational laws and regulations of each financial organization such as the Banking Act, Insurance Business Act, etc.

Practically, importance is attached to the various public notices, supervisory guidance, guidelines, etc. of competent authorities. In particular, the Financial Services Agency’s “Comprehensive Supervisory Guidelines for Financial Instruments Business Operators” is important.

The following is an outline of the principal business regulations of Type I Financial Instruments Businesses engaged in by so-called securities companies. Type I Financial Instruments Businesses are broadly divided into : (1) the buying and selling, etc. of securities with high liquidity such as stocks and corporate bonds, etc. (dealing business, broker business, selling business, private placement dealing business, clearing business, market derivatives transactions, intermediary, brokerage, and agency service, etc. of securities, etc.), (2) over-the-counter derivatives business, (3) securities underwriting business, (4) proprietary trading system (PTS) businesses and (5) securities, etc. management business, etc. (Financial Instruments Act, Article 28, Paragraph 1).

The financial instruments business may not be engaged in as a business without being registered by the Prime Minister (authority delegated the Commissioner of the Financial Services Agency). To the extent that an applicant does not fall within the prescribed grounds for refusal of registration, the Prime Minister may not refuse registration and entry has been liberalized. It is possible to obtain registration under numerous types of financial instrument businesses and, also, foreign securities brokers may be registered. As special provisions of the registration system, there are special provisions for foreign securities brokers and special provisions for specially permitted business for qualified institutional investors, etc. Of the Type I Financial Instruments Businesses, when engaging in the above noted (4) proprietary trading system businesses further authorization of the Prime Minister is required because specialized operations and a high level of risk management capabilities are required.

Because it is anticipated that transactions, etc. will be accompanied by high risk and that there will numerous interested persons, Type I Financial Instruments Businesses are required to put aside a financial instruments business liability reserve in addition to the maintenance of minimum capital regulation, net asset regulation (net asset above the minimum amount of capital), capital adequacy ratio as a requirement of registration in order to ensure the soundness of finance. In addition, there are regulations relating to accounting and regulations restricting the concurrent holding of directorships, etc. of a parent bank, etc.

As the supervisory authority of the Prime Minister (Commissioner of the Financial Services Agency), in addition to ordering the collection of information, the submission of materials and inspections, the Prime Minister can cancel registration / authorization or suspend operations, order the resignation of officers and order improvements in

operations, etc. A notification obligation is imposed in certain cases of the suspension or discontinuance of the financial instruments business.

Financial institutions such as banks, etc. may have, as a subsidiary company or parent company, a financial instruments business operator, but, excluding transactions for ones' own investments purposes, etc., the main body of the financial institution is, as a general principle, prohibited from engaging in securities related businesses, etc. The reason for this is to protect depositors, to prevent conflicts of interest, and to preclude the abuse, etc. of superior position by the financial institution. However, financial institutions may be registered and engaged in securities related services, etc. within a certain scope. The intent of requiring registration is to extend unified supervision and regulation based on the Financial Instruments Act.

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