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Securities Activities of Japanese Banks Under the 1993 Japanese Financial System Reform

*Masaki Yagyu**

I. INTRODUCTION

What is unique to the Japanese banking system is high *specialization*. In Japan, the banking industry is divided into many segments, including short-term banking, long-term banking, trust banking, retail banking, wholesale banking, small business banking, and international trade banking. In addition, Japan has many types of banking organizations, such as regular banks (*Futsû Ginkô*), long-term credit banks (*Chôki Shin'yô Ginkô*)¹, trust banks (*Shintaku Ginkô*), a foreign exchange bank (*Gaikoku Kawase Ginkô*)², and credit unions (*Shin'yô Kinko*). Each type of the banking organizations has been expected to specialize in some of the segments.

Regular banks, a foreign exchange bank and credit unions have been expected to specialize in short-term banking. They have traditionally taken short-term deposits and provided short-term credits. There is no legal restriction on terms of deposits and loans. However, the Ministry of Finance (*Ôkurashô*), which is the regulatory authority

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¹ Three long-term credit banks currently exist: *The Industrial Bank of Japan, Ltd.*, *The Long-Term Credit Bank of Japan, Ltd.*, and *Nippon Bond Credit Bank, Ltd.*

² *The Bank of Tokyo, Ltd.* is currently the only foreign exchange bank in existence; however, the bank decided to merge with Mitsubishi Bank Ltd., which is a large regular bank. This merger would eliminate the foreign exchange bank.

of the banking and securities industries, has customarily limited the terms of deposits on a non-statutory basis; thus, regular banks have made short-term loans on a matching basis.

Long-term credit banks and trust banks have been expected to specialize in long-term banking. Long-term credit banks have traditionally collected long-term funds by issuing special debentures (*Kin'yūsai*) and managed such funds by long-term loans. There are some legal restrictions on their taking deposit and making short-term loans. On the other hand, trust banks have been expected to take long-term funds, and manage such funds, through trusts. Legally, trust banks are licensed regular banks, which have concurrent approval for trust business and have the same corporate power as regular banks, as well as trust power; however, the Ministry of Finance has expected trust business to function as a form of long-term fund intermediation and trust banks to specialize in such business. At the same time, the Ministry of Finance has taken a position of not granting a trust business approval to other banking organizations and thus strictly segregating this segment from other banking segments³ and other industries.

Long-term credit banks, a foreign exchange bank and credit unions are required by law to some extent to provide their services to certain segments of customers. Long-term credit banks have been expected to provide funds to businesses, rather than consumption and have thus played an important role in wholesale banking. A foreign exchange bank is expected to engage principally in foreign exchange transactions, activities related to letters of credit, and other financing of international trades. Credit unions have been expected to specialize in small business banking and retail banking. There is no legal limitation of this kind on regular banks; however, it is true that regular banks have played an important role in retail banking.

The *specialization*, which is unique to the Japanese banking industry, can be found not only in the fact that each type of banking organization has specialized in some segments of the banking industry, but also in the fact that the banking industry itself has been segregated from other financial industries. That is, entries of banking

³ For historical reasons, prior to 1993, only three regular banks, *Daiwa Bank Ltd.*, *Okinawa Bank Ltd.*, and *Ryūkyū Bank, Ltd.*, were permitted to have limited trust power (excluding loan-trust). Otherwise, only trust banks were given trust power. *But see supra* note 9. While non-bank trust companies may theoretically exist under Japanese law, no such companies exist at least in presence due to the Ministry of Finance's recent policy of disallowing any nonbank from participating in the trust business.

organizations into the securities and insurance industries have been strictly restricted.⁴

The system separating the banking industry from the securities industry was established in 1948, by enacting the so-called Japan's Glass-Steagall Act, or Article 65 of Securities and Exchange Law,⁵ which is modeled after America's Glass-Steagall Act.⁶ It has been said that this system purported to protect depositors against banks' losses arising from risky securities activities and to reduce banking organizations' power of control over economics, which relied too much on bank loans at that time.⁷ This separation was gradually mitigated, permitting banking organizations to engage in underwriting and dealing in government bonds, derivative activities (e.g., futures and options) related to domestic and foreign government bonds, and activities related to some money market instruments, such as commercial paper and certificates of deposit. Nevertheless, the separation system had basically been maintained for more than forty years after the enactment of the Securities and Exchange Law.

The traditional *specialization* system of the banking industry has significantly changed during the last decade. Many segments of the banking industry have virtually broken down, so that each type of banking organization has invaded segments other than its own. The segmentation between the long and short-term fund intermediaries are terminating, due to innovations of financial technologies, such as interest rate swaps, gradual deregulations on deposit terms, and access to foreign money markets; for instance, regular banks can make long-term loans even at fixed interest rates by using interest rate swaps. All types of banking organizations have been providing more or less retail and small business banking services, because large companies have been shifting at least a part of their fund raising from bank loans to securities markets (e.g., debentures, commercial paper, etc.).

⁴ In the same respect, the securities industry has been prohibited from entering into the banking and insurance industries, while the insurance industry has been segregated from the banking and securities industries.

⁵ *Shōken Torihiki Hō* [Securities and Exchange Law], Law No. 25 of 1948.

⁶ Before the enactment, there was no legal limitation on banks' securities activities. Banks actively participated in underwriting as lead underwriter, and dealing in, government bonds and debentures, while securities firms usually acted as mezzanine underwriters there. On the other hand, banks were customarily passive participants in stock-related activities, major players of which were securities firms.

⁷ The system expected securities market to develop and function as an alternative funding source of economics to bank loans and free from banks' control. For this purpose, banks were excluded from the securities industry. Also, it has been said that one of the purposes of the exclusion was to protect securities firms against competition with banks so that they could undertake to bring up securities market to be such an alternative and independent funding source.

In addition, as the financial industry went through deregulation, internationalization (globalization) and securitization of finance on a world-wide basis, significant reforms were implemented in 1993 to substantially deregulate the restrictions on trust and securities business. Banking organizations are now permitted to own trust bank⁸ and securities firm subsidiaries.⁹

These recent changes, nevertheless, did not extinguish the legal framework characterized by the *specialization*. Deposit terms are still limited. Legal restrictions remain on long-term credit banks' deposit taking and making short-term loans and as to which customers banking organizations, other than regular banks should provide their services. Banking organizations are still basically prohibited from directly entering into the trust and securities business. However, such specialization systems are no more what they previously were, and the banking industry, rather the financial industry, is getting segmentless in substance.

Standing upon these recent developments in Japan's banking system, this article describes the Japan's current *specialization* system, focusing on securities activities of Japanese banking organizations. In the concrete, this article describes what kinds of securities activities Japanese banking organizations may directly, or indirectly through their affiliates, engage in under Japanese laws, and to which restrictions under Japanese laws such securities activities are subjected.¹⁰ This article focuses on securities activities because under the above circumstances, securities activities recently have most significantly changed among all kinds of activities of banking organizations. In addition, compared with other activities, securities activities of banking organizations are getting more important for banking organizations, as companies are shifting their fund raising from loans to securities financing and securitization of assets is progressing. It should be noted that the article has the following assumptions: This article cov-

⁸ Recently, the Ministry of Finance has permitted relatively small regular banks operating on a regional basis, or the so-called regional bank (*Chihō Ginkō*), to engage directly in limited kinds of trust business. Thus, the Ministry of Finance has become less rigid with respect to its policy of not granting trust business licenses to banking organizations other than trust banks. See *supra* note 3.

⁹ At the same time, the reforms have permitted securities firms to own trust bank subsidiaries. Securities and Exchange Law art. 43-2.

¹⁰ However, this article does not cover restrictions under *Gaikoku Kawase Oyobi Bōeki Kanri Hō* [Foreign Exchange and International Trade Control Law], Law No. 228 of 1949. See *infra* note 14.

ers only securities activities of city banks (*Toshi Ginkō*)¹¹ (including their affiliates), which can be defined as regular banks operating business on a nation-wide basis, because a majority of large Japanese banking organizations are included in this classification.¹² On the other hand, this article covers all kinds of activities related to “securities” in the broadest sense; thus, the analyses herein are not limited to securities being traded on existing exchange or over-the-counter markets, but also cover all kinds of instruments, certificates, interests, claims, or rights, that are unmarketable at present.

II. REGULATORY FRAMEWORK

For preliminary purposes, this chapter overviews which laws (including related non-statutory administrative rules), and what kinds of restrictions involved in the laws, could affect securities activities of city banks or their affiliates.¹³

¹¹ The term “city bank” is used by the Ministry of Finance to describe those large regular banks operating on a nation-wide basis. In contrast, the term “regional bank” (*Chihō Ginkō*) is used to describe those relatively small regular banks operating on a regional basis. While there is technically no legal distinction between a “city bank” and a “regional bank,” the Ministry of Finance has been known to treat the two differently under its administrative rules. See *supra* note 9.

¹² For example, *Sumitomo Bank Ltd.*, *Mitsubishi Bank Ltd.*, *Dai-ich Kangyō Bank Ltd.*, and *Sanwa Bank Ltd.*, are all city banks.

¹³ In addition to the laws listed below in text, *Gaikoku Kawase Oyobi Bōeki Kanri Hō* [Foreign Exchange and International Trade Control Law], Law No. 228 of 1949, also affects securities activities of a city bank and its affiliates.

This law first restricts foreign exchange business of a bank, requiring prior approval of the Minister of Finance of any bank that regularly engages in such business, including certain kinds of securities transactions that involve any non-resident and/or foreign currency.

Also, this law regulates individual transactions of many kinds which involve either any non-resident or a payment in any foreign currency. These regulated transactions also include certain kinds of securities transactions. While this law requires approval of, or notice to, the Minister of Finance in advance of such individual transactions, it exempts from such restrictions many kinds of transactions involving a bank which has obtained the above prior approval for foreign exchange business.

This law imposes important restrictions on securities activities of a bank and its affiliates; however, these restrictions were established from a perspective of how currencies should be controlled, rather than who should engage in securities activities subject to what kinds of restrictions. On this point, this law significantly differs from other laws listed in text. Discussing restrictions in different natures together makes this article out of focus. In addition, the Foreign Exchange Control Law generally sets restrictions, standing upon and respecting the financial system established by other laws, as listed in text, and does not materially change the system. For these reasons, this article omits discussions of restrictions under the law.

*Banking Law*¹⁴

This law restricts banking business in various ways, such as, permitting only licensed banks to engage in banking business, and limiting corporate power of city banks. It also regulates affiliations and relationships between city banks and other companies.

Securities and Exchange Law

This law restricts certain types of activities related to securities as defined therein, permitting only licensed securities firms to engage in such securities business, limiting corporate power of securities firms, and subjecting securities business to various restrictions. Also, while the law generally prohibits securities activities of financial institutions other than securities firms, approved financial institutions may engage in certain exempted securities activities subject to some restrictions.¹⁵ It also limits relationships between a securities firm and other companies.

*Trust Business Law*¹⁶ and *Banks' Trust Business Law*¹⁷

These laws restrict trust activities, permitting only licensed non-bank trust companies¹⁸ and approved banks to engage in trust business.

*Anti-Monopoly Law*¹⁹

This law limits financial institutions' acquisition and retention of stock in domestic companies. It also prohibits any holding company, including a bank holding company, and any merchant from employing unfair transaction methods.

¹⁴ *Ginkō Hō* [Banking Law], Law No. 59 of 1981. The Banking Law applies only to regular banks, including city banks, regional banks and trust banks. Other types of banking organizations have their governing laws, such as *Chōki Shin'yō Ginkō Hō* [Long-Term Credit Bank Law], Law No. 187 of 1952, *Gaikoku Kawase Ginkō Hō* [Foreign Exchange Bank Law], Law No. 67 of 1954, and *Shin'yō Kinko Hō* [Credit Union Law], Law No. 238 of 1951.

¹⁵ In addition to the approval, license for securities business is not required of a financial institution which engages in such exempted securities activities.

¹⁶ *Shintakugyō Hō* [Trust Business Law], Law No. 65 of 1922.

¹⁷ *Futsū Ginkō No Shintaku Gyōmu No Ken'ei Tō Ni Kansuru Hōritsu* [Law Regarding Regular Banks' Concurrent Engagement in Trust Business], Law No. 43 of 1943.

¹⁸ But see *supra* note 3.

¹⁹ *Shiteki Dokusen No Kinshi Oyobi Kōsei Torihiki No Kakuho Ni Kansuru Hōritsu* [Law Regarding Prohibition against Private Monopoly and Insurance of Fair Transactions], Law No. 54 of 1947.

*Securities Advisory Business Law*²⁰

This law restricts business of providing advisory and discretionary management services on securities investment, permitting only registered investment advisors to engage in investment advisory business and to act as discretionary investment managers with prior additional approval. It also regulates relationships between such advisors (or managers) and other companies.

*Securities Investment Trust Law*²¹

This law restricts activities related to securities investment trusts (mutual funds), permitting only licensed companies to originate and create such trusts and to provide trustees with instructions on trust asset management, limiting such originators' other businesses, and allowing only trust banks to administer such trusts as trustees in accordance with the instructions of such originators (trustors). It also regulates relationships between such originators (trustors) and other companies.

*Asset Securitization Law*²²

This law restricts activities relating to securitization of lease and credit receivables of nonbanks, permitting only financial institutions and other licensed companies to acquire, pool, and securitize such nonbank assets and/or distribute such asset-backed certificates. This limits such packagers' other businesses, and allows only trust banks to package and securitize such nonbank assets through trusts and to distribute beneficial interests in such trusts.

*Commodity Fund Law*²³

This law restricts activities related to commodity investment funds, permitting only financial institutions and other licensed companies to originate such funds and/or to distribute interests in such funds. Under this law, only trust banks can administer as trustees the funds taking the form of trust and distribute certain kinds of beneficial

²⁰ *Yūkashōken Ni Kansuru Tōshikomongyō No Kisei Tō Ni Kansuru Hōritsu* [Law Regarding Restrictions, etc. on Investment Advisory Business on Securities], Law No. 74 of 1986.

²¹ *Shōken Tōshi Shintaku Hō* [Securities Investment Trust Law], Law No. 198 of 1951.

²² *Tokutei Saiken Tō Ni Kakaru Jigyō No Kisei Ni Kansuru Hōritsu* [Law Regarding Restrictions on Business Relating to Certain Monetary Claims, etc.], Law No. 77 of 1992.

²³ *Shōhin Tōshi Ni Kakaru Jigyō No Kisei Ni Kansuru Hōritsu* [Law Regarding Restrictions on Business Relating to Commodity Investment], Law No. 66 of 1991.

interests in such trusts. Only approved companies can provide discretionary management services on commodity investment.

III. DOMESTIC SECURITIES ACTIVITIES

A. Domestic Securities Activities of City Banks (Domestic Offices)

This part discusses what kinds of domestic securities activities city banks may engage in directly through their domestic offices and what kinds of restrictions such domestic securities activities are subjected to under Japanese laws.

1. *In General*

As seen in the last part, various laws affect securities activities of city banks. However, the Banking Law and the Securities and Exchange Law provide basic restrictions, because both laws cover large areas of securities activities, whereas other laws cover only small parts. Thus, for a preliminary purpose, this part analyzes what kinds of restrictions both laws impose on city banks' securities activities.

a. Banking Law

As a matter of corporate power,²⁴ the law provides for permissible activities of city banks, classifying them into the three categories: the so-called, *core banking business* (*Hon'gyō*),²⁵ *incidental banking business* (*Fuzui Gyōmu*),²⁶ and *other banking business* (*Ta'gyō*).²⁷

²⁴ As a matter of theory, it is possible to construe that the Banking Law does not limit corporate power of a bank but merely restricts activities of banks outside of corporate power. Under this view, when a bank conducts activities impermissible under the Banking Law, problems of *ultra vires* do not arise, but violations of the Banking Law followed by some punishments result. However, in reality, descriptions of corporate purpose in banks' articles of incorporation are such as "banking business and such other business as incidental thereto," the scope of which depends upon what kinds of activities the Banking Law permits. Accordingly, as a practical matter, the Banking Law limits corporate power of banks through the description of corporate purposes.

²⁵ Banking Law art. 10(1).

²⁶ *Id.* art. 10(2).

²⁷ *Id.* art. 11. With respect to the *incidental banking business*, it is construed from its nature that it may be conducted only to the extent incidental to the *core banking business*. In addition, Article 11 of the Banking Law provides that the *other banking business* may be conducted except to the extent it interferes with the *core banking business*. These limitations purport to restrict *incidental banking business* relative to *core banking business* and to restrict *other banking business* even more than the *incidental banking business*. The classification of city banks' activities is established principally to implement these limitations. However, as a practical matter, such limitations are not so significant, because they will become problematic only in an extreme case where city banks are viewed as engaging principally in either the *incidental banking business* or

The law exclusively lists certain kinds of activities as the *core banking business* and the *other banking business*. On the other hand, it only illustratively lists certain kinds of activities as the *incidental banking business* and thus permits city banks to engage in other non-listed activities as incidental to the *core banking business*. Such non-listed incidental activities are called *non-listed incidental banking business* (*Sonota Fuzui Gyômu*). In sum, under the Banking Law city banks may engage in the listed activities and the *non-listed incidental banking business*. City banks may not engage in other activities.²⁸

The listed activities include many kinds of securities activities: (a) trading (investment), underwriting, distribution, dealing, private placement activities and brokerage activities²⁹ in connection with (i) "monetary claims (*Kinsen Saiken*)"³⁰ and (ii) government bonds, regional government bonds and government-guaranteed bonds; (b) trading (investment), purchases or sales upon the written order, and for the account, of customers, and private placement activities, in connection with other "securities".³¹ The Banking Law does not define the term "securities" as used therein; rather, it is generally construed that the term has the same meaning as that defined in the Securities

other banking business rather than the *core banking business*. Thus, this article disregards such classification of activities, e.g., into which category a certain kind of securities activity is classified.

²⁸ *Id.* art. 12.

²⁹ The term "brokerage activities" as used herein includes purchases or sales upon the written order, and for the account of, customers.

³⁰ As discussed below in text, some kinds of monetary claims are securities as defined in the Securities and Exchange Law, while others are not. With respect to monetary claims which are concurrently securities as defined in the Securities and Exchange Law, the Banking Law expressly permits all of the types of activities listed in the text. On the other hand, with respect to other monetary claims, the Banking Law does not list all of the listed types of activities, but merely permits city banks to engage in "[a]cquiring and assigning monetary claims." Banking Law art. 10(2)(v). The Banking Law does not define the phrase "[a]cquiring and assigning"; however, it is generally construed that this term includes all of the types of activities listed in the text. See UJIKANE HIROYUKI AND NAKA HIROSHI, *GINKÔ HÔ NO KAISETSU* [EXPLANATION OF BANKING LAW] 57 (1994).

Notwithstanding this interpretation of the Banking Law, it should be noted that the Ministry of Finance has imposed substantial non-statutory restrictions on these activities. In general, the Ministry of Finance often imposes such non-statutory restrictions on banks' activities, which are usually published but are sometimes oral. These non-statutory restrictions are called administrative instructions (*Gyôsei Shidô*). It is true that such restrictions make Japan's banking regulations difficult to understand. In considering whether or not, or to what extent, a type of activity is permissible, it is indispensable to look into not only the Banking Law but also the related Ministry of Finance non-statutory administrative rules.

³¹ Some kinds of securities derivative activities are also permitted under the Banking Law; e.g., trading, dealing in, and brokerage activities of futures and options of domestic and foreign government bonds or indices thereof on domestic and foreign markets. Banking Law arts. 10(2)(ii), 11. This article omits these derivative activities of a bank.

and Exchange Law.³² Also, the Banking Law does not define the term "monetary claims" as used therein (hereinafter "Monetary Claims"); however, the Banking Law has a list of covered financial instruments, which includes certificates of deposit, commercial paper, certain kinds of trust beneficial certificates backed by residential mortgages or other loans, other residential-mortgage-backed certificates and asset-backed certificates covered by the Asset Securitization Law, and commodity-fund certificates covered by the Commodity Fund Law.³³ The list is not exclusive but merely illustrative, and the term "monetary claims" generally means rights to request a certain other person to pay money to himself or herself. Thus, even what is not listed now can be included in Monetary Claims so long as it has such nature. Monetary Claims basically do not include securities as defined in the Securities and Exchange Law (hereinafter "Securities and Exchange Law Securities"), unless the Banking Law adds them to the above lists. Indeed, some of the Monetary Claims, or foreign certificate of deposits,³⁴ commercial paper,³⁵ and some kinds of trust beneficial certificates backed by residential mortgages³⁶ and other loans,³⁷ are concurrently Securities and Exchange Law Securities.³⁸

On the other hand, other kinds of securities activities, although not listed in the Banking Law, are permissible for city banks under the Banking Law if they constitute the so-called *non-listed incidental banking business*.³⁹ Generally, the scope of such *non-listed incidental banking business* is determined by interpretations.⁴⁰ For an activity to

³² For the definition of the term "securities" under the Securities and Exchange Law, see *infra* text accompanying note 45.

³³ *Ginkō Hō Shikō Kisoku* [Banking Law Administrative Ordinance], *Okura Shōrei* [Ordinance of MOF], art. 12, No. 10, Mar. 3, 1982, as amended [hereinafter BL Administrative Ordinance].

³⁴ See *infra* note 84.

³⁵ See *infra* note 85.

³⁶ See *infra* note 86.

³⁷ See *infra* note 87.

³⁸ For purposes of the scope of permissible activities, there is no distinction under the Banking Law between Monetary Claims which are concurrently Securities and Exchange Law Securities and Monetary Claims which are not. In other words, banks are permitted under the Banking Law to engage in trading, underwriting, distribution, dealing, private placement activities, and brokerage activities, in connection with both types of Monetary Claims. Banking Law art. 10(5); see also *supra* note 31.

³⁹ Other laws, of course, can regulate activities included in the *non-listed incidental banking business*.

⁴⁰ An administrative rule of the Ministry of Finance has an illustrative list of the *non-listed incidental banking business*. The list includes (a) credit card financing, (b) guaranteeing residence or other consumer financing, (c) factoring, (d) selling asset-backed certificates covered by the Asset Securitization Law, and (e) selling commodity-fund certificates covered by the Com-

constitute such *non-listed incidental banking business*, all of the following conditions must be satisfied: (a) the activity is not risky; (b) the activity is profitable; (c) the activity does not adversely affect other industries; (d) the activity has some proximity with the *core banking business*;⁴¹ and (e) it does not exceed the *core banking business* in scale.⁴² The scope of the *non-listed incidental banking business* is determined flexibly on a case-by-case basis, taking into account the functions expected of a bank by society and economics.⁴³

b. Securities and Exchange Law

The Securities and Exchange Law only applies to certain types of activities related to Securities and Exchange Law Securities.

Types of Activities

Types of activities covered by the Securities and Exchange Law consist basically of (a) underwriting, (b) distribution, (c) dealing, (d) private placement activities, and (e) brokerage activities.⁴⁴ Trading (investment) is not included in Securities and Exchange Law Activities.⁴⁵

modity Fund Law. *Kin'yū Kikan To Sono Kanrenigaisya No Kankei Ni Tsuite* [Regarding Relationships Between Financial Institutions and Their Affiliates], *Jimu Renraku* [Administrative Notice], (Jul. 3, 1975), as amended (hereinafter "MOF Domestic Affiliate Notice"). In addition, the Ministry of Finance has not formally made any opinion on it, but it is generally accepted that currency and interest rate swap transactions, and advisory activities on corporate mergers and acquisitions are also included in such *non-listed incidental banking business*. See *infra* note 198.

⁴¹ The *core banking business* consists of: (a) accepting deposits and installment savings; (b) lending money or discounting bills and notes; and (c) conducting exchange transactions. Banking Law art. 10(1).

⁴² Gotō Norio, *Ginkō No Betsugaisya Ni Yoru Kei'ei Senryaku* [Management Strategies through Subsidiaries of Banks], *KIN'YŪ ZAISEI JUŌ* [FINANCIAL AND FISCAL AFFAIRS], Sept. 1, 1969, at 23-24. See also UJIKANE & NAKA, *supra* note 31, at 52-53; Ōkurashō *Kin'yū Hōrei Kenkyū Kai* [MOF Financial Law Study Group], SHIN GINKŌ HŌ SEIGI [NEW BANKING LAW COMMENTARY], 143-144 (1982), both of which point out only the two (2) conditions (d) and (e) as mentioned in text.

⁴³ Ōkurashō *Kin'yū Hōrei Kenkyū Kai* [MOF Financial Law Study Group], *supra* note 43, at 143-144.

⁴⁴ Securities and Exchange Law art. 2(8). Some kinds of securities derivative activities are also included in Securities and Exchange Law Activities; e.g., trading and dealing in, and brokerage activities of, futures and options of Securities and Exchange Law Securities or indices thereof on domestic and foreign markets. Securities and Exchange Law art. 2(8)(i)-(iii). This article omits these derivative activities.

⁴⁵ KANZAKI KATSURO, SHŌKEN TORIHIKI HŌ [SECURITIES AND EXCHANGE LAW] 330 (new ed. 1987).

Definition of Securities

The Securities and Exchange Law lists as securities certain kinds of instruments, certificates, interests, claims, or rights.⁴⁶ They basically are (a) government bonds, regional government bonds and government-guaranteed bonds, (b) stock certificates and warrant certificates, (c) debenture certificates, (d) commercial paper, (e) beneficial certificates of securities investment trusts (mutual funds) and loan trusts, (f) foreign instruments with the same nature as the above,⁴⁷ (g) certain kinds of trust beneficial certificates backed by residential mortgages or other loans, and (h) foreign certificate of deposits. This list is exclusive, not illustrative. In addition, the list focuses mainly on legal forms and presence of physical documents rather than substances of underlying interests, claims or rights. Furthermore, the Securities and Exchange Law does not have any catch-all provision which automatically includes in the Securities and Exchange Law Securities instruments, etc., that meet certain conditions.⁴⁸ These make the definition of securities under the Securities and Exchange Law much less flexible than that under United States securities laws, which have a catch-all term, such as "investment contract"⁴⁹ backed by the *Howey* test.⁵⁰ The Securities and Exchange Law, nevertheless, reserves some flexibility by allowing a cabinet order or ministry ordinance thereunder to add other non-listed instruments, etc., to the above Securities and Exchange Law Security list without amending

⁴⁶ Securities and Exchange Law art. 2(1), (2).

⁴⁷ The Securities and Exchange Law Securities include "Securities or certificates issued by . . . a foreign judicial person and having the same nature as the securities or certificates listed in each preceding item." Securities and Exchange Law art. 2(1)(ix). The coverage of this involves some uncertainties. For example, it is unclear whether or not foreign partnership interests and beneficial interests in foreign trusts are viewed as securities issued by "a foreign judicial person." But see *infra* notes 252, 325.

⁴⁸ Once a type of instrument, etc. constitutes Securities and Exchange Law Securities, the Securities and Exchange Law subjects Securities and Exchange Law Activities of such instrument to the prior license requirement or other restrictions. See *supra* text accompanying note 16. A violation of such requirement or restrictions results in some criminal sanction. In general, a principle of Japan's criminal law requires that restrictions any violation of which results in some criminal sanction be clearly set forth. It is said that for this reason, the Securities and Exchange Law by this list intended to clearly define "securities" and does not have any catch-all provision. Uchida Taruki, Shōken Torihiki Seido No Kaikau No Tame No Kankei Hōritsu No Seibi Tō Ni Kansuru Hōritsu'an Ni Tsuite [Regarding Proposed Law Improving, etc. Related Law Which Reform the Securities Transaction System], SHIMON SHUO [Capital Market], May 1992 at 8.

⁴⁹ 15 U.S.C. §§ 77b, 78c(a) (1988).

⁵⁰ See *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

the Security and Exchange Law, if such instruments, etc. satisfy certain conditions.⁵¹

The Securities and Exchange Law prohibits city banks from engaging in Securities and Exchange Law Activities of Securities and Exchange Law Securities⁵² with exceptions,⁵³ where city banks are exempted from this prohibition to the extent that city banks are expressly authorized by the Banking Law to engage in such activities.⁵⁴ This law, nevertheless, subjects such exempted activities to some restrictions, including the prior approval requirement.⁵⁵ That is, once the prohibition applies to a line of activity, even though such activity is exempted by the Securities and Exchange Law from the prohibition, a city bank may engage in such activity only with prior approval of the Minister of Finance under the Securities and Exchange Law⁵⁶ and subject to other restrictions thereunder.⁵⁷ However, the Securities and Exchange Law does not impose these restrictions on trading (investment), and purchases and sales for the written order, and for the account, of customers in connection with all kinds of Securities and Exchange Law Securities.⁵⁸ This represents that trading is not included in Securities and Exchange Law Activities. Such passive brokerage activities are assumed by the Securities and Exchange Law to raise few problems; thus the Securities and Exchange Law does not apply to these activities.

c. Relationships Between the Banking Law and the Securities and Exchange Law

In considering the relationship between the Banking Law and the Securities and Exchange Law, it is useful to classify securities activities into the following two categories:

⁵¹ Securities and Exchange Law art. 2(1)(viii), (x), (xi), (2).

⁵² Securities and Exchange Law art. 65(1).

⁵³ *Id.* at art. 65-(1)(proviso), (2).

⁵⁴ It is more exact to say that all of the securities activities exempted from the prohibition by the Securities and Exchange Law are authorized by the Banking Law. Banking Law art. 10(2)(ii), (2)(v), (5); art. 11; Securities and Exchange Law art. 65.

⁵⁵ Securities and Exchange Law art. 65-2(1).

⁵⁶ *Id.*

⁵⁷ *Id.* art. 65-2(2)-(8).

⁵⁸ *Id.* art. 65-2(1)(proviso).

*Securities and Exchange Law Activities of Securities
and Exchange Law Securities*

The Securities and Exchange Law prohibits these activities of city banks,⁵⁹ but exempts some of them.⁶⁰ Such exempted activities other than trading (investment), and purchases and sales upon the written orders, and for the account, of customers, are subjected by the Securities and Exchange Law to restrictions,⁶¹ including the prior approval requirement.⁶² On the other hand, the Banking Law authorizes city banks to engage in all of such exempted activities.⁶³

It can be pointed out that the Banking Law and the Securities and Exchange Law draw the same line between the permissible and impermissible securities activities of city banks. Thus, the Securities and Exchange Law here does not function independently of the Banking Law as a limitation on the scope of city banks' permissible securities activities. It merely dictates the Banking Law's limitations on corporate power of city banks in a different way. The Securities and Exchange Law has its own significance only in subjecting banks' securities activities permissible under the Banking Law to the prior approval requirement and other restrictions.⁶⁴ On this point, the Securities and Exchange Law differs from Section 16 of the U.S. Glass-Steagall Act, whose sole function is to limit the scope of banks' securities activities.⁶⁵

*Other Activities*⁶⁶

The Securities and Exchange Law does not apply to these activities. On the other hand, whether or not such activities are permissible for city banks under the Banking Law depends upon whether or not such activities come under activities related to Monetary Claims,⁶⁷ the

⁵⁹ *Id.* art. 65(1).

⁶⁰ *Id.* arts. 65(1)(2).

⁶¹ *Id.* art. 65-2(2)-(8).

⁶² *Id.* art. 65-2(1).

⁶³ Banking Law art. 10(2)(ii), (v), (5); art. 11.

⁶⁴ In other words, there is no reason why Article 65 of the Securities and Exchange Law exists in the Securities and Exchange Law, and only Article 65-2 thereof need be in the Securities and Exchange Law.

⁶⁵ If this point is emphasized, what should be presently called the Japan's Glass-Steagall Act are Articles 10 through 12 of the Banking Law rather than Article 65 of the Securities and Exchange Law.

⁶⁶ These activities consist of (a) Securities and Exchange Law Activities of non-Securities and Exchange Law Securities, (b) non-Securities and Exchange Law Activities of Securities and Exchange Law Securities, and (c) non-Securities and Exchange Law Activities of non-Securities and Exchange Law Securities.

⁶⁷ Banking Law art. 10(2)(v).

so-called *non-listed incidental banking business*,⁶⁸ or activities otherwise permitted by the Banking Law (*i.e.*, listed permissible activities).⁶⁹ If such activities are permissible under the Banking Law, city banks may engage in them, at least not subject to any restriction under the Securities and Exchange Law.⁷⁰ Thus, city banks, for example, may engage in all kinds of Securities and Exchange Law Activities of Monetary Claims which are not Securities and Exchange Law Securities,⁷¹ free from any Securities and Exchange Law restriction⁷².

2. Trading (Portfolio Investment)

This section describes city bank's restrictions on investment in securities, or securities activities to be booked for trading account. However, only passive investment for the purpose of portfolio management is focused on here. Investment for the purpose of controlling another company or participating in the management is excluded.⁷³ Thus, this section does not cover, for example, the case where a city bank acquires more than fifty percent of the outstanding stock in another company or less than fifty percent but otherwise controls such other company.

a. In General

The Banking Law permits a city bank to purchase and sell any kinds of Securities and Exchange Law Securities for the purpose of investment.⁷⁴ The Securities and Exchange Law exempts such investment from the prohibition against securities activities, without subjecting such investment to any restrictions, including the prior approval requirement.⁷⁵ This represents that trading does not constitute Secur-

⁶⁸ *Id.* art. 10(2).

⁶⁹ *Id.* arts. 10-12.

⁷⁰ But other laws than the Banking Law and the Securities and Exchange Law, of course, can regulate such activities.

⁷¹ Banking Law art. 10(2)(v).

⁷² In reality, to what extent these activities are permissible depends upon non-statutory restrictions imposed by the Ministry of Finance administrative rules. *See supra* note 31. In addition, some kinds of Monetary Claims could be designated in the future as Securities and Exchange Law Securities by a cabinet order or ministry ordinance under Article 2(1)(viii), (x) or (xi), or Article 2(2), of the Securities and Exchange Law. *See supra* text accompanying note 52. If so designated, the activities of the Monetary Claims are fully subject to the Securities and Exchange Law regulatory framework.

⁷³ Restrictions on investment for the purpose of control will be discussed in the context of limitations on affiliations between a bank and other companies. *See infra* note 346 and surrounding text.

⁷⁴ Banking Law art. 10(2)(ii).

⁷⁵ Securities and Exchange Law arts. 65(1)(proviso), 65-2(1).

ities and Exchange Law Activities and the Securities and Exchange Law does not apply to trading. A city bank may also purchase and sell Monetary Claims that are not Securities and Exchange Law Securities, for the purpose of investment, not subject to any Securities and Exchange Law regulatory framework.⁷⁶

Stock

Neither the Banking Law nor the Securities and Exchange Law limits stock holding of a bank; on this point, the Japanese system outstandingly differs from the United States' Glass-Steagall System, which prohibits a bank from investing in stock with limited exceptions.⁷⁷ However, Japan's Anti-Monopoly Law prohibits a city bank from, without prior approval of Fair Trade Commission (*Kôsei Torihiki Iinkai*), acquiring or retaining more than five percent of the outstanding stock in a domestic company, with small exceptions.⁷⁸ Thus, a city bank can invest in stock of any domestic company only within this five percent limitation.

Other Securities and Exchange Law Securities and Monetary Claims

Neither the Banking Law nor the Securities and Exchange Law sets any standard for investment quality or marketability of Securities and Exchange Law Securities, other than stock, or non-Securities-and-

⁷⁶ Banking Law art. 10(2)(v). It merely permits "[a]cquiring and assigning" Monetary Claims. But it is generally construed that, this covers purchases and sales thereof for the purpose of investment. See *supra* note 31.

⁷⁷ 12 U.S.C. § 24 (1994).

⁷⁸ Anti-Monopoly Law art. 11(1). It should be noted that if a bank owns a securities firm subsidiary and/or a trust bank subsidiary, the bank is subject to the five percent limitation as amended. See *infra* text accompanying notes 380, 433.

On the other hand, this five percent limitation does not apply to stock holding arising from (a) dealing of a securities firm, (b) foreclosures of collateral, and (c) acquisitions for trust accounts.

In addition, this five percent limitation does not apply to stock in any foreign company; thus, a city bank should be able to invest in such foreign stock without any limitation. However, a city bank is instructed by the Ministry of Finance to limit its holding of stock in any foreign company to ten percent or less of the outstanding stock therein, if such foreign company is engaged in activities impermissible for any domestic affiliates of a bank. Such impermissible activities basically are activities unrelated to banking, including real estate retail business, travel agency business, product sales, hotel business, warehouse business, marine courier business, and mining business. On the other hand, there is almost no express limitation under the Banking Law or the Securities and Exchange Law on passive investment in less than fifty percent of the outstanding stock in any foreign company that is engaged in activities *permissible* for domestic affiliates of a bank. See *infra* text accompanying note 517. *Kin'yû Kikan To Sono Shussisaki Gaikoku Hôjin Tono Kankei Ni Tsuite* [Regarding Relationships between Financial Institutions and Their Invested Foreign Companies] *Jimu Renraku* [Administrative Notice] (Apr. 23, 1976) as amended (hereinafter "MOF Foreign Affiliate Notice").

Exchange Law Securities Monetary Claims, which can be invested in by a bank, unlike the United States' Glass-Steagall Act.⁷⁹ The five percent limitation under the Anti-Monopoly Law,⁸⁰ of course, is irrelevant here. Thus, a city bank may invest in non-stock Securities and Exchange Law Securities and Monetary Claims, without regard to the investment quality, marketability or the investment amount.

b. Concept of Trading (Portfolio Investment)

A city bank may trade in Securities and Exchange Law Securities and Monetary Claims within the above limitations; on the other hand, dealing in Securities and Exchange Law Securities is more restrictively permitted, as mentioned below. Thus, a standard for distinguishing trading from dealing is important. On this point, there are some disputes.⁸¹ A commentator says that the standard is whether or not securities are so frequently sold and purchased as to be viewed as dealing. This view maybe requires that securities booked for trading account be held during a long period. On the other hand, other commentators state that if securities are sold and purchased targeting the general public, dealing exists. This view appears to permit a bank to trade in securities on a regular basis for trading account, regardless of the holding period, if a bank does not intend to transact with the general public (many unspecified people), for example, by trading solely through brokers (*i.e.*, securities firms).

3. *Underwriting, Distribution and Dealing*

This section describes restrictions on city bank's underwriting, distributing, and dealing in, securities. Securities purchased in these activities are to be booked for dealing account.

a. In General

The Banking Law permits a city bank to underwrite, distribute, and deal in, (a) government bonds, regional bonds and government-guaranteed bonds⁸², (b) foreign certificates of deposit,⁸³ (c) commer-

⁷⁹ 12 U.S.C. § 24 (1994).

⁸⁰ Anti-Monopoly Law art. 11(1).

⁸¹ KANZAKI, *supra* note 46, at 403, 404-405 n. 8.

⁸² Banking Law arts. 10(2)(ii), (iv), 11; Securities and Exchange Law art. 65(2)(i).

⁸³ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(i). The Banking Law Administrative Ordinance includes any certificates of deposits in Monetary Claims, whereas only foreign certificates of deposit constitute Securities and Exchange Law Securities. Securities and Exchange Law art. 2(1)(vxi); *Shōken Torihiki Hō Shikōrei* [SEL Administrative Ordinance] Seirei [Cabinet Order] as amended, art. 1, No. 321 (Sept. 30, 1965) (hereinafter "SEL Adminis-

cial paper,⁸⁴ and (d) certain kinds of trust beneficial certificates backed by residential mortgages⁸⁵ or other loans.⁸⁶ The Securities and Exchange Law exempts such activities from the prohibition against securities activities,⁸⁷ but subjects them to the prior approval requirement⁸⁸ and some other restrictions covering unfair transactions⁸⁹ and

trative Order"). This is because there is some limitation on transferability of domestic certificates of deposit. That is, a transfer of a domestic certificate of deposit is perfected only by a notice to, or consent of, the issuer bank in writing with a notarized date.

⁸⁴ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(ii). The Banking Law Administrative Ordinance includes domestic and foreign commercial paper in Monetary Claims, whereas both constitute Securities and Exchange Securities. Securities and Exchange Law art. 2(1)(viii), (ix); *Shōken Torihiki Hō Dainijō Ni Kiteisuru Teigi Ni Kansuru Shōrei* [Ministry Ordinance Regarding Definitions Prescribed in Article 2 of Securities and Exchange Law], art. 1 *Ōkura Shōrei* [Ordinance of MOF] No. 14 (Mar. 3, 1993) as amended (hereinafter "SEL Definition Ordinance").

⁸⁵ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(iv). Monetary Claims include "beneficial certificates of a trust for residential mortgages," the term of which is not defined in the Banking Law.

On the other hand, Securities and Exchange Law Securities include "beneficial interests in a trust (which is limited to a trust whose initial beneficiary is the trustor thereof) for loans under contracts where a bank, a trust company," a certain financial institution, or a licensed commercial lending company, "lends funds necessary for acquisitions of residences (including land to be used for such residences and interests in such land)," regardless of whether or not such beneficial interests are represented by any securities or certificates. Securities and Exchange Law art. 2(2); SEL Administrative Order art. 1-3. (This Securities and Exchange Law Security does not look to the presence of physical document, unlike the others. See *supra* note 47 and accompanying text. This is an exception.) Also, such beneficial interests constitute Securities and Exchange Law Securities, regardless of whether they are issued by domestic or foreign judicial persons. Securities and Exchange Law art. 2(2)(ii).

In sum, although there is some uncertainty regarding the relationship between the beneficial interests included in Monetary Claims and those included in Securities and Exchange Law Securities, beneficial interests in a trust for residential mortgages, roughly described, constitute both Monetary Claims and Securities and Exchange Law Securities, if the initial beneficiary is the trustor; otherwise, such interests are Monetary Claims, but not Securities and Exchange Law Securities.

⁸⁶ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(vi), (vii), (ix). The BL Administrative Ordinance includes in Monetary Claims "beneficial certificates of a trust for general loans." BL Administrative Ordinance art. 12(vi). Also, Monetary Claims involve "beneficial certificates of a trust for loans to regional governments, etc. BL Administrative Ordinance art. 12(ix). Both kinds of trust beneficial certificates do not constitute Securities and Exchange Law Securities.

Furthermore, Monetary Claims include "certificates or securities issued by a foreign judicial person and representing beneficial interests in a trust for loans of a person engaged in banking business or other persons engaged in money lending as a business." BL Administrative Ordinance art. 12(vii). Such foreign certificates or securities concurrently constitute Securities and Exchange Law Securities. Securities and Exchange Law art. 2(1)(x); SEL Definition Ordinance art. 2.

⁸⁷ Securities and Exchange Law art. 65(2)(i)-(iii).

⁸⁸ Securities and Exchange Law art. 65-2(1).

⁸⁹ Securities and Exchange Law art. 65-2(3), (4). A bank is prohibited from soliciting customers to sell or purchase Securities and Exchange Law Securities by: (a) rendering unsubstanti-

personnel qualification.⁹⁰ Both the Banking Law and the Securities and Exchange Law prohibit a city bank from underwriting, distributing, or dealing in, other Securities and Exchange Securities, such as stock, warrants, debentures, debentures with rights of conversion into stock or with warrants, and beneficial interests in securities investment trusts and loan trusts.⁹¹

A city bank may also underwrite, distribute, and deal in, Monetary Claims that are not Securities and Exchange Law Securities,⁹² not subject to any Securities and Exchange Law regulatory framework. Such Monetary Claims include domestic certificates of deposit,⁹³ certain kinds of trust beneficial certificates backed by residential mortgages⁹⁴ or other loans,⁹⁵ other residential-mortgage-backed certificates,⁹⁶ asset-backed certificates covered by the Asset Securi-

ated advice on security prices, Securities and Exchange Law art. 50(1)(i); (b) employing high pressure sale tactics which could interfere with fair price making, Securities and Exchange Law art. 50(1)(v); Ginkō Tō No Shōkengyō Ni Kansuru Shōrei [Ministry Ordinance Regarding Banks' Securities Business, etc.] Ōkura Shōrei [Ordinance of MOF], art. 8(v), No.62 (Dec. 15, 1981) [hereinafter "SEL Bank Ordinance"]; (c) making materially mistaken or misleading representations, Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(i); and (d) offering loss indemnification or other special compensations, Securities and Exchange Law arts. 50-3, 50(1)(vi); SEL Bank Ordinance art. 8(ii). A bank also may not condition its credits to customers on the customers' entry into transactions with the bank. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(vi). No officer or employee of a bank may sell or purchase Securities and Exchange Law Securities by using information gained in the course of their jobs. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(iv). In addition to these prohibitions, a bank must timely disclose to customers in which status, as principal, intermediary, agent or broker, the bank will act and send transaction confirmations to them. Securities and Exchange Law arts. 46, 48.

⁹⁰ Each employee, or any other person, who engages in underwriting or distribution of, or dealing in, Securities and Exchange Law Securities on behalf of a bank must be registered with the Ministry of Finance. Securities and Exchange Law arts. 62, 65-2(3).

⁹¹ Banking Law art. 12; Securities and Exchange Law art. 65(1).

⁹² Banking Law art. 10(2)(v). It merely permits "Acquiring and assigning" Monetary Claims. But it is generally construed that includes all of underwriting, distribution, and dealing. See *supra* note 31.

⁹³ BL Administrative Ordinance art. 12(i). See *supra* note 84.

⁹⁴ Banking Law art. 12(iv). Beneficial certificates of a trust for residential mortgages do not constitute Securities and Exchange Law Securities, unless the initial beneficiary is the truster thereof. Securities and Exchange Law art. 2(2); SEL Administrative Order art. 1-3. See *supra* note 86.

⁹⁵ BL Administrative Ordinance art. 12(vi), (vii), (ix). Beneficial certificates of a trust for other loans of a financial institution do not constitute Securities and Exchange Law Securities, unless such certificates are issued by a foreign judicial person. Securities and Exchange Law art. 2(1)(x); SEL Definition Ordinance art. 2. See *supra* note 87.

⁹⁶ BL Administrative Ordinance art. 12(iii). See *infra* text following note 300.

tization Law,⁹⁷ and commodity-fund certificates covered by the Commodity Fund Law.⁹⁸

Government Bonds

A city bank may underwrite, distribute, and deal in, government bonds, regional government bonds⁹⁹ and government-guaranteed bonds within the above limitations. There is no other restriction under the Banking Law or the Securities and Exchange Law; however, a bank is instructed by the Ministry of Finance to limit the outstanding balance of these bonds booked for dealing account so as not to exceed the amount of owned capital of the bank.¹⁰⁰

Other Securities and Exchange Law Securities & Monetary Claims

As mentioned above, a city bank may underwrite, distribute, and deal in, some other kinds of Securities and Exchange Law Securities, within some limitations under the Securities and Exchange Law. Neither the Banking Law nor the Securities and Exchange Law sets any other restrictions on such activities. Also, there is no restriction under the Banking Law or the Securities and Exchange Law on bank's underwriting, distributing, or dealing in, Monetary Claims that are not

⁹⁷ BL Administrative Ordinance art. 12(viii). See *infra* text accompanying and following note 252.

⁹⁸ BL Administrative Ordinance art. 12(v). See *infra* text accompanying and following note 324.

⁹⁹ The term "government bonds" as used in the Banking Law and the Securities and Exchange Law literally does not include bonds issued by any foreign government. Neither the Banking Law nor the Securities and Exchange Law defines the term; however, the Securities and Exchange Law defines Securities and Exchange Law Securities to include "Securities or certificates issued by a foreign country. . .and having the same nature as the securities or certificates prescribed in each preceding item," and "the securities and certificates" as used therein include "government bonds." Securities and Exchange Law art. 2(1)(ix). In addition, Article 65(2)(v)(c) of the Securities and Exchange Law uses the term "foreign government bonds" and defines the term to mean securities or certificates issued by a foreign country and having the same nature as "government bonds." These indicate that the term "government bonds" as used in the Securities and Exchange Law does not include foreign government bonds. In addition, it is generally construed that the same term as used in both the Banking Law and the Securities and Exchange Law has the same meaning, unless otherwise defined.

Thus, a city bank is prohibited from underwriting, distributing, or dealing in, foreign government bonds. Banking Law art. 12; Securities and Exchange Law art. 65(1). Only trading (investment), sales and purchases upon a written order, and for the account, of customers, and private placement activities, are permissible in connection with foreign government bonds. Banking Law art. 10(2)(ii), (vi); Securities and Exchange Law art. 65(1), (2)(iv).

¹⁰⁰ *Futsū Ginkō No Gyōmu Un'ei Ni Kansuru Kihon Jikō Tō Ni Tsuite* [Regarding Basic Matters, etc. Relating to Business Operations of Regular Banks], *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau], No. 901, (Apr. 1, 1982), as amended (hereinafter "MOF Business Operation Rule").

Securities and Exchange Law Securities. Nevertheless, a bank is instructed by the Ministry of Finance to comply with substantial non-statutory limitations in connection with investment qualities, purchasers, sale amounts, disclosures, maturity dates, resales, and so on.¹⁰¹ Such limitations are discussed below.¹⁰²

b. Concepts of Underwriting, Distribution and Dealing

i. Underwriting and Distribution

Within the above limitations, a city bank may participate in public distributions of Securities and Exchange Law Securities and Monetary Claims in various ways.

Public Issues

In connection with a public issue of Securities and Exchange Law Securities and Monetary Claims, which roughly means an initial offering of them to fifty or more people including at least one unsophisticated investor,¹⁰³ a bank may, as principal, purchase them with a view of

¹⁰¹ *Commercial Paper Tō No Toriatsukai Ni Tsuite* [Regarding Handling of Commercial Paper, etc.] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 610 (Apr. 1, 1993) as amended (hereinafter "MOF CP Rule"); *Shin Yūkashōken Ni Kakaru Shōken Gyōmu Oyobi Shibo No Toriatsukai Gyōmu No Suikō Ni Tsuite* [Regarding Performance of Securities Business Relating to New Securities and Business of Handling Private Placement] *Ōkurashō Shōken Kyoku* [MOF Security Bureau] No. 437 (Mar. 24, 1993) (hereinafter "MOF New Securities & Private Placement Rule"); *Yokin, Unokin Oyobi Teiki Tsumikin No Shōhinsei Oyobi Sono Toriatsukai Ni Tsuite* [Regarding Conditions and Handling of Deposits, Savings and Installment Savings] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 521 (Apr. 1, 1992) as amended (hereinafter "MOF Deposit Rule"); *Koguchi Saiken Hanbai Ni Kakaru Gyōmu No Toriatsukai Ni Tsuite* [Regarding Handling of Business Relating to Sales of Divided Monetary Claims] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 1075 (Jun. 1, 1993) (hereinafter "MOF Asset Securitization Rule"); *Kinyū Kikan No Kashitsuke Saiken No Ryūdōka Tō Jiko Shihon Hiritsu Kōjōsaku Ni Tsuite* [Regarding Measures for improving Owned Capital Ratio including liquidation of Loans of Financial Institutions] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 800 (Apr. 30, 1992) as amended (hereinafter "MOF Loan Liquidation Rule") *Teitōken Tsuki Jūtaku Kashitsuke Saiken No Jōto No Tame No Jūtaku Teitō Shōsho Ni Tsuite* [Regarding Residential Mortgage-Backed Certificates for Assignments of Loans Secured by Residential Mortgages] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 3095 (Sept. 6, 1974) as amended (hereinafter "MOF Mortgage Certificate Rule"); *Shōhin Tōshi Ni Kakaru Gyōmu No Toriatsukai Ni Tsuite* [Regarding Handling of Business Relating to Commodity Fund Investment] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 1246 (Jun. 25, 1992) (hereinafter "MOF Commodity Fund Rule").

¹⁰² See *infra* text accompanying and following note 203.

¹⁰³ Securities and Exchange Law art. 2(3). Exactly stated, a public issue in which a bank may participate within the limitations as described in text above is an issue which does not qualify for "private placements" do not qualify [*Shibo*]. Such a public issue is described as "public offerings" [*Boshū*] in the Securities and Exchange Law. The meaning of "private placements" is very complicated. See *infra* text accompanying and following note 137.

resale,¹⁰⁴ solicit the general public to purchase them from the bank¹⁰⁵ and then resell them to the general public. These activities are the so-called firm commitment underwriting. Also, bank may, as agent of the issuer, both solicit the general public to purchase securities to be publicly offered¹⁰⁶ and sell them to the general public. These activities are the so-called best efforts underwriting. Thus, both firm commitment and best efforts underwritings are subject to the same limitations.¹⁰⁷ On this point, the Japanese system is clearer than the United States' Glass-Steagall system, where there are some disputes on whether or not a bank may conduct best efforts underwriting in bank-ineligible securities not in violation of Section 16 of the Glass-Steagall Act.¹⁰⁸

Secondary Public Offering

In connection with a secondary offering to the general public of Securities and Exchange Law Securities and Monetary Claims already issued (e.g., those privately placed or issued exclusively outside Japan), which basically means a secondary offering of them to fifty or

¹⁰⁴ Securities and Exchange Law art. 2(6). The activities are included in "Underwriting" [*Hiki'uke*], which is listed in Article 2(8)(iv) of the Securities and Exchange Law as one type of Securities and Exchange Law Activities. The Securities and Exchange Law does not define the term "underwriting," but the term "underwriter" [*Hiki'ukenin*] is defined to mean: (a) "a person who acquires all or part of an issue of securities from the issuer thereof with a view of secondary distribution thereof"; (b) "a person who undertakes to acquire the unsold portion of an issue of securities, in case there is no other person who acquires it"; (c) "a person who engages in a public offering or public distribution of an issue of securities on behalf of the issuer thereof"; and, (d) "other person who directly or indirectly participates in a public offering or public distribution of an issue of securities and who receives a commission, compensation or other consideration in excess of a commission which is ordinarily paid to distributors of securities."

¹⁰⁵ Securities and Exchange Law art. 2(8). The activities constitute "secondary distributions" [*Uridashi*], which is listed therein as Securities and Exchange Law Activities. The term "secondary distributions" roughly means to solicit, *on its own behalf*, fifty or more people under uniform terms to purchase securities already issued. Securities and Exchange Law art. 2(4); SEL Administrative Order art. 1-8.

¹⁰⁶ Securities and Exchange Law art. 2(8)(iv), (vi). The activities constitute "Underwriting" and "Handling public offering" [*Boshû No Toriatsukai*], both of which are listed therein as Securities and Exchange Law Activities. The term "Handling public offerings" roughly means to solicit, *on behalf of others*, fifty or more people, including at least one (1) unsophisticated investor, under uniform terms to purchase securities to be newly issued. The term "Underwriting" includes the term "Handling public offerings." For the meaning of the term "Underwriting," see *supra* note 105.

¹⁰⁷ Kawamura Yûsuke & Idemura Yasutaka, *Shibosai Toriatsukai Wo Meguru Kihon Mondai* [Basic Problems Relating to Handling Private Placement Securities Privately Placed], SHIHON SHIJÔ [CAPITAL MARKET], Dec. 1985, at 11.

¹⁰⁸ 12 U.S.C. § 24 (1994). See *Securities Industry Association v. Board of Governors of the Federal Reserve System (Bankers Trust II)*, 483 U.S. 1005 (1987), where the Supreme Court left this issue open.

more people (regardless of how sophisticated such people are),¹⁰⁹ a bank may, as principal, purchase them from the present holders (owners) with a view of resale,¹¹⁰ solicit the general public to purchase them from the bank,¹¹¹ and resell them to the general public. Also, a bank may, as principal, solicit the general public to purchase securities previously issued to the bank,¹¹² and sell them to the general public. Furthermore, a bank may, as agent of present holders (owners), both solicit the general public to purchase securities to be secondarily distributed¹¹³ and sell them to the general public.

ii. Dealing

Within the above limitations, a city bank may, as principal, purchase from the general public (many unspecific people) with a view of resale, and sell to the general public (many unspecific people), securities already distributed to the general public.¹¹⁴

4. Private Placement Activities

This section describes restrictions on city bank's private placement activities of securities.

a. In General

The Banking Law permits a city bank to engage in private placement activities of all kinds of Securities and Exchange Law Securities, debt or equity.¹¹⁵ The Securities and Exchange Law exempts such ac-

¹⁰⁹ Securities and Exchange Law art. 2(4). Such a secondary public offering is described as "secondary distributions" [*Uridashi*] in the Securities and Exchange Law. For the meaning of the term, see *supra* note 106. It is worthy of note that the term "secondary distributions" does not look to the sophistication of offerees, unlike the term "public offerings." See *supra* text accompanying note 104.

¹¹⁰ Literally construed, this activity is not included in Securities and Exchange Law Activities; however, it is generally considered that the activity is included in the term "secondary distributions" as defined in Article 2(4) of the Securities and Exchange Law. Kanzaki Katsurō, *Shōken Gyōmu To Ginkō Gyōmu [Securities Business and Banking Business]*, SHŌKEN TORIHIKI HŌ TAIKEI [SECURITIES AND EXCHANGE LAW THESIS COLLECTION], at 387.

¹¹¹ Securities and Exchange Law art. 2(8)(v). These activities constitute "secondary distributions." For the meaning of the term, see *supra* note 106.

¹¹² See *supra* note 106.

¹¹³ These activities constitute "Handling . . . secondary distributions" [*Uridashi No Toriatukai*], which are listed therein as Securities and Exchange Law Activities. The term "Handling . . . secondary distributions" roughly means to solicit, *on behalf of others*, fifty or more people under uniform terms to purchase securities already issued.

¹¹⁴ These activities constitute "Purchasing and selling" [*Baibai*], as listed in Article 2(8)(i) of the Securities and Exchange Law as one type of Securities and Exchange Law Activities.

¹¹⁵ Banking Law art. 10(2)(vi). The Banking Law was amended in 1993 to adopt this provision, which expresses for the first time that private placement activities are within corporate

tivities from the prohibition against securities activities,¹¹⁶ but subjects them to the prior approval requirement¹¹⁷ and other restrictions mainly covering unfair transactions¹¹⁸ and personnel qualification.¹¹⁹

Also, a city bank may engage in private placement activities of any Monetary Claims that are not Securities and Exchange Law Securities, not subject to any Securities and Exchange Law regulatory framework.¹²⁰

Neither the Banking Law nor the Securities and Exchange Law sets any other restrictions on private placement activities of Securities and Exchange Law Securities. Also, there is no limitation under the

power of a bank. Prior to the amendment, it was generally construed that the Banking Law permitted a bank to engage at least in such activities of debt securities, because such activities were considered to be included in the so-called *non-listed incidental banking business*, or activities ancillary to money lending activities. On the other hand, it was quite unclear whether or not such activities of equity securities were permissible under the law. Possibly for this reason, banks actively participated in private placements of debt securities but not of equity securities.

¹¹⁶ Securities and Exchange Law art. 65(2)(iv). This provision was adopted in 1993 at the same time the Banking Law was amended to expressly permit a bank to engage in private placement activities. Prior to the amendment, private placement activities, which basically meant placement activities with less than fifty people, did not constitute Securities and Exchange Law Activities. Thus, the prohibition against securities activities was not applied at all to such activities of a bank.

¹¹⁷ Securities and Exchange Law art. 65-2(1). Any bank which had been engaged in private placement activities prior to the 1993 amendment to the Securities and Exchange Law and which filed with the Minister of Finance a notice reporting such previous engagement within three months after the amendment is deemed to have obtained the approval for such activities only to the extent that the bank had been engaged in such activities before the amendment. *Shōken Torihiki Hō Shikō Fusoku* [Securities and Exchange Law Supplemental Rule], art. 26, Law No. 87 of 1993. Before the amendment, banks actively conducted private placement activities of debt securities but not of equity securities. See *supra* note 116. Thus, it appears that many city banks have the constructive approval for private placement activities of debt securities but possibly no approval has been obtained yet with respect to equity securities.

¹¹⁸ Securities and Exchange Law art. 65-2(3), (4). A bank is prohibited from soliciting customers to enter into private placement transactions of Securities and Exchange Law Securities by: (a) rendering unsubstantiated advice on security prices, Securities and Exchange Law art. 50(1)(i); (b) making materially mistaken or misleading representations, Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(i); and (c) offering loss indemnification or other special compensations, Securities and Exchange Law arts. 50-3, 50(1)(vi); SEL Bank Ordinance art. 8(ii). A bank also may not condition its credits to customers on the customers entry into private placement transactions with the bank. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(vi). No officer or employee of a bank may enter into private placement transactions by using information gained in the course of their jobs. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(iv).

¹¹⁹ Each employee, or any other person, who engages in private placement activities of Securities and Exchange Securities on behalf of a bank must be registered with the Ministry of Finance. Securities and Exchange Law arts. 65-2(3), 62.

¹²⁰ Banking Law art. 10(2)(v). It merely permits "[a]cquiring and assigning" Monetary Claims. But, it is generally construed that this includes private placement activities. See *supra* note 31.

Banking Law or the Securities and Exchange Law on such activities of Monetary Claims that are not Securities and Exchange Law Securities. Nevertheless, a bank is instructed by the Ministry of Finance to comply with substantial non-statutory restrictions as follows.

*Domestic Debentures*¹²¹

A bank, in engaging in private placement activities of domestic debentures, must obtain from each purchaser a written statement that debentures will not be resold for the following two years, and set the conditions and terms of private issues that are appropriately balanced with the those of public issues. Also, a bank must periodically file with the Ministry of Finance reports on its private placement activities.

Additional restrictions are imposed on each private placement of domestic debentures whose total offering price is two billion yen or more. For such a large private placement to be eligible for private placement activities of a bank, the total offering price of each may not exceed twenty billion yen. In addition, there must not be more than six large private placements of debentures of the same issuer for a fiscal year.¹²² Nor may the aggregated total offering price of large private placements of debentures of the same issuer in the current fiscal year exceed one hundred and twenty billion yen in any way, but in certain cases, the smaller amount.¹²³

Placement agent, including banks acting as such, may purchase debentures in a large private placement thereof only to the extent of fifty percent or less of the total offering price, and each placement agent's purchase thereof must be limited to the same or smaller percentage.¹²⁴ None of financial institutions which are engaged in private

¹²¹ MOF New Securities & Private Placement Rule, *supra* note 102. These non-statutory restrictions are not applied to debentures with rights of conversions into stock or with warrants.

¹²² The term "fiscal year" as used herein means a year beginning on April 1 and ending on March 31 in the next year.

¹²³ If the largest aggregated total offering price of public issues of debentures of an issuer in a fiscal year within the preceding full three fiscal years exceeds twenty billion yen, the aggregated total offering price of large private placements of debentures of the same issuer in the current fiscal year may not exceed the less of (a) such largest aggregated total public offering price or (b) one hundred and twenty billion yen. In other cases, twenty billion yen may not be exceeded. MOF New Securities & Private Placement Rule, *supra* note 102.

¹²⁴ Each placement agent must limit his or her own purchase of debentures in a large private placement thereof to (a) if the total offering price does not exceed five billion yen, fifty percent or less of the total offering price, (b) if it does not exceed ten billion yen, ten percent or less, and (c) if it exceeds ten billion yen, five percent or less. MOF New Securities & Private Placement Rule, *supra* note 102.

placement activities as a business may purchase debentures in any large private placement in which no placement agent is involved.

*Foreign Government Bonds and Foreign Debentures*¹²⁵

A placement agent bank must obtain a written statement of each purchaser concerning the resale limitations, set appropriate conditions and terms, and file periodical reports with the Ministry of Finance, as in the case of a large private placement of domestic debentures.

For a private placement of foreign government bonds or foreign debentures to be eligible for private placement activities of a bank, the total offering price of each may not exceed thirty billion yen, if such bonds or debentures have the highest investment grade; otherwise, twenty billion yen may not be exceeded.

In no case, may the purchase amount of each placement agent exceed ten percent of the total offering price. None of financial institutions which are engaged in private placement activities as a business may purchase such foreign bonds or debentures in any private placement in which no placement agent is involved.

Other Securities and Exchange Law Securities and Monetary Claims

A bank must file with the Ministry of Finance periodical reports on its private placement activities of other Securities and Exchange Law Securities as well.¹²⁶ Also, there are substantial non-statutory restrictions on private placement activities concerning some other kinds of Securities and Exchange Law Securities, such as foreign certificates of deposit,¹²⁷ commercial paper,¹²⁸ certain kinds of trust beneficial certificates backed by residential mortgages or other loans.¹²⁹ Likewise, substantial non-statutory restrictions are imposed by the Ministry of Finance on private placement activities of some kinds of Monetary Claims that are not Securities and Exchange Law Securities, such as domestic certificates of deposit,¹³⁰ certain kinds of trust beneficial certificates backed by residential mortgages or other

¹²⁵ MOF New Securities & Private Placement Rule, *supra* note 102. These non-statutory restrictions are not applied to debentures with rights of conversions into stock or with warrants.

¹²⁶ MOF New Securities & Private Placement Rule, *supra* note 102.

¹²⁷ MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rules, *supra* note 102. See *supra* note 84.

¹²⁸ MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102. See *supra* note 84.

¹²⁹ MOF New Securities & Private Placement Rule, *supra* note 102; MOF Loan Liquidation Rule, *supra* note 102. See also *supra* notes 86, 87.

¹³⁰ MOF Deposit Rule, *supra* note 102. See *supra* note 84.

loans,¹³¹ other residential-mortgage-backed certificates,¹³² asset-backed certificates covered by the Asset Securitization Law,¹³³ and commodity-fund certificates covered by the Commodity Fund Law.¹³⁴ These non-statutory restrictions set requirements concerning investment qualities, purchasers, sale amounts, disclosures, maturity dates, resales, and so on. Such restrictions are discussed below.¹³⁵

b. Concept of Private Placement Activities¹³⁶

i. *In General*

Private placement is an opposing concept to public offering. As mentioned above, a city bank is prohibited under the Banking Law and the Securities and Exchange Law from, as underwriter and/or distributor, participating in a public offering of Securities and Exchange Law Securities other than government bonds, regional government bonds, government-guaranteed bonds, foreign certificates of deposit, commercial paper and certain kinds of trust beneficial certificates backed by residential mortgages or other loans, whereas it is permitted under both laws, as placement agent, participate in a private placement of all kinds of Securities and Exchange Law Securities. Thus, it is important to know the distinction between the two terms in connection with Securities and Exchange Law Securities.¹³⁷ The Banking

¹³¹ MOF Loan Liquidation Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102. See also *supra* text accompanying notes 95-96.

¹³² MOF Mortgage Certificate Rule, *supra* note 102. See *infra* text following note 300.

¹³³ MOF Asset Securitization Rule, *supra* note 102. See *infra* text accompanying and following note 252.

¹³⁴ MOF Commodity Fund Rule, *supra* note 102. See *infra* text accompanying and following note 324.

¹³⁵ See *infra* text accompanying and following note 203.

¹³⁶ The disclosure system under the Securities and Exchange Law is briefly described here. In general, in publicly offering an issue of Securities and Exchange Law Securities, the issuer of such securities must (a) file a written notice with the Minister of Finance in advance, and (b) make and distribute prospectuses on or prior to such offering. Securities and Exchange Law arts. 4(1), 13, 15(1), (2). The requirements are applied to both initial and secondary public offerings. The notice and prospectus are expected to function as a registration statement and prospectus as required under the United States' Securities Act of 1933.

On the other hand, in a private placement of an issue of Securities and Exchange Law Securities, the notice and prospectus requirements are not applied.

¹³⁷ A city bank is permitted to participate in any public offering and private placement of any Monetary Claims that are not Securities and Exchange Law Securities; thus, the distinction is not important in connection with such Monetary Claims. See *supra* note 31. However, it should be noted that in realty substantial non-statutory restrictions are imposed by the Ministry of Finance on underwriting, distribution, and private placement activities, of such Monetary Claims. See *infra* text accompanying and following note 203.

Law does not have its own definition of these terms; rather, it refers to the definitions under the Securities and Exchange Law.¹³⁸

*Professional Private Placement*¹³⁹

An initial offering of Securities and Exchange Law Securities constitutes a private placement, if (a) all offerees are qualifying institutional investors,¹⁴⁰ which include banks, securities firms, and insurance companies, (b) such securities to be offered are not equity securities,¹⁴¹ and (c) any transfer (resale) of such securities to non-qualifying institutional investors is restricted in certain ways.¹⁴² No information on the issuer or the securities need be made available to offerees.¹⁴³ In addition, it does not matter how many qualifying institutional investors are offered to; however, if even only one non-quali-

¹³⁸ Banking Law art. 10(6).

¹³⁹ Securities and Exchange Law art. 2(3)(ii)(a), (8)(vi).

¹⁴⁰ SEL Administrative Order art. 1-5; SEL Definition Ordinance art. 4.

¹⁴¹ SEL Administrative Order art. 1-5. Such equity securities include stock, warrants, and debentures with rights of conversions into stock or with warrants. In general, for an offering to qualify for a private placement, some restrictions must be effectively imposed on transfers (resales) to non-qualifying institutional investors. See *infra* note 143. However, such restrictions cannot be imposed on these equity securities in anyway under applicable Japanese laws. Thus, equity securities are excluded.

¹⁴² SEL Administrative Order art. 1-5. In general, the name of securities must clearly indicate the prohibition against any transfer (resale) to non-qualifying institutional investors. SEL Definition Ordinance art. 5(2), (3)(iii). Additional restrictions are imposed, depending upon the type of securities.

For example, in the case of debentures and foreign government bonds, the following two conditions must be met. First, such debentures or bonds must be registered with the issuer, its transfer agent, or a registration institution. SEL Definition Ordinance art. 5(2)(i)(a), (3)(i). The legal background of this restriction is that a transfer of such registered debenture is not effective against the issuer or other third party under applicable Japanese laws without a transfer registration. SHOHÔ [Commercial Code], art. 307(1), Law No. 48 of 1899 (hereinafter "Commercial Code"); *Shasai Tô Tôroku Hô* [Bond Registration Law], art. 5(1), Law No. 11 of 1942. Second, each certificate, if issued, must bear a legend clearly indicating the prohibition against any transfer (resale) to non-qualifying institutional investors. SEL Definition Ordinance art. 5(2)(i)(b). If no certificate is issued, such prohibition must be disclosed to offerees, and conditioned on sales to offerees. SEL Definition Ordinance art. 5(3)(ii).

In the case of commercial paper, the following two conditions must be met. First, any indorsement must be effectively prohibited under applicable law. SEL Definition Ordinance art. 5(2)(ii). Second, each note must bear a legend clearly indicating the prohibition against any transfer (resale) to non-qualifying institutional investors. *Id.*

¹⁴³ Those who engage in private placement activities are required (with some exceptions) to notify offerees in writing of (a) lack of a notice to the Ministry of Finance as required for public offering or secondary distribution and (b) limitations on transfers (resales). A failure of this notice does not make the private placement a public offering. No other information on the issuer or the securities need be notified. Securities and Exchange Law art. 23-13; *Kigyô Naiyô Tô No Kaiji Ni Kansuru Shôrei* [Ministry Ordinance Regarding Disclosures of Corporate Information, etc.] *Ôkura Shôrei* [Ordinance of MOF], arts. 14-14(2), 14-15(1), No. 5, (Jan. 30, 1973) (hereinafter "SEL Disclosure Ordinance").

fyng institutional investor offeree is involved, or otherwise any one of the above three conditions is dissatisfied, an offering does not constitute a private placement but a public offering, unless such offering comes within a small number private placement as described below.

*Small Number Private Placement*¹⁴⁴

An initial offering of securities constitutes a private placement, if (a) the total number of offerees (qualifying and non-qualifying institutional investors) involved in the offering, together with the aggregated number of offerees involved in other small number private placements of securities of the same issuer with the same class¹⁴⁵ that were conducted during the preceding six-month period, is less than fifty,¹⁴⁶ (b) where such offered securities are equity securities, they are unmarketable stock¹⁴⁷ or other equity securities which such unmarketable stock underlies, and (c) any transfer (resale) of non-stock securities (including equity securities other than stock) and debt securities to fifty or more people is restricted in certain ways.¹⁴⁸ No information on the issuer or the securities need be made available to offerees.¹⁴⁹ In addi-

¹⁴⁴ Securities and Exchange Law art. 2(3)(i), (ii)(b), (8)(vi).

¹⁴⁵ Article 6 of the SEL Definition Ordinance defines the term "the same class." For example, if the interest rate and the maturity date of debentures to be offered are the same as those of debentures previously offered, the class of both is the same. *Id.* art. 6(i). In addition, if stock to be offered and stock previously offered involve the same divided rights to the same issuer, the class of both is the same. *Id.* art. 6(iv).

¹⁴⁶ SEL Administrative Order arts. 1-4, 1-6.

¹⁴⁷ SEL Administrative Order art. 1-7(i). The term "unmarketable stock" as used herein means stock issued by a person who has never issued the following: (a) stock listed on any stock exchange, Securities and Exchange Law art. 24(1)(i); (b) stock registered for over-the-counter market [*Tentō Baibai Kabushiki*], Securities and Exchange Law art. 24(1)(ii); SEL Administrative Order art. 3; (c) stock with the same class as stock with respect to which a notice was previously filed with the Minister of Finance for any public offering or secondary distribution, Securities and Exchange Law art. 24(1)(iii); and (d) stock the total number of whose holders is five hundred or more, Securities and Exchange Law art. 24(1)(iv); SEL Administrative Order art. 3-6(2).

¹⁴⁸ SEL Administrative Order art. 1-7(ii), (iii). For instance, in the case of debentures, foreign government bonds and commercial paper, the following four conditions must be met. First, they must be registered with the issuer or its transfer agent. For the legal effect of such registration, see *supra* note 143. Second, each certificate must bear a legend that each purchaser may not resell them unless he or she resells the whole block purchased by him or her in the small number private placement. Third, the total number of certificates issued in the small number private placement, together with the aggregated number of certificates issued in other small number private placements of securities of the same kind and the same issuer and with the same class that took place during the preceding six-month period, may not be fifty or more. Fourth, splitting a certificate into smaller units must be prohibited, and a legend of the prohibition against such splitting must be born by each initial certificate. SEL Definition Ordinance art. 7(3)(i)(b), (ii).

¹⁴⁹ See *supra* note 144.

tion, it does not matter how sophisticated offerees are. If any one of the above three conditions is dissatisfied, the offering does not constitute a private placement but a public offering, unless such offering comes within a professional private placement as described above.

Although the concept of private placement is similar to that under Rule 506 of the United States' Securities Act of 1933,¹⁵⁰ both differ in many respects, including requirements regarding the number and sophistication of purchasers (offerees), and the availability of information on issuers and/or securities.¹⁵¹

ii. *Permissible Activities Related to Private Placement*

Placement Agent Activities

A city bank may as agent of an issuer solicit purchase of Securities and Exchange Law Securities and Monetary Claims on a private basis¹⁵².

¹⁵⁰ 17 C.F.R. § 230.506 (1994).

¹⁵¹ United States banking law does not define the concept of "private placement" for the Glass-Steagall Act purposes; thus, the concept under United States securities laws is relevant, or it provides at least guidance. See *Securities Industry Association v. Board of Governors of the Federal Reserve System (Bankers Trust II)*, 807 F.2d 1052 (D.C. Cir. 1986), cert. denied, 483 U.S. 1005 (1987); OCC Interpretive Letter No. 329 Fed. Banking L. Rep. (CCH) ¶85,449 (Mar. 4, 1985); *Bankers Trust New York Corp.*, 75 Fed. Res. Bull. 829 (1989). Although United States securities laws also do not define such concept, courts have tried to do it, and Rule 506 of Regulation D under Securities Act of 1933 provides for a safe harbor rule.

In defining the term "private placement," Japanese laws have taken clear-cut approaches as described in text. On this point, the concept of "private placement" under Japanese laws clearly differs from that established by courts under United States laws. See, e.g., *Securities and Exchange Commission v. Ralston Purina*, 346 U.S. 119 (1953); *Doran v. Petroleum Management Corp.*, 545 F.2d 893 (5th Cir. 1977). Rather, it is similar to Rule 506.

However, Rule 506 permits thirty-five or less unaccredited investors, and unlimited number of accredited investors, to purchase securities, while it requires such unaccredited investors to be supported by purchaser representatives. See 17 C.F.R. §§ 230.506(b)(2), 230.501(a)(8) (1994). On the other hand, a professional private placement under the Securities and Exchange Law requires all offerees (and purchasers) to be qualified institutional investors. A small number private placement thereunder limits the numbers of offerees (and purchasers) to less than fifty, whereas it does not require any sophistication of offerees (or purchasers). In addition, while Rule 506 requires availability of some information on the issuer and the securities, Japanese laws do not at all. See 17 C.F.R. §§ 230.506(b)(1), 230.502(b) (1994). On these points, the concepts under Japanese laws and Rule 506 are clearly different.

¹⁵² This activity constitutes "Handling . . . private placements" [*Shibo No Toriatsukai*], which is listed in Article 10(2)(vi) of the Banking Law as permissible for a city bank, and is listed in Article 65(2)(iv) of the Securities and Exchange Law and defined in Article 2(3) and (8)(vi) of the Securities and Exchange Law. The term "Handling . . . private placements" roughly means soliciting purchase of securities *on behalf of others* in an issue which qualifies for a private placement. Thus, activities of providing issuers with advice or other assistance in connection with private placements of securities are not included in "Handling . . . private placements." For the

Financial Advisor Activities

A city bank may also as financial advisor of issuers render them advice or other assistance regarding their private placements of Securities and Exchange Law Securities and/or Monetary Claims.¹⁵³ On the other hand, a city bank cannot as financial advisor of investors (prospective purchasers) render them advice or other assistance regarding private placements of Securities and Exchange Law Securities, because such activities constitute investment advisory activities covered by the Investment Advisory Business Law.¹⁵⁴ Also, there is some uncertainty on whether or not a bank can provide investors with the same services on private placements of Monetary Claims.¹⁵⁵

Firm Commitment Private Placement

For the Securities and Exchange Law disclosure purposes, transfers (resales) of Securities and Exchange Law Securities privately placed without disclosure are strictly restricted; however, they can still be made without disclosure within the certain limitations.¹⁵⁶ In addition, private agents may purchase securities to be privately placed by them to the extent of the certain percentage of the total offering price.¹⁵⁷ Thus, another prospectively feasible form of private placement activities is that a city bank makes a firm commitment to purchase from the issuer certain portion of securities to be privately

terms "Handling public offerings" and "Handling . . . secondary distributions," *see supra* notes 107, 114.

It should be noted that a city bank may invest in Securities and Exchange Law Securities to be privately placed as placement agent by the bank, subject to some limitations under the Securities and Exchange Law. These restrict purchases of securities to be privately placed and resales thereof. For the limitations on such purchases, *see supra* text accompanying note 125 and following note 126. Also, for the resale limitation, *see infra* note 157. On the other hand, a city bank may invest in Monetary Claims, not subject to these limitations. *See supra* note 31.

¹⁵³ *See infra* text accompanying and following note 198.

¹⁵⁴ *See infra* text accompanying notes 193, 202.

¹⁵⁵ *See infra* text accompanying notes 197, 201, 202-2.

¹⁵⁶ Transfers (resales) of Securities and Exchange Law Securities privately placed are restricted in three ways. One, securities issued without disclosure in reliance on the professional private placement system can be resold without disclosure, only if all offerees (and purchasers) are qualified institutional investors. *See* Securities and Exchange Law art. 4(2). It does not matter how many qualified institutional investors are offered. Two, stock issued without disclosure in reliance on the small number private placement system can be resold without disclosure, only if the number of offerees (and purchasers) is less than fifty. *See* Securities and Exchange Law 4(1). Three, other securities issued without disclosure in reliance on the small number private placement system can be resold without disclosure, only if the number of offerees is less than fifty and the whole block purchased in the small number private placement is resold. *See* Securities and Exchange Law art. 4(1); SEL Administrative Order art. 1-7(ii), (iii).

¹⁵⁷ *See supra* text accompanying note 125 and following note 126.

placed, with a view of resale and resells them within these limitations. This activity can be called firm commitment private placement activities.

Where a bank purchases securities to be privately placed, with a view of resale to fifty or more people, and solicits fifty or more people to purchase such securities from the bank, such activities constitute underwriting¹⁵⁸ and distribution.¹⁵⁹ It is irrelevant whether or not all offerees are qualified institutional investors.¹⁶⁰ Thus, banks may engage in such firm commitment private placement activities only within the limitations under the Banking Law and the Securities and Exchange Law on underwriting and distribution as well as the above purchase and resale limitations under the Banking Law and Securities and Exchange Law.¹⁶¹

¹⁵⁸ A bank's purchase of securities to be privately placed with a view of resale to fifty or more people constitute "underwriting." For the meaning of the term "underwriting," see *supra* note 105.

¹⁵⁹ A bank's solicitation of fifty or more people to purchase such securities from the bank constitutes "secondary distributions." For the meaning of the term "secondary distributions," see *supra* note 106.

¹⁶⁰ See *supra* note 110.

¹⁶¹ With respect to the kinds of Securities and Exchange Law Securities as to which underwriting and distribution are permissible for banks under the Banking Law and the Securities Exchange Law, banks may engage in firm commitment private placement activities targeting fifty (50) or more investors, subject to the restrictions under the Securities and Exchange Law including the purchase and resale limitations. See *supra* text accompanying note 83. Such Securities and Exchange Law Securities include government bonds, regional government bonds, government-guaranteed bonds, commercial paper, foreign certificates of deposit, and certain kinds of trust beneficial certificates backed by residential mortgages or other loans. However, it should be noted that the notice and prospectus requirements do not apply to government bonds, regional government bonds, and government-guaranteed bonds. Securities and Exchange Law art. 3. As a practical matter, private placement of such securities cannot occur.

With respect to the kinds of Securities and Exchange Law Securities as to which underwriting and distribution are *impermissible* for banks under Banking Law and Securities and Exchange Law, banks may not engage in firm commitment private placement activities targeting at fifty or more investors. See *supra* text accompanying note 92. Such securities include stock, warrants, debentures with rights of conversion into stock or with warrants, and beneficial interests in securities investment trusts and loan trusts.

With respect to Monetary Claims other than Securities and Exchange Law Securities, underwriting and distribution are permissible for banks under the Banking Law and are not subject to the purchase and Securities and Exchange Law regulatory framework; thus, banks can engage in such kind of activity, not subject to the purchase and resale limitation under the Securities and Exchange Law. See *supra* text accompanying note 93. Such Monetary Claims include domestic certificates of deposit, certain kinds of trust beneficial certificates backed by residential mortgages or other loans, other residential-mortgage-backed certificates, asset-backed certificates covered by the Asset Securitization Law, and commodity-fund certificates covered by the Commodity Fund Law. See *supra* notes 94-99. However, such activities are subject to the Ministry of Finance's non-statutory restrictions. See *infra* text accompanying and following note 203.

On the other hand, where the number of offerees is less than fifty, such activities do not constitute underwriting or distribution but a literal interpretation of the Securities and Exchange Law includes such activities in other Securities and Exchange Law Activities,¹⁶² although MOF's position is completely unclear. Thus, it is uncertain whether or not banks are authorized to engage in such activities under the Banking Law and the Securities and Exchange Law.¹⁶³

Inter-Qualified Institutional Investor Dealing

Securities issued without disclosure in reliance on the professional private placement system can be resold without disclosure, if all offerees (and purchasers) are qualified institutional investors.¹⁶⁴ It does not matter how many qualified institutional investor offerees (or purchasers) are involved.¹⁶⁵ Thus, another form of prospectively feasible activities relating to securities privately placed is that qualified institutional investors deal in such professional private placement securities.

Where a bank purchases securities to be privately placed, with a view of resale and solicits fifty or more people to purchase such securities from the bank, such activities constitute underwriting¹⁶⁶ and distribution.¹⁶⁷ It is irrelevant whether securities are issued in a professional private placement, and all offerees are qualified institu-

¹⁶² It is clear that firm commitment private placement activities targeting less than fifty investors do not constitute "underwriting" or "secondary distributions." See Kanzaki, *supra* note 111, at 387; 403 at n.8. For the meanings of these terms, see *supra* notes 105, 106. However, they might constitute "purchasing and selling," which is listed as one type of Securities Exchange Law Activities. Securities and Exchange Law art. 2(8)(i). The phrase "purchasing and selling" is generally considered to mean "dealing." See *supra* text accompanying note 115. While there is no explicit limitation restricting the meaning of the phrase to such meaning, firm commitment private placement activities really involve "purchasing and selling" securities.

¹⁶³ If firm commitment private placement activities targeting less than fifty investors constitute, then banks may engage in such activities only within the limitations on dealing which are the same as those on underwriting and distribution as well as the purchase and resale limitations. See *supra* note 161.

On the other hand, if those activities do not fall within the Securities and Exchange Law Activities, then, such activities are not subject to the Securities and Exchange Law regulatory framework. However, the Banking Law does not expressly authorize or prohibit such activities. In addition, it is simply understood that the risks involved in such activities are the same as those involved in firm commitment private placement activities targeting fifty or more investors. Thus, while the Ministry of Finance's view seems unclear, it appears that a bank could engage in such activities, subject to the same limitations as applied to underwriting and distribution. See *supra* note 161.

¹⁶⁴ See *supra* note 157.

¹⁶⁵ See *supra* note 157.

¹⁶⁶ See *supra* note 158 and accompanying text.

¹⁶⁷ See *supra* note 159 and accompanying text.

tional investors.¹⁶⁸ In addition, where securities are purchased and sold either on a regular basis or targeting many unspecified people, such activities constitute dealing.¹⁶⁹ It is irrelevant whether securities are issued in a professional private placement, and purchased and sold only among qualified institutional investors. Thus, banks may engage in such inter-qualified institutional investor dealing in professional private placement securities only within limitations under the Banking Law and the Securities and Exchange Law on distribution and dealing.¹⁷⁰

5. *Brokerage Activities*

This section describes restrictions on city bank's brokerage activities of securities.

a. In General

The Banking Law permits a city bank to engage in brokerage activities of (a) government bonds, regional bonds and government-guaranteed bonds, (b) foreign certificates of deposit, (c) commercial paper, and (d) certain kinds of trust beneficial certificates backed by residential mortgages or other loans.¹⁷¹ The Securities and Exchange Law exempts such activities from the prohibition against securities activities,¹⁷² but subjects them to the prior approval requirement¹⁷³ and

¹⁶⁸ See *supra* note 110.

¹⁶⁹ See *supra* text accompanying note 82.

¹⁷⁰ See *supra* note 161.

¹⁷¹ See *supra* text accompanying note 83.

¹⁷² Securities and Exchange Law art. 65(2)(i)-(iii).

¹⁷³ Securities and Exchange Law art. 65-2(1).

some other restrictions covering unfair transactions¹⁷⁴ and personnel qualification.¹⁷⁵

Both the Banking Law and the Securities and Exchange Law prohibit a city bank from engaging in brokerage activities of any other Securities and Exchange Law Securities, such as stock, warrants, debentures, debentures with rights of conversion into stock or with warrants, and trust beneficial interests in securities investment trusts and loan trusts.¹⁷⁶ The Banking Law authorizes a city bank to sell and purchase any kind of Securities and Exchange Law Securities upon the written orders and for the accounts, of customers,¹⁷⁷ and the Securities and Exchange Law exempts such activities from the prohibition against securities activities without subjecting them to the prior approval requirement or any other restriction.¹⁷⁸ However, it is generally construed that a bank may not solicit the services at all,¹⁷⁹ nor provide such services to any persons other than existing customers of the bank.¹⁸⁰ A bank may only passively accept written requests of its existing customers.¹⁸¹ Thus, the limited scope of the activities construed under Japanese laws cannot provide any basis of authorizing a bank to engage in brokerage activities, unlike the United States' Glass-Steagall Act.¹⁸²

¹⁷⁴ Securities and Exchange Law art. 65-2(3), (4). A bank is prohibited from soliciting customers to enter into brokerage transactions of Securities and Exchange Law Securities by: (a) rendering unsubstantiated advice on security prices, Securities and Exchange Law art. 50(1)(i); (b) employing high pressure sale tactics which could interfere with fair price making, Securities and Exchange Law art. 50(1)(v); SEL Bank Ordinance art. 8(v); (c) making materially mistaken or misleading representations, Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(i); and (d) offering loss indemnification or other special compensations, Securities and Exchange Law arts. 50-3—50(1)(vi); SEL Bank Ordinance art. 8(ii). A bank also may not condition its credits to customers on the customers' entry into brokerage transactions with the bank. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(vi). No officer or employee of a bank may enter into brokerage transactions by using information gained in the course of their jobs. Securities and Exchange Law art. 50(1)(vi); SEL Bank Ordinance art. 8(iv). In addition to these prohibitions, a bank must timely disclose to customers in which status, as principal, intermediary, agent or broker, the bank will act and send confirmations to them. Securities and Exchange Law arts. 46, 48.

¹⁷⁵ Each employee, or any other person, who engages in brokerage activities of Securities and Exchange Law Securities on behalf of a bank must be registered with the Ministry of Finance. Securities and Exchange Law arts. 65-2(3), 62.

¹⁷⁶ Banking Law art. 12; Securities and Exchange Law art. 65(1).

¹⁷⁷ Banking Law art. 10(2)(ii).

¹⁷⁸ Securities and Exchange Law arts. 65(1)(proviso), 62-2(1).

¹⁷⁹ But a bank may be compensated for such services.

¹⁸⁰ Kanzaki, *supra* note 46, at 403. Such written request of a customer must be made each time the kind of transaction is entered into. A document covering several transactions, such as a master agreement, cannot qualify for such written request. Kanzaki, *supra* note 46, at 403.

¹⁸¹ Kanzaki, *supra* note 46, at 403.

¹⁸² 12 U.S.C. § 24 (1994).

On the other hand, a city bank may engage in brokerage activities of Monetary Claims that are not Securities and Exchange Law Securities,¹⁸³ not subject to any Securities and Exchange Law regulatory framework. Such Monetary Claims include domestic certificates of deposit, certain kinds of trust beneficial certificates backed by residential mortgages or other loans, other residential-mortgage-backed certificates, asset-backed certificates covered by the Asset Securitization Law, and commodity-fund certificates covered by the Commodity Fund Law.¹⁸⁴

As mentioned above, a city bank may engage in brokerage activities of Securities and Exchange Law Securities of some kinds, within some limitations under the Securities and Exchange Law. Neither the Banking Law nor the Securities and Exchange Law set any other restrictions on such activities. Also, there is no restriction under the Banking Law or the Securities and Exchange Law on bank's brokerage activities of Monetary Claims that are not Securities and Exchange Law Securities. Nevertheless, a bank is instructed by the Ministry of Finance to comply with substantial non-statutory limitations regarding investment qualities, purchasers, sale amounts, disclosures, maturity dates, resales, and so on. Such limitations are discussed below.¹⁸⁵

b. Concept of Brokerage Activities

i. *In General*

Brokerage activities which a city bank may conduct within the above limitations include acting as intermediary, agent or broker in connection with sales and purchases of securities.¹⁸⁶

¹⁸³ Banking Law art. 10(2)(v). It merely permits "[a]cquiring and assigning" Monetary Claims. But it is generally construed that this includes brokerage activities. *See supra* note 31.

¹⁸⁴ *See supra* text accompanying note 94-99.

¹⁸⁵ *See infra* text accompanying and following note 203.

¹⁸⁶ Securities and Exchange Law art. 2(8)(ii). Brokerage activities include acting as intermediary, agent or broker in giving an order to a member of an exchange market on behalf of a customer to sell or purchase a security on the market. Securities and Exchange Law art. 2(8)(iii).

ii. Riskless Principal Transactions

It is uncertain whether or not the so-called riskless principal transactions¹⁸⁷ constitute brokerage activities on which the above limitations are imposed.¹⁸⁸

6. Advisory Activities

This section describes restrictions on various advisory activities of a city bank on securities.

a. Investment Advice and Discretionary Investment Management

Activities of providing investment advisory services and discretionary investment management services do not constitute Securities and Exchange Law Activities,¹⁸⁹ and are not subject to the Securities and Exchange Law regulatory framework, regardless of whether or not such activities relate to Securities and Exchange Law Securities. Thus, whether such advisory activities are permissible for a bank depends upon whether such activities are authorized by the Banking Law as a matter of corporate power and permitted by other applicable laws.

Securities and Exchange Law Securities

The Investment Advisory Business Law regulates investment advisory activities on Securities and Exchange Law Securities. That is, the law requires a prior registration with the Minister of Finance of any person who provides advice¹⁹⁰ on the values of Securities and Ex-

¹⁸⁷ The term "riskless principal transactions" as used herein means transactions in which a bank, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer. 12 C.F.R. § 240.10b-10(a)(8)(i) (1994).

¹⁸⁸ It is unclear what position the Ministry of Finance has taken with respect to this issue; however, riskless principal transactions would be viewed as dealing, rather than brokerage activities, for the purposes of the Banking Law and the Securities and Exchange Law. The scope of permissible dealing of a bank is presently the same as that of permissible brokerage activities under the Banking Law and the Securities and Exchange Law. Thus, it does not matter, at least today, whether riskless principal transactions constitute dealing or brokerage activities. However, if the laws are amended in the future to expand the scope of permissible brokerage activities, without simultaneously expanding that of permissible dealing to the same extent, the conclusion of this discussion will become crucial.

¹⁸⁹ See Securities and Exchange Law art. 2(8).

¹⁹⁰ The Investment Advisory Business Law does not regulate activities of providing investment advice by publishing news paper, magazines, or books, which can be bought anytime by anyone. Investment Advisory Business Law art. 2(1).

change Law Securities, or investment judgment¹⁹¹ based upon analyses of the values, and receives compensation from the advisee for that service.¹⁹² Thus, a city bank may engage in such activities, only if such activities are within corporate power of a bank under the Banking Law and the registration requirement is met under the Investment Advisory Business Law. It is generally construed that the investment advisory activities are not permissible for a bank under the Banking Law as a matter of corporate power.¹⁹³

The Investment Advisory Business Law also requires prior approval of the Minister of Finance¹⁹⁴ as well as the above registration of any person who engages in activities of managing investment in Securities and Exchange Law Securities as agent of customers on a discretionary basis.¹⁹⁵ Considering that investment advisory activities are construed to be impermissible for a bank as a matter of corporate power, the discretionary investment management activities would also be impermissible.

Other Monetary Claims

The Investment Advisory Business Law only regulates investment advisory and discretionary investment management activities of "Securities and Exchange Law Securities." These activities of Monetary Claims that are not Securities and Exchange Law Securities¹⁹⁶ are not subject to the regulatory framework of the Investment Advisory Business Law; nor any other laws (except the Banking Law) regulate them. Thus, a bank may engage in these activities of such Monetary Claims, if authorized by the Banking Law; however, it is uncertain

¹⁹¹ *Id.* The term "investment judgment" means judgment on (a) what kinds, which issues, and how many issues, of Securities and Exchange Law Securities to be invested in at what price, (b) whether to sell or purchase, and (c) how and when to invest. Thus, providing general economic information and advice, general economic statistical forecasting services, and industry studies, is not subject to the law.

¹⁹² *Id.* art. 4. The registration is not required when a bank as placement agent of an issuer provides prospective purchasers with information on securities to be issued, and solicits them to purchase such securities. This is because the bank does not provide advice to investors, but solicits them on behalf of the issuer. A more technical reason is that the bank receives compensation from the issuer, not from prospective purchasers.

¹⁹³ In the MOF Domestic Affiliate Notice, *supra* note 41, the Ministry of Finance expressed its position that the investment advisory activities constitute the so-called *proximate nonbanking business*, in which a bank may not engage directly, but may indirectly, through its affiliate. See *infra* text accompanying note 369. See also Kanzaki, *supra* note 111, at 401.

¹⁹⁴ Investment Advisory Business Law arts. 3, 24(1).

¹⁹⁵ *Id.* art. 2(4) (defining "discretionary investment management business").

¹⁹⁶ See *supra* text accompanying note 94.

whether or not they are within corporate power of a bank under the Banking Law.¹⁹⁷

b. Financial Transaction Advice

Possibly, a city bank is permitted under the Banking Law to provide advice on financial transactions, including loans, issues of securities, and private and public financing, to those who *raise* funds in such transactions.¹⁹⁸ The services may include assistance in structuring and evaluating the transactions, identifying, soliciting, and negotiating with, prospective lenders or investors, and reviewing offering memoranda and closing documents. These activities would constitute the so-called *non-listed incidental banking business*, because it can be considered that a bank merely utilizes essentially the same abilities and resources as used in its money lending activities.

However, in the case of public financing involving Securities and Exchange Law Securities other than government bonds, regional government bonds, foreign certificates of deposit, commercial paper, and certain kinds of trust beneficial certificates backed by residential mortgages or other loans, a bank can be prohibited from soliciting, and negotiating with, perspective investors. This is because unless such activities come within private placement activities, they constitute underwriting or distribution of Securities and Exchange Law Securities, both of which are impermissible for a bank under both the Banking Law¹⁹⁹ and the Securities and Exchange Law.²⁰⁰

On the other hand, it is unclear whether or not a city bank is permitted to provide advice on financing transactions, including loans,

¹⁹⁷ Given that banks cannot participate in investment advisory activities of Securities and Exchange Law Securities, it would seem also that they should not be allowed to engage in investment advisory and discretionary investment advisory activities relating to Monetary Claims. The reason for such view would be that the bank would then be doing essentially the same things as an investment advisor of Securities and Exchange Law Securities does. However, a bank is permitted to engage in all kinds of Securities and Exchange Law Activities relating to Monetary Claims under the Banking Law as Monetary Claim—related activities are considered more closely related to the so-called *core banking business*, especially money lending activities. See *supra* note 31. Thus, it might be acceptable for a bank to engage in investment advisory and discretionary investment management activities relating to Monetary Claims, even though it is not permitted to engage in the same activities relating to Securities and Exchange Law Securities.

¹⁹⁸ A city bank is also permitted to provide advice on corporate mergers and acquisitions. Such services may include assistance in (a) structuring and evaluating the transactions, (b) identifying, soliciting and negotiating with prospective sellers or purchasers, and (c) reviewing related documents. These activities are generally considered to constitute the *non-listed incidental banking business*. See *supra* note 41.

¹⁹⁹ Banking Law art. 12.

²⁰⁰ Securities and Exchange Law art. 65(1).

issues of securities, and private and public financing, to those who *provide* funds in such transactions.²⁰¹ The services could include assistance in evaluating the transactions, negotiating with a person who raises funds in such transactions, and reviewing closing documents.

In the case of private and public financing involving Securities and Exchange Law Securities, a bank can be prohibited from providing such services to prospective purchasers of the securities. This is because such activities can include investment advisory activities on Securities and Exchange Law Securities, which are generally construed to be outside corporate power of a bank under the Banking Law and trigger at the registration requirement under the Investment Advisory Business Law.²⁰² Also, in the case of public and private financing involving Monetary Claims, a bank may be prohibited from engaging in the same advisory activities. The reason for this is that such activities can involve investment advisory activities and so may be unauthorized by the Banking Law.²⁰³

7. *Commercial Paper Activities*

Commercial paper, whether domestic or foreign, is included in Securities and Exchange Law Securities.²⁰⁴ A city bank, nevertheless, is permitted under the Banking Law²⁰⁵ and the Securities and Exchange Law²⁰⁶ to engage in all kinds of Securities and Exchange Law Activities of domestic and foreign commercial paper, or underwriting, dealing, private placement activities, and brokerage activities;²⁰⁷ however, there are some statutory restrictions under the Securities and Exchange Law,²⁰⁸ including the prior approval requirement.²⁰⁹ How-

²⁰¹ Given that a bank is not permitted to engage in investment advisor activities of Securities and Exchange Law Securities and is not supposed to do so in relation to Monetary Claims, it would seem likely that a bank would therefore not be permitted to provide advice to those who provide funds for such financial transactions. Nevertheless, it appears that advisory activities relating to financial transactions are viewed as more closely related to the so-called *core banking business*, especially money lending activities, than investment advisory activities of Monetary Claims as well as Securities and Exchange Law Securities. *See supra* note 197. Thus, while banks are not permitted to engage in investment advisory activities related to Securities and Exchange Law Securities and Monetary Claims, banks may be able to do so with respect to financial transactions.

²⁰² Investment Advisory Business Law art. 4. *See supra* text accompanying note 150.

²⁰³ *See supra* note 197.

²⁰⁴ *See supra* note 85.

²⁰⁵ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(ii).

²⁰⁶ Securities and Exchange Law art. 65(2)(ii).

²⁰⁷ Banks are also permitted to trade in commercial paper, and extend credits to both cover the unsold portion of commercial paper (backup-line credits) and to pay commercial paper (guarantee and overdraft). MOF CP Rule, *supra* note 102.

²⁰⁸ *See supra* notes 90, 91, 119, 120, 174, 175.

ever, city banks are instructed by the Ministry of Finance to comply with additional non-statutory limitations.²¹⁰

Under the non-statutory limitations, commercial paper is eligible for the above activities of a bank, only if it has certain investment quality, term, denomination, etc.²¹¹ Such commercial paper may be sold only to sophisticated institutional investors, and the minimum purchase amount of each purchaser must be one hundred million yen.²¹² Certain disclosure documents must be made available to customers at main offices of a bank conducting primary market activities of commercial paper.²¹³ Commercial paper eligible for secondary market activities of a bank is limited to commercial paper which is issued using any banking organization or securities firm as underwriter or placement agent. As a result of these non-statutory restrictions, a bank may not conduct any public-oriented activities of commercial paper, such as underwriting and distribution.

For advisory activities of commercial paper, see above text.²¹⁴

8. Certificate of Deposit Activities

A city bank, under the Banking Law, may engage in all kinds of Securities and Exchange Law Activities of domestic certificates of deposit, or underwriting, distribution, dealing, private placement activi-

²⁰⁹ Securities and Exchange Law art. 65-2(1).

²¹⁰ MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²¹¹ With respect to domestic commercial paper, (a) the term must be no shorter than two weeks but no longer than nine months, (b) the interest must be paid in the form of issue discount, (c) the denomination must be one hundred million yen or more, (d) the investment quality must be within the top two short-term grades, and (e) the issuer (other than any foreign government or a certain public institution) must be a company (i) whose stock is listed on any stock exchange or (ii) which has satisfied the disclosure requirement under the Securities and Exchange Law for at least three years (where the issuer is a foreign company, at least both of the two conditions of (i) or (ii) above must be satisfied). MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

On the other hand, with respect to foreign commercial paper, (a) the term must be no longer than nine months, (b) the investment quality must be within the top two short-term grades, and (c) commercial paper must be issued on any reliable market, such as the United States or European market (no sale of commercial paper is, for the time being, permitted within two weeks after the commercial paper was issued). MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²¹² Cooperative purchase of two or more persons is prohibited, at least if the divided purchase amount of each purchaser is less than the minimum purchase amount. MOF CP Rule, *supra* note 102; MOF New Securities and Placement Rule, *supra* note 102.

²¹³ The disclosure documents need not include information on which disclosure is required under the Securities and Exchange Law. MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²¹⁴ See *supra* text accompanying and following note 190.

ties, and brokerage activities,²¹⁵ subject to no Securities and Exchange Law regulatory framework. This is because domestic certificates of deposit constitute Monetary Claims.²¹⁶ On the other hand, foreign certificates of deposit are Securities and Exchange Securities.²¹⁷ A bank is, nevertheless, permitted under the Banking Law²¹⁸ and the Securities and Exchange Law²¹⁹ to engage in the same activities of foreign certificates of deposit; however, there are some statutory restrictions under the Securities and Exchange Law,²²⁰ including the prior approval requirement.²²¹ Notwithstanding these statutory frameworks, banks are instructed by the Ministry of Finance to comply with substantial non-statutory limitations.²²²

Under the non-statutory limitations, certificates of deposit, whether domestic or foreign, are eligible for the above activities of a bank, only if they have certain term and denomination, etc.²²³

With respect to domestic certificates of deposit, a bank may not act as intermediary, agent or broker in connection with any issue of certificates of deposit; thus, best efforts underwriting and private placement activities are prohibited. In addition, a bank is prohibited from repurchasing (redeeming) certificates of deposit issued by itself. Other activities are permissible for a bank. A bank must file a notice with the Ministry of Finance in advance of engaging in such permissible activities, and subsequently file periodical reports on such activities with the Ministry of Finance. As a result of these non-statutory limitations, a bank may engage only in underwriting and secondary

²¹⁵ Banking Law art. 10(2)(v); BL Administrative Ordinance art. 12(i). *See supra* note 31. Of course, a bank may trade in domestic certificates of deposit.

²¹⁶ *See supra* note 84.

²¹⁷ *See supra* text accompanying note 84.

²¹⁸ Banking Law art. 10(2)(v), (5); BL Administrative Ordinance art. 12(i).

²¹⁹ Securities and Exchange Law art. 65(2)(iii).

²²⁰ *See supra* notes 90, 91, 119, 120, 174, and 175.

²²¹ Securities and Exchange Law art. 65-2(1).

²²² MOF Deposit Rule, *supra* note 102; MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²²³ With respect to domestic certificates of deposit, (a) the term must be no shorter than two weeks but no longer than two years, (b) the denomination must be fifty million yen or more, (c) the maturity date must be specified when the certificate is issued, and (d) mid-term interest of two-year certificates of deposit must be paid one year from the issue date. MOF Deposit Rule, *supra* note 102.

On the other hand, with respect to foreign certificates of deposit, (a) they must be denominated in any foreign currency, (b) the term must be no longer than six months, must be (c) the issuer such that which raises no apprehension on protection of investors (*e.g.*, an issuer ranked within the top one hundred and fifty in total assets in the world), and (d) they must be issued on any reliable market, such as the United States or European market. MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

market activities, such as dealing and brokerage activities in connection with domestic certificates of deposit.

With respect to foreign certificates of deposit, they may be sold only to sophisticated institutional investors, and the minimum purchase amount of each purchaser must be fifty million yen.²²⁴ Certain disclosure documents must be made available to customers at main offices of a bank engaging in the permissible activities.²²⁵ As a result of these non-statutory limitations, a bank may not conduct any public-oriented activities of foreign certificates of deposit, such as underwriting and distribution.

For advisory activities of certificates of deposit, see above text.²²⁶

9. Securities Investment Trust (Mutual Fund) Activities

This section describes restrictions on city bank's activities related to securities investment trusts (mutual funds).

a. Trustee Activities

In Japan, mutual funds always take the form of trust, not the form of corporation. The Securities Investment Trust Law requires prior license from the Minister of Finance of a company which engages in activities of creating securities investment trusts²²⁷ and giving the trustees instructions on how to manage trust assets (hereinafter "Trustee Company").²²⁸ The licensing guideline²²⁹ set by the Ministry

²²⁴ Cooperative purchase by two or more persons is prohibited, if the divided purchase amount of each purchaser is less than the minimum purchase amount. MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²²⁵ The disclosure documents need not include information on which disclosure is required under the Securities and Exchange Law. MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²²⁶ See *supra* text accompanying and following notes 190, 196.

²²⁷ The term "securities investment trust" means "a trust whose purpose is to manage trust assets by investing in certain securities in accordance with instructions of the trustee . . . and to distribute divided interests in the trust to unspecified and many people." Securities Investment Trust Law art. 2(1). The term "securities" as used therein means Securities and Exchange Law Securities. Securities Investment Trust Law art. 2(2). Thus, the law does not apply to any investment trusts whose trust assets are managed by investment in Monetary Claims that are not Securities and Exchange Law Securities.

²²⁸ Securities Investment Trust Law arts. 6, 4(1).

²²⁹ The Ministry of Finance's licensing guideline has recently been amended. Sakakibara Takashi, Tōshi Shintaku Kaikaku No Gutaiteki Hōsaku No Gaiyō [Outline of Concrete Measures for Investment Trust Reform], 1379 SHŌJI HŌMU [COMMERCIAL LAW AFFAIRS], Feb. 5, 1995, at 6-7.

The previous guideline permits a Trustee Company to be established only by any securities firm, and/or discretionary investment manager, that has certain business experience.

of Finance does not permit a city bank to obtain the license itself²³⁰ or to participate in mutual fund activities as originator or fund manager.²³¹

b. Trustee Activities

The Securities Investment Trust Law prohibits any companies, other than licensed trust companies and licensed trust banks, from being trustees of securities investment trusts.²³² City banks do not have trust power except the three regular banks,²³³ and must obtain prior approval of the Minister of Finance under the Banks' Trust Business Law in order to engage in activities of acting as trustees;²³⁴ however, the Ministry of Finance has taken a position of not granting the approval to existing city banks.²³⁵ Thus, a city bank cannot directly administer securities investment trusts as trustees by selling and purchasing securities in accordance with a Truster Company's instructions.²³⁶

On the other hand, the new guideline also permits a discretionary investment manager to concurrently engage in activities of acting as truster of securities investment trusts, if the aggregated outstanding amount of funds with respect to which the manager has undertaken to provide discretionary investment management services is three hundred billion (300,000,000,000) yen or more.

Anyway, the guideline does not allow a bank to obtain directly a license for acting as Truster Company.

²³⁰ The Securities Investment Trust Law requires prior approval of the Minister of Finance of a Truster Company which concurrently engages in other activities. Securities Investment Trust Law art. 18. The guideline set by the Ministry of Finance, for the time being, limits permissible concurrent activities to investment advisory activities. See *Shōken Tōshi Shintaku Itakugaisya No Gyōmu Un'ei Ni Tsuite* [Regarding Business Operation of Truster Companies of Securities Investment Trusts] *Ōkurashō Shōken Kyoku* [MOF Security Bureau] No. 995 (Jul. 20, 1992). Thus, for this reason as well, a city bank cannot obtain license for acting as Truster Company.

²³¹ Also, in my view, under the Banking Law, there is considerable uncertainty whether the activities are within the corporate power of a bank.

However, a city bank has its investment advisor affiliate engaging in activities of providing discretionary management services on securities investment; thus, indirectly through such an affiliate, a city bank may engage in activities of acting as a Truster Company. See *infra* text accompanying and following note 482.

²³² Securities Investment Trust Law art. 4(1).

²³³ See *supra* note 3.

²³⁴ Banks' Trust Business Law art. 1.

²³⁵ See *supra* note 3 and accompanying text. But see *supra* note 9.

²³⁶ However, as mentioned below, a city bank can engage in such activities indirectly through its trust bank subsidiary. See *infra* text accompanying note 442. But see *infra* text accompanying note 454.

c. Trust Beneficial Interest Activities

Beneficial interests in securities investment trusts are Securities and Exchange Law Securities.²³⁷ Thus, a city bank cannot engage in Securities and Exchange Law Activities of such beneficial interests, unless permitted by the Banking Law and exempted by the Securities and Exchange Law from the prohibition against securities activities thereunder.²³⁸ Both laws prohibit a city bank from engaging in Securities and Exchange Law Activities other than private placement activities.²³⁹ However, the Ministry of Finance currently does not permit securities investment trusts whose beneficial interests are privately placed. Thus, in reality, a bank may engage in almost no activities of such beneficial interests.

On the other hand, for advisory activities of beneficial interests in securities investment trusts, see above text.²⁴⁰

10. Securitized Asset Activities

This section describes restrictions on city bank's activities related to securitized assets (asset-backed securities).

a. Certificates Backed by Nonbank Lease and Credit Receivables

i. In General

In 1992, the Asset Securitization Law was enacted to regulate securitization of certain kinds of lease and credit receivables of nonbanks (hereinafter "Nonbank Assets")²⁴¹ including sales of divided in-

²³⁷ Securities and Exchange Law art. 2(1)(vii).

²³⁸ Banking Law arts. 10-12; Securities and Exchange Law art. 65(i).

²³⁹ A city bank, of course, may trade in beneficial interests in securities investment trusts, and sell and purchase upon written order, and for the account, of customers. See *supra* text accompanying notes 32, 46, 177-81.

²⁴⁰ See *supra* accompanying and following note 190.

²⁴¹ The Asset Securitization Law regulates securitization of (a) lease receivables under leases of machineries or other goods whose terms are longer than one year; (b) credit card receivables which arise from sales of goods and which involve (i) at least three installment payments over at least two months or (ii) installment payments in agreed methods; (c) credit card receivables which arise from sales of services and which involve installment payments in agreed methods; (d) credit receivables which arise from sales of specified goods and which involve at least three installment payments over at least two months; (e) credit card account receivables which arise from sales of goods or services and which involve (i) at least three installment payments over at least two (2) months or (ii) installment payments in agreed methods; and (f) account receivables which arise from machineries and which involve at least three installment payments over at least six months. Asset Securitization Law art. 2(1); *Tokutei Saiken Tō Ni Kakaru Jigyō No Kisei Ni Kansuru Hōritsu Shikōrei* [Administrative Order of Law Regarding Restrictions on Business Relating to Certain Monetary Claims] Seirei [Cabinet Order], art. 1, No. 178 (May 26, 1993) (hereinafter "Asset Securitization Order").

terests in Nonbank Assets (hereinafter "Unit Interests") to investors. This is the first Japanese law to establish a regulatory framework for asset securitization. The law contemplates the following three types of schemes:²⁴²

Assignment Type

Investors purchase divided interests in the installment obligations that a special purpose company, in exchange for its purchase of Nonbank Assets, owes to the nonbank.²⁴³

Partnership Type

Investors purchase interests in a general partnership²⁴⁴ or limited partnership²⁴⁵ which is administered and managed by a special purchase company as general partner and purchases Nonbank Assets from the nonbank.

Trust Type

Investors purchase divided beneficial interests in a trust created by a nonbank's transferring Nonbank Assets to trust banks.²⁴⁶

Whichever scheme is used, a nonbank transferor of Nonbank Assets and a transferee thereof must first file a plan of securitization with the Minister of Commerce and Industry.²⁴⁷ Transfers of Nonbank Assets for securitization must be perfected without delay.²⁴⁸ A nonbank

²⁴² Asset Securitization Law art. 2(4). It is uncertain whether the law intends to permit only these three types of schemes or any other schemes as well, such as a corporate type.

²⁴³ *Id.* art. 2(4)(i)(b)(i).

²⁴⁴ The law contemplates as possible securitization vehicles civil code partnerships [*Minpōjō No Kumiai*], which have a similar legal form to general partnerships under United States Uniform General Partnership Act. Asset Securitization Law art. 2(4)(ii)(B), (6)(ii).

²⁴⁵ The law contemplates as possible securitization vehicles anonymous partnerships [*Tokumei Kumiai*] under the Commercial Code, which have a similar legal form to limited partnerships under the United States Revised Uniform Limited Partnership Act. Asset Securitization Law art. 2(4)(ii)(A), (6)(ii).

²⁴⁶ See Asset Securitization Law arts. 2(6)(iv), 11.

²⁴⁷ Asset Securitization Law arts. 3, 4, 6. But this requirement is exempted, if all offerees are certain kinds of institutional investors, including banks, securities firms, insurance companies, and resales to other investors are prohibited. *Id.* art. 68.

²⁴⁸ Asset Securitization Law art. 5. The law specially permits the transfer to be perfected by a notice of the transfer in certain kinds of newspaper. *Id.* art. 7. This perfection requirement is exempted if all offerees of Unit Interests are certain kinds of institutional investors, including banks, securities firms, insurance companies, and resales to other investors are prohibited. *Id.* art. 68.

transferor must have irrevocable authority to collect Nonbank Assets as agent of transferee thereof.²⁴⁹

ii. Special Purpose Company/Trustee Activities

Special Purchase Company Activities

In the above schemes other than the trust type, the Asset Securitization Law requires a company which acts as special purchase companies to obtain prior approvals of the Ministers of Finance and of Commerce and Industry.²⁵⁰ An approved company acting as a special purchase company may not concurrently engage in other activities without another prior approval thereof.²⁵¹ This intends to prevent Nonbank Assets from being misappropriated for such other activities in order to protect investors. The law also imposes some other restrictions on the special purchase company activities. However, banks and other financial institutions, such as securities firms and insurance companies, are exempted from all of these restrictions under the law.²⁵² Nevertheless, it is generally considered that such special purchase company activities are impermissible for banks and such other financial institutions, because they cannot specialize in such activities.

Trustee Activities

In general, city banks do not have trust power; thus, they must first obtain prior approval of the Minister of Finance under Banks' Trust Business Law in order to act as trustee.²⁵³ However, the Ministry of Finance has taken a position of denying such approval to any existing city banks.²⁵⁴ Thus, a city bank cannot become a trustee in the trust-type scheme.

²⁴⁹ Asset Securitization Law art. 9.

²⁵⁰ *Id.* art. 30. It appears that the law is not applied to the special purpose company activities outside Japan. In other words, the law possibly does not regulate any person acting as a special purpose company outside Japan in the assignment-type scheme, nor any person as a special purpose company administering and managing any foreign partnership in the partnership-type scheme. In addition, when the total amount of nonbank assets transferred to a special purpose company during a period of one year is less than ten million yen, the approval is not required, even if the special purpose company activities take place in Japan. *Id.*; Asset Securitization Order art. 3.

²⁵¹ Asset Securitization Law art. 41.

²⁵² Asset Securitization Law art. 71. This is because banks, for example, have already been subject to other regulatory framework (Banking Law) and duplication of regulations should be avoided.

²⁵³ Banks' Trust Business Law art. 1.

²⁵⁴ See *supra* note 3 and accompanying text. But see *supra* note 9.

iii. *Unit Interest Activities*

The Asset Securitization Law requires prior approvals of the Ministers of Finance and of Industry and Commerce for a company to engage in activities of selling Unit Interests²⁵⁵ or acting as intermediary or agent in connection with such sales.²⁵⁶ The law also imposes many other restrictions on such activities.²⁵⁷ However, banks and other financial institutions, such as securities firms and insurance companies, are exempted from these restrictions under the law.²⁵⁸

Unit Interests do not constitute Securities and Exchange Law Securities,²⁵⁹ but Monetary Claims;²⁶⁰ thus, a city bank should be able to engage in all kinds of Securities and Exchange Law Activities of Unit Interests, or underwriting, distribution, dealing, private placement activities, and brokerage activities, under the Banking Law, not subject to any restriction under the Securities and Exchange Law.²⁶¹ There is no express limitation on these activities under the Banking Law; how-

²⁵⁵ Unit Interests include claims against "a foreign judicial person" which are similar to domestic Unit Interests. Asset Securitization Law art. 2(6)(v). It should be noted that the law basically regulates such sales of foreign Unit Interests which occur in Japan or involve any resident of Japan, while it possibly does not regulate foreign special purpose company activities. See *supra* note 247. Unit Interests apparently include divided interests in installment obligations of a foreign special purpose company in the assignment-type scheme. In addition, although a literal interpretation raises some doubt, claims against "foreign judicial persons" possibly include interests in a foreign partnerships created in the partnership-type scheme, and beneficial interests in foreign trusts created in the trust-type scheme for the purpose of the Asset Securitization Law. See *infra* note 325.

²⁵⁶ Asset Securitization Law art. 52.

²⁵⁷ For Unit Interests to be eligible for these activities, it is necessary to satisfy many conditions, including limitations on the maturities of Unit Interests, the minimum sale amount, and resales and redemptions of Unit Interests. In addition, written disclosure of certain kinds of information on Unit Interests is required both before and upon sales of such interests. Also, there are restrictions on advertisement, solicitation, and financing, of such sales. A purchaser may cancel his or her purchase of Unit Interests within a certain period, with some exceptions by the law without reimbursing the seller against damages arising from the cancellation. These restrictions closely resemble those imposed by the Ministry of Finance on banks. See *infra* text accompanying note 260.

²⁵⁸ Asset Securitization Law art. 71. See *supra* note 249. Banks, however, are instructed by the Ministry of Finance to comply with restrictions which are the same as exempted by the law.

²⁵⁹ Unit Interests, of course, can be included in Securities and Exchange Law Securities under Article 2(1)(xi) of Securities and Exchange Law, if they are added by a cabinet order to the Securities and Exchange Law Security list. See *supra* text accompanying note 52. However, they have not been added yet, because transferability thereof is strictly limited now. See *infra* note 260 and accompanying text.

²⁶⁰ BL Administrative Ordinance art. 12(viii).

²⁶¹ Banking Law art. 10(2)(v). It merely permits "[a]cquiring and assigning" Monetary Claims, but it is generally construed that this includes all kinds of Securities and Exchange Law Activities. See *supra* note 31.

ever, banks are instructed by the Ministry of Finance to comply with many non-statutory restrictions.²⁶²

For Unit Interests to be eligible for activities of a bank, (a) the term must be one month or longer, (b) any resale must be prohibited with limited exceptions,²⁶³ one of which allows a bank to resell to investors Unit Interests purchased with a view of resale,²⁶⁴ (c) redemptions of Unit Interests must be prohibited prior to the maturity date with limited exceptions,²⁶⁵ (d) repurchase, and cancellation of purchase, of Unit Interests must be prohibited with limited exceptions,²⁶⁶ and (e) the minimum purchase amount must be fifty million yen and purchase amounts must be multiples of ten million yen. Due to the limitations on resales, a city bank cannot engage in secondary market activities of Unit Interests, such as dealing and brokerage activities. In addition, only trust banks can sell Unit Interests created in the *trust-type scheme* or act as intermediary or agent in connection with sale thereof.²⁶⁷ Thus, a city bank may engage only in underwriting, distribution, and private placement activities, in connection with issues of Unit Interests created in the assignment- and partnership-type schemes.²⁶⁸ A bank must file a prior notice, and subsequent periodical reports, with the Ministry of Finance in engaging in these activities. In addition, written disclosure of certain kinds of information on Unit Interests is required both prior to and upon sales of Unit Inter-

²⁶² MOF Asset Securitization Rule, *supra* note 102.

²⁶³ One of the exceptions allows a transfer upon death (inheritance or testacy) or merger of a purchaser, and in bankruptcy, reorganization, or liquidation, of a purchaser, or upon garnishment of a purchaser's creditor. MOF Asset Securitization Rule, *supra* note 102.

²⁶⁴ Also, the prohibition does not apply where a bank which sold Unit Interests repurchases such interests. MOF Asset Securitization Rule, *supra* note 102. See *infra* notes 262, 263.

²⁶⁵ This prohibition does not apply where Unit Interests are exceptionally repurchased by a bank which sold them. Such redemption may be made with good cause without being subject to the prohibition, unless such redemption interferes with protection of investors. MOF Asset Securitization Rule, *supra* note 102. See *infra* note 263.

²⁶⁶ With some exceptions, any purchaser may cancel his or her purchase agreement of Unit Interests within eight days after receiving a confirmation from the seller, without reimbursing the seller against damages arising from such cancellation. In addition, where a purchaser has held Unit Interests for one month or more, a bank which sold them to such purchaser may exceptionally repurchase such interests, unless such repurchase interferes with protection of investors. MOF Asset Securitization Rule, *supra* note 102.

²⁶⁷ This applies not only to a trust bank which creates a trust but also to other trust banks who may sell beneficial interests therein. This restriction relies upon the separation system between banking and trust business. See *supra* note 3 and accompanying text. See *supra* note 9.

²⁶⁸ With respect to Unit Interests created in the assignment- and partnership-type schemes, a city bank may (a) purchase them from the issuer with a view of resale, solicit any investors to purchase them from the bank and resell them, or (b) as agent of the issuer solicit any investors to purchase them and sell them. A city bank, of course, may trade in any kind of Unit Interests. See *supra* note 312 and accompanying text.

ests.²⁶⁹ Furthermore, there are restrictions on advertisement, solicitation, and financing, of sales.²⁷⁰

In sum, a bank may engage only in primary market activities of Unit Interests created in the assignment- and partnership-type schemes. On the other hand, for advisory activities on Unit Interests, see above text.²⁷¹

b. Certificates Backed by Loans of Financial Institutions

i. *Trust Beneficial Certificates Backed by Residential Mortgages*

Domestic and foreign certificates of beneficial interests in a trust for residential mortgages of a bank or other financial institution (hereinafter "Residential-Mortgage-Backed Certificates") constitute Monetary Claims.²⁷² But if the initial beneficiary is the truster, who transfers such residential mortgages to the trust, the certificates, whether domestic or foreign, constitute Securities and Exchange Law Securities at the same time.²⁷³

With respect to Residential-Mortgage-Backed Certificates which are *not* Securities and Exchange Law Securities, a city bank is permitted under the Banking Law²⁷⁴ to engage in all kinds of Securities and Exchange Law Activities, or underwriting, distribution, dealing, private placement activities, and brokerage activities,²⁷⁵ not subject to the Securities and Exchange Law regulatory framework.

With respect to Residential-Mortgage-Backed Certificates which are Securities and Exchange Law Securities at the same time, a city bank is also permitted under the Banking Law²⁷⁶ and the Securities

²⁶⁹ This disclosure is required, regardless of whether a bank acts as principal, agent or broker. In addition, a bank must make documents containing information on Unit Interest to be sold available to purchasers in its offices. MOF Asset Securitization Rule, *supra* note 102.

²⁷⁰ Limitations on advertisement include prohibitions against misrepresentations on (a) projected profits and losses derived from Unit Interest, (b) businesses of nonbank transferors, (c) the bank's creditworthiness, and (d) its experience of sales of Unit Interests, (d) purchasers' rights of cancellation, and (e) fees to be charged to purchasers. Limitations on solicitation include prohibitions against (a) employing misrepresentation of material facts, oppression and annoyance, and (b) offering special benefits. A bank may not finance purchase of Unit Interests from the bank, or act as intermediary, agent or broker in connection with financing of such purchase. MOF Asset Securitization Rule, *supra* note 102.

²⁷¹ See *supra* text accompanying note 196.

²⁷² Banking Law art. 10(2)(v); BL Administrative Ordinance art. 12(iv). See *supra* note 86.

²⁷³ Securities and Exchange Law art. 2(2); SEL Administrative Order art. 1-3. See *supra* note 86.

²⁷⁴ Banking Law art. 10(2)(v).

²⁷⁵ Of course, a bank may invest in the Residential-Mortgage-Backed Certificates. See *supra* note 31 and accompanying text.

²⁷⁶ Banking Law art. 10(2)(v), (5).

and Exchange Law²⁷⁷ to engage in all kinds of Securities and Exchange Law Activities, but such activities are subject to the prior approval requirement²⁷⁸ and some other restrictions under the Securities and Exchange Law covering unfair transactions and personnel qualification.²⁷⁹

There is no other express restriction on these activities under the Banking Law or the Securities and Exchange Law; however, banks are instructed by the Ministry of Finance to comply with some additional non-statutory restrictions.²⁸⁰ Under the non-statutory restrictions, for such Residential-Mortgage-Backed Certificates to be eligible for activities of a bank, (a) the minimum purchase amount of each purchaser must be one hundred million yen,²⁸¹ and (b) the trustee of the trust must be a trust bank.²⁸² Such certificates may be sold only to sophisticated institutional investors. A bank transferring residential mortgages to a trust may not solicit purchase of such certificates.²⁸³ A bank must file a prior notice, and subsequent periodical reports, with the Ministry of Finance regarding these activities. As a result of these non-statutory restrictions, a city bank may not conduct at least any public-oriented activities of such certificates, such as underwriting and distribution.

On the other hand, for advisory activities on Residential-Mortgage-Backed Certificates, see above text.²⁸⁴

ii. Foreign Trust Beneficial Certificates Backed by Loans

Securities or certificates issued by a foreign judicial person that represents beneficial interests in a trust for loans of a bank or other

²⁷⁷ Securities and Exchange Law art. 65(2)(iii); SEL Administrative Order art. 17-2(2).

²⁷⁸ Securities and Exchange Law art. 65-2(1).

²⁷⁹ *Id.* arts. 65-2(3)-(4), 62. See *supra* notes 90, 91, 119, 120, 174, and 175.

²⁸⁰ MOF Loan Liquidation Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102. However, it appears that the rules assume the restrictions thereunder apply only to domestic Residential-Mortgage-Backed Certificates. It is unclear to what extent these restrictions are applied to foreign certificates.

²⁸¹ Cooperative purchase by two or more purchasers is prohibited.

²⁸² Transfer of residential mortgages to a trust can be unconditional, if such mortgages are guaranteed by a credit-guaranteeing company, or insured by an insurance company. On the other hand, with respect to unguaranteed or uninsured residential mortgages, a financial institution transferring them to a trust must owe obligations to repurchase them, or exchange them for other residential mortgages, at the expiration of the trust term or any other time such repurchase or exchange is needed. The transferor as agent of the trustee may collect the underlying residential mortgages. MOF Asset Securitization Rule, *supra* note 102.

²⁸³ Other financial institutions, such as other banks and securities firms, must be employed. The transferor bank may refer investors to such other financial institutions soliciting investors. MOF Loan Liquidation Rule, *supra* note 102.

²⁸⁴ See *supra* text accompanying and following notes 190 and 196.

financial institution (hereinafter "Foreign Loan-Backed Certificates") constitute Securities and Exchange Law Securities.²⁸⁵ But the certificates constitute Monetary Claims at the same time.²⁸⁶ Thus, a city bank is permitted under the Banking Law²⁸⁷ and the Securities and Exchange Law²⁸⁸ to engage in all kinds of Securities and Exchange Law Activities of such certificates, or underwriting, distribution, dealing, private placement activities, and brokerage activities,²⁸⁹ subject to the prior approval requirement²⁹⁰ and some other restrictions under the Securities and Exchange Law covering unfair transactions and personnel qualification.²⁹¹ There is no other express restriction on these activities under the Banking Law or the Securities and Exchange Law; however, banks are instructed by the Ministry of Finance to comply with substantial additional non-statutory restrictions.²⁹²

Under the restrictions, for such Foreign Loan-Backed Certificates to be eligible for activities of a bank, the investment quality must be within the top three long term grades. Such certificates may be sold only to sophisticated institutional investors. A bank must file a prior notice, and subsequent periodical reports, with the Ministry of Finance in engaging in these activities. Certain disclosure documents must be made available to investors at main offices of a bank selling them or soliciting purchases thereof. As a result of these non-statutory restrictions, a city bank may not conduct at least any public-oriented activities of such certificates, such as underwriting and distribution.

On the other hand, for advisory activities on Foreign Loan-Backed Certificates, see above text.²⁹³

*iii. Domestic Trust Beneficial Certificates Backed by
Regional Government & General Loans*

Domestic certificates representing beneficial interests in a trust for loans to regional government and general loans of a bank or other

²⁸⁵ Securities and Exchange Law art. 2(1)(x); SEL Definition Ordinance art. 2. *See supra* note 87.

²⁸⁶ Banking Law art. 10(2)(v); BL Administrative Ordinance art. 12(vii). *See supra* note 87.

²⁸⁷ Banking Law art. 10(2)(v), (5).

²⁸⁸ Securities and Exchange Law art. 65(2)(iii).

²⁸⁹ Of course, a bank may invest in Foreign Loan-Backed Certificates. *See supra* note 31.

²⁹⁰ Securities and Exchange Law art. 65-2(1).

²⁹¹ Securities and Exchange Law arts. 65-2(3), (4), 62. *See supra* notes 90, 91, 119, 120, 174 and 175.

²⁹² MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

²⁹³ *See supra* text accompanying note 190.

financial institution (hereinafter "Domestic Loan-Backed Certificates") constitute Monetary Claims²⁹⁴ but, Securities and Exchange Law Securities. Thus, a city bank is permitted under the Banking Law²⁹⁵ to engage in all kinds of Securities and Exchange Law Activities of such certificates, or underwriting, distribution, dealing, private placement activities, and brokerage activities,²⁹⁶ not subject to the Securities and Exchange Law regulatory framework. There is no express restriction on these activities under the Banking Law; however, banks are instructed by the Ministry of Finance to comply with some non-statutory restrictions.²⁹⁷

Under the restrictions, for such Domestic Loan-Backed certificates to be eligible for activities of a bank, (a) the underlying loans must be loans to regional governments²⁹⁸ or general loans,²⁹⁹ (b) the minimum purchase amount of each purchaser must be one hundred million yen, and (c) the trustee of the trust must be a trust bank. Such certificates may be sold only to sophisticated institutional investors. Only a trust bank acting as trustee of the trust can make initial offering of such certificates.³⁰⁰ As a result of these non-statutory restrictions, a city bank may only engage in secondary market activities of such certificates that target only sophisticated institutional investors.

On the other hand, for advisory activities on Domestic Loan-Backed Certificates, see above text.³⁰¹

²⁹⁴ Banking Law art. 10(2)(v); BL Administrative Ordinance art. 12(vi)(ix). See *supra* note 87.

²⁹⁵ Banking Law art. 10(2)(v), (5).

²⁹⁶ Of course, a bank may invest in Domestic Loan-Backed Certificates. See *supra* note 31 and accompanying text.

²⁹⁷ MOF Loan Liquidation Rule, *supra* note 102.

²⁹⁸ The term "regional governments" as used herein includes a company twenty-five percent of whose outstanding stock is owned by a regional government. Regional government loans may be transferred to a trust only with prior consent of the borrowers. The original lender as agent of the trustee may collect the underlying regional government loans. See MOF Loan Liquidation Rule, *supra* note 102.

²⁹⁹ The term "general loan" as used herein means loans made to general clients, other than residential mortgages and loans to regional governments. Transfer of general loans to a trust can be unconditional, if the original lender (financial institution) of such loans directly creates a trust. On the other hand, if a financial institution which receives transfer of general loans from the original lender creates a trust by re-transfer thereto, this obligates the original lender either to repurchase the loans upon default thereof or to guarantee the payments of the loans. The original lender as agent of the trustee may collect the underlying loans. MOF Loan Liquidation Rule, *supra* note 102.

³⁰⁰ However, city banks may refer investors to the trustee trust bank. MOF Loan Liquidation Rule, *supra* note 102.

³⁰¹ See *supra* text accompanying and following note 196.

11. *Loan Participation Activities*

a. *In General*

In Japan, loan participation markets have not developed enough to give lending institutions the flexibility to liquidate their loan positions and change their loan portfolios. This is because loan participation activities have been heavily regulated by the Ministry of Finance on a non-statutory basis. The Ministry of Finance has not permitted a form of loan participation, popular and traditional in the United States, where a lender bank transfers to investors only a beneficial interest in a loan, not any legal claim or right against the borrower.³⁰² A permissible form is a conditional or unconditional assignment of loans which might or might not be perfected by consents of the borrowers. However, even when using this form, no resale of such assigned loans is permitted.

On the other hand, due to the lack of transferability, loan participation interests are not included in Securities and Exchange Law Securities. Thus, a city bank can engage in loan participation activities under the Banking Law, without worrying about the Securities and Exchange Law regulations. Rather, a city bank should pay attention to the above non-statutory restrictions of the Ministry of Finance. What kinds of restrictions apply depends upon the kind of loan to be participated in or out.

b. *Residential Mortgages*³⁰³

A city bank may package its own residential mortgages with the same conditions and terms and assign them³⁰⁴ with the borrowers' consent. The assignees must be banks, insurance companies or other financial institutions. The assigned mortgages may not be resold. The assignor bank must guarantee the payments of the assigned mortgages, and repurchase them upon the expiration of a certain period (which, for the time being, must be a five year period). An assignor bank must file a notice, and subsequent periodical reports, with the Ministry of Finance.

³⁰² One of the primary reasons why this form of loan participation has not been permitted is that an accounting method for such a form has not been clearly established. Reportedly, city banks have been urging permission to conduct this type of loan participation.

³⁰³ MOF Mortgage Certificate Rule, *supra* note 102.

³⁰⁴ The assignor bank must continue to collect the assigned mortgages as agent of the assignees. The assignees may not directly exercise any right of the mortgages against the borrowers (or the mortgagors). The assignor bank must also keep all related documents held on behalf of the assignees. In addition, the assignor bank, upon the assignment, must issue to the assignees certificates which describe the assigned mortgages. MOF Mortgage Certificate Rule, *supra* note 102.

c. Regional Government Loans³⁰⁵

A city bank may assign³⁰⁶ (usually on an unconditional basis) its own loans to regional governments³⁰⁷ only with their advance consents. The assignees must be sophisticated institutional investors. The minimum purchase amount of each purchaser must be one hundred million yen. The assigned loans may not be resold. An assignor bank must submit periodical reports to the Ministry of Finance.

d. General Loans³⁰⁸

A city bank may assign³⁰⁹ (usually on an unconditional basis) other kinds of loans, to general clients, of its own with or without consent of the borrowers. The assignees are basically limited to financial institutions.³¹⁰ The minimum purchase amount of each purchaser must be one hundred million yen. The assigned loans may not be resold. An assignor bank must submit periodical reports to the Ministry of Finance.

12. *Commodity Fund Activities*

This section describes restrictions on city bank's activities related to commodity funds.

a. In General

In 1991, the Commodity Fund Law was enacted to regulate activities related to commodity funds, including sales of divided interests in

³⁰⁵ MOF Loan Liquidation Rule, *supra* note 102.

³⁰⁶ The assignor bank must continue to collect the assigned loans as agent of the assignees. The assignees may not exercise any right of the loans against the borrowers. The assignor bank must also keep all related documents held on behalf of the assignees. In addition, the assignor bank, upon the assignment, must issue to the assignees certificates which describe the assigned loans. MOF Loan Liquidation Rule, *supra* note 102.

³⁰⁷ Loans eligible for the assignment also include those of a company, twenty-five percent of whose outstanding stock is owned by a regional government. MOF Loan Liquidation Rule, *supra* note 102.

³⁰⁸ MOF Loan Liquidation Rule, *supra* note 102.

³⁰⁹ The assignor bank must continue to collect the assigned loans as agent of the assignees. The assignees may not exercise any right of the loans against the borrowers. The assignor bank must also keep all related documents held on behalf of the assignees. In addition, the assignor bank, upon the assignment, must issue to the assignees certificates which describe the assigned loans. MOF Loan Liquidation Rule, *supra* note 102.

³¹⁰ If both the assignor bank and the borrower are companies whose stock is listed on any stock exchange and have satisfied the disclosure requirements under the Securities and Exchange Law, other sophisticated institutional investors may also purchase such loans. MOF Loan Liquidation Rule, *supra* note 102.

commodity funds to investors. The law contemplates the following two types of fund schemes:³¹¹

Partnership Type

Investors purchase interests in a general partnership³¹² or limited partnership³¹³ which administers and manages partnership assets principally by investment in commodities.

Trust Type

Investors purchase divided beneficial interests in a trust which administers and manages trust assets principally by investment in commodities.³¹⁴

b. Originator/Truster/Trustee Activities

Originator Activities (Partnership)

The Commodity Fund Law requires prior approval of the proper minister(s) of a company which enters into partnership agreements involved in the partnership-type fund scheme.³¹⁵ This restriction applies where a company enters into a partnership agreement with a view of (a) originating commodity-fund partnerships and (b) offering and/or selling such partnership interests.³¹⁶ The law also imposes some other restrictions on the originator activities. However, banks and other financial institutions, such as securities firms and insurance companies, are exempted from all of these restrictions under the law.³¹⁷ Notwithstanding these statutory framework, the Ministry of Finance, by its non-statutory administrative rule, imposes some restrictions on the above originator activities, *for the time being* prohibiting banks from entering into *domestic* commodity-fund partnership

³¹¹ Commodity Fund Law art. 2(2). It is uncertain whether the law intends to permit only these two types of schemes or any other schemes as well, such as a corporate type.

³¹² The law contemplates as possible fund vehicles domestic civil code partnerships and foreign general partnerships. Commodity Fund Law art. 2(2)(ii), (iii); (3)(i), (iii). For civil code partnerships, *see supra* note 241.

³¹³ The law contemplates as possible fund vehicles domestic anonymous partnerships and foreign limited partnerships. Commodity Fund Law art. 2(2)(i), (iii); (3)(i), (iii). For anonymous partnerships, *see supra* note 242.

³¹⁴ *See* Commodity Fund Law art. 3(ii). The law contemplates both domestic and foreign trusts. *Id.* art. 3(iii).

³¹⁵ Commodity Fund Law art. 3.

³¹⁶ The Commodity Fund Law basically regulates the originator activities both inside and outside Japan, so long as commodity-fund interests are sold in Japan or any Japanese resident is involved in such sale. Commodity Fund Law art. 2(2)(iii).

³¹⁷ Commodity Fund Law art. 48(1).

agreements for any purpose.³¹⁸ On the other hand, while the Ministry of Finance's view is unclear, a bank might be able to originate *foreign* commodity-fund partnerships;³¹⁹ however, the bank cannot manage investment of such partnership funds in commodities on behalf of investors in the partnership. That is, the Ministry of Finance rule prohibits banks from entering into commodity-fund partnership agreements (whether domestic or foreign), unless the banks employed any discretionary commodity investment managers, who are either approved under the Commodity Fund Law³²⁰ or authorized under equivalent foreign law, to manage the commodity funds.³²¹

Truster Activities

There is no restriction under the Commodity Fund Law on activities of originating commodity-fund trusts.³²² The non-statutory administrative rule of the Ministry of Finance³²³ expressly permits banks to engage in such truster activities.³²⁴

³¹⁸ MOF Commodity Fund Rule, *supra* note 102. The term "domestic . . . partnership agreements" as used herein means agreements to create civil code partnerships or anonymous partnerships. See *supra* notes 309, 310.

³¹⁹ One commentator points out that these activities of foreign partnership interests created in the partnership-type scheme may be conducted only indirectly through an affiliate of a bank. Ôgami, *Shôhin Tôshi Ni Kakaru Gyômu No Toriatsukai Ni Tsuite* [Regarding Handling of Business Relating to Commodity Investments], CHIGINKYÔ GEPPÔ [Regional Bank Association Monthly Report], Aug. 1992, at 48. No such limitation is found in the MOF Commodity Fund Rule, *supra* note 102; thus, there might be an additional oral instruction of the Ministry of Finance to the above effect. For commodity-fund-related activities of banks' affiliates, see *infra* text accompanying note 497.

³²⁰ The Commodity Fund Law requires prior approvals of proper ministers of any company that engage in activities of managing investment in commodities as agent of customers on a discretionary basis. Commodity Fund Law art. 30. Banks could not obtain the approval, due to the limitation on corporate power under the Banking Law.

³²¹ MOF Commodity Fund Rule, *supra* note 102.

³²² It appears that the Ministry of Finance, nevertheless, limits conductors of the truster activities to (a) companies which are authorized to sell commodity-fund interests by approval of proper ministers under the Commodity Fund Law, and (b) banks or other financial institutions that are otherwise authorized to do such activities. See *Shôhin Tôshi Ni Kakaru Jigyô No Un'ei Ni Tsuite* [Regarding Operation of Business Related to Commodity Investment] *Ôkurashô Ginkô Kyoku* [MOF Bank Bureau] No.985, (Jun. 1, 1992) (hereinafter "MOF Commodity-Fund Trust Rule").

³²³ MOF Commodity Fund Rule, *supra* note 102.

³²⁴ With respect to trust asset management, trustees basically have discretion within management plans made by banks in creating commodity-fund trusts. MOF Commodity-Fund Trust Rule, *supra* note 319.

Trustee Activities

In general, city banks do not have trust power; thus, they must first obtain prior approval of the Minister of Finance under Banks' Trust Business Law in order to act as trustee.³²⁵ However, the Ministry of Finance has taken a position of not giving such approval to any existing city banks.³²⁶ Thus, a city bank cannot become a trustee in the trust-type fund scheme.

c. Commodity-Fund Interest Activities

The Commodity Fund Law requires prior approvals of proper ministers³²⁷ for a company to engage in activities of selling interests in commodity funds in the form of partnership or trust³²⁸ or acting as agent or intermediary in connection with such sales.³²⁹ The law also imposes many other restrictions on such activities.³³⁰ However, banks and other financial institutions, such as securities firms and insurance companies, are exempted from all of these restrictions under the law.³³¹

³²⁵ Banks' Trust Business Law art. 1.

³²⁶ See *supra* note 3 and accompanying text. But see *supra* note 9.

³²⁷ Commodity Fund Law art. 49(1). The law requires approvals of either two or all of the three ministers: Minister of Finance, Minister of Commerce and Industry, and Minister of Agriculture, Forestries and Fisheries. Which ministers' approval is needed depends upon what kinds of commodities a commodity fund principally invests in. For example, if a fund is to be managed principally in investing in agricultural products, approvals of the Ministers of Finance and of Agriculture, Forestries and Fisheries are required.

³²⁸ Commodity-fund interests include claims against "a foreign judicial person" which are similar to domestic commodity-fund interests. Commodity Fund Law art. 2(3)(iii). The law regulates sales of foreign commodity-fund interests as well as the foreign originator activities. See *supra* note 313. Literal interpretation raises uncertainty about whether or not claims against "a foreign judicial person" include foreign partnership interests created in the partnership-type scheme and trust beneficial interests created in the trust-type scheme, for the purpose of the Commodity Fund Law. Nevertheless, it is generally construed that the law regulates sales of both types of foreign commodity-fund interests.

³²⁹ Commodity Fund Law arts. 3, 2(4).

³³⁰ For commodity-fund interests to be eligible for these activities, it is necessary to satisfy many conditions, including limitations on the kinds of investments made by the underlying funds, the maturities of commodity-fund interests, the minimum sale amount, and resales and redemptions of commodity-fund interests. In addition, written disclosure of certain kinds of information on commodity-fund interests is required both before and upon sales of such interests. Also, there are restrictions on advertisement, solicitation, and financing, of such sales. A purchaser, with some exceptions by the law, cancel his or her purchase of commodity-fund interests within a certain period, without reimbursing the seller against damages arising from the cancellations. These restrictions resemble restrictions imposed by the Ministry of Finance on banks. See *infra* text accompanying note 333.

³³¹ Commodity Fund Law art. 48(1). This is because banks, for example, have already been subject to other regulatory framework (Banking Law) and the duplication of regulations should

Commodity-fund interests do not constitute Securities and Exchange Law Securities,³³² but Monetary Claims,³³³ thus, a city bank should be able to engage in all kinds of Securities and Exchange Law Activities of commodity-fund interests, or underwriting, distribution, dealing, private placement activities, and brokerage activities, under the Banking Law, not subject to any restriction under the Securities and Exchange Law.³³⁴ There is no express limitation on these activities under the Banking Law; however, banks are instructed by the Ministry of Finance to comply with many non-statutory restrictions.³³⁵

For commodity-fund interests to be eligible for activities of a bank, (a) the certain portion of the underlying fund must be invested in commodities,³³⁶ (b) the underlying fund may not be invested in financial products with some exceptions,³³⁷ (c) the term must be five years or longer, (d) the underlying fund must be managed by any discretionary commodity investment managers who are either approved under the Commodity Fund Law or authorized under equivalent foreign law,³³⁸ (e) any resale must be prohibited with limited exceptions,³³⁹ (f) redemptions of commodity-fund interests must be

be avoided. As mentioned in text below, banks are nevertheless instructed by the MOF to comply with restrictions which are the same as so exempted by the law.

³³² Commodity-fund interests, of course, can be included in Securities and Exchange Law Securities under Article 2(1)(xi) of the Securities and Exchange Law, if they are added by a cabinet order to the Securities and Exchange Law Security list. *See supra* text accompanying note 52. However, they have not been added yet, because transferability thereof is strictly limited now. *See infra* text accompanying note 336.

³³³ BL Administrative Ordinance art. 12(v).

³³⁴ Banking Law art. 10(2)(v). It merely permits "[a]cquiring and assigning" Monetary Claims, but it is generally construed that this includes all kinds of Securities and Exchange Law Activities. *See supra* note 31.

³³⁵ MOF Commodity Fund Rule, *supra* note 102.

³³⁶ More than fifty percent of the underlying fund must be managed by investment in commodities (including indices, futures and options thereof); otherwise, more than thirty percent thereof must be managed by investment in future and/or option transactions of commodities. MOF Commodity Rule, *supra* note 102.

Commodity-fund trusts must be designed and managed to minimize a risk of beneficial interests falling below the par value; otherwise, beneficial interests must be sold only to sophisticated institutional investors. MOF Commodity Rule, *supra* note 102.

³³⁷ For instance, the underlying fund may not be invested in (a) any loans or (b) Securities and Exchange Law Securities, with some exceptions. On the other hand, the fund may be invested in (a) bank deposits (other than deposits whose interest rates have been liberalized), (b) government bonds, regional government bonds and government-guaranteed bonds, and (c) beneficial interests in commodity-fund trusts. MOF Commodity Rule, *supra* note 102.

³³⁸ *See supra* text accompanying note 317.

³³⁹ One of the exceptions allows a transfer upon death (inheritance or testacy) or merger of a purchaser, and in bankruptcy, reorganization, or liquidation, of a purchaser, or upon garnishment of a purchaser's creditor. The prohibition does not apply where a bank which sold com-

prohibited for the first three years with limited exceptions,³⁴⁰ (g) repurchase and cancellation of purchase of commodity-fund interests must be prohibited with limited exceptions,³⁴¹ and (h) the minimum purchase amount must be one hundred million yen and purchase amounts must be multiples of ten million yen.³⁴² Due to the limitations on resales, a city bank cannot engage in secondary market activities of commodity-fund interests, such as dealing and brokerage activities.

More important restrictions are imposed on bank's activities of commodity-fund interests. First, a bank is, *for the time being*, prohibited by the non-statutory rule from entering into *domestic* commodity-fund partnership agreements,³⁴³ thus, a bank may not purchase domestic partnership interests either as principal with a view of resale or as agent of customers. Second, only a trust bank may sell beneficial interests in commodity-fund trusts and act as agent or intermediary in connection with sales thereof,³⁴⁴ except that a city bank may acquire as initial beneficiary, and sell, beneficial interests in commodity-fund trusts created by the city bank as trustee.

A bank must file a prior notice, and subsequent periodical reports, with the Ministry of Finance in engaging in these activities. In addition, written disclosure of certain kinds of information on commodity-fund interests is required both prior to and upon sales of com-

modity-fund interests repurchases such interests. MOF Commodity Rule, *supra* note 102. See *infra* notes 337 and 338.

³⁴⁰ This prohibition does not apply to redemption of interests in commodity funds which are not designed to minimize a risk of falling below the par value. Such risky interests may be sold only to sophisticated institutional investors. See *supra* note 333. They may be redeemed even within the first three years. In addition, where commodity-fund interests are exceptionally repurchased by a bank which sold them, such redemption may also be made for good cause without being subject to the prohibition, unless such redemption interferes with protection of investors. MOF Commodity Fund Rule, *supra* note 102. See *infra* note 338.

³⁴¹ With some exceptions, any purchaser may cancel his or her purchase of commodity-fund interests within ten days after receiving a confirmation from the seller, without reimbursing the seller bank against damages arising from such cancellation. In addition, where a purchaser has held commodity-fund interests for one year or more, a bank which sold them to such purchaser may exceptionally repurchase such interests. MOF Commodity Fund Rule, *supra* note 102.

³⁴² Where a bank has sold commodity-fund interests at least three times and the aggregated sale price exceeds ten billion yen, the minimum sales price may be fifty million yen. MOF Commodity Fund Rule, *supra* note 102.

³⁴³ MOF Commodity Fund Rule, *supra* note 102. The term "domestic . . . partnership agreements" as used herein means agreements to create civil code partnerships or anonymous partnerships. See *supra* notes 309, 310.

³⁴⁴ It is unclear whether only a trust bank which creates a commodity-fund trust may sell beneficial interests therein or other trust banks may also sell such interests. Possibly, the latter is true. See *supra* note 264.

commodity-fund interests.³⁴⁵ Furthermore, there are restrictions on advertisement and solicitation of sales.³⁴⁶

As a result of the non-statutory limitations, a city bank may (a) only as intermediary participate in issues of domestic partnership interests created in the partnership-type scheme, (b) conduct primary market activities, such as underwriting, distribution and private placement activities, of foreign partnership interests involved in the partnership-type scheme,³⁴⁷ and (c) as truster create a commodity-fund trust, and acquire as initial beneficiary, and sell, beneficial interests in such trust.³⁴⁸

On the other hand, for advisory activities on commodity-fund interests. See above text.³⁴⁹

B. Domestic Securities Activities of Domestic Affiliates

As seen in the last subchapter, Japanese city banks can directly engage in domestic securities activities, subject to various limitations set by the Banking Law, the Securities and Exchange Law or other laws, or the Ministry of Finance's non-statutory administrative rules. All of these limitations are not applied directly to activities of banks' domestic affiliates; rather, banks are engaged indirectly through their domestic affiliates in securities activities, subject to other limitations. This subchapter focuses on such restrictions on securities activities of banks' domestic affiliates.

1. *In General*

Japan's Anti-Monopoly Law has affected banks' affiliations with other domestic companies. The law prohibits any domestic and foreign company from functioning as a holding company of domestic

³⁴⁵ This disclosure is required, regardless of whether a bank acts as principal, agent or broker. In addition, a bank must make documents concerning the underlying funds available to purchasers in its offices. MOF Commodity Fund Rule, *supra* note 102.

³⁴⁶ Limitations on advertisement include prohibitions against misrepresentations on projected profits and losses derived from commodity-fund interests, purchasers' rights of cancellation, and other material facts and matters. Limitations on solicitation include prohibitions against employing misrepresentation of material facts, and offering special benefits. MOF Commodity Fund Rule, *supra* note 102.

³⁴⁷ One commentator points out that these activities of foreign partnership interests created in the partnership-type scheme may be conducted only indirectly through an affiliate of a bank. See *supra* note 316.

³⁴⁸ A city bank, of course, may trade in any kind of commodity-fund interests. See *supra* note 31 and accompanying text.

³⁴⁹ See *supra* text accompanying note 196.

companies.³⁵⁰ This prohibition covers a bank holding company; thus, the affiliations are usually vertical (parent/child relationships), not horizontal (sibling relationships). In addition, the law prohibits financial institutions, including banks and, securities firms from acquiring or retaining more than five percent of the outstanding stock in a domestic company without approval of the Fair Trade Commission.³⁵¹ This prohibition is not affected by whether financial institutions intend to control the company through stock ownership or merely invest in it on a passive basis. Thus, the affiliations are often recognized as financial, trade and/or personnel relationships rather than a capital relationship.

Within such limitations, the Banking Law and the Securities and Exchange Law control some of the affiliations between city banks and other domestic companies. The Banking Law expressly permits a city bank to acquire and retain more than fifty percent of the outstanding voting stock in a domestic securities firm and/or a domestic trust bank³⁵² with approval of the Minister of Finance.³⁵³ The Securities and Exchange Law also expressly acknowledges that the prohibition against bank's securities activities does not bar bank's acquisition of a securities firm.³⁵⁴ It should be noted that the approval of the Minister of Finance under the Banking Law does not exempt the requirement of Fair Trade Commission's approval under the Anti-Monopoly Law;³⁵⁵ thus, a city bank acquiring each of these subsidiaries must separately obtain the two approvals. These approvals would not be given, at least unless a bank acquires all of the outstanding voting stock in them on a *de novo* basis or acquires more than fifty percent of the outstanding voting stock in any of the existing ones which are failing or have failed. As a practical matter, bank's acquisition of a healthy existing securities firm and/or trust bank is almost impossible. As mentioned below, the Banking Law, the Securities and Exchange Law and the Ministry of Finance's administrative rules have set arm's length rules, firewall conditions, and personnel interlock limitations, regulating parent/child and sibling relationships among a parent bank,

³⁵⁰ Anti-Monopoly Law art. 9. The term "a holding company" as used herein means a company whose primary business is to control business activities of any domestic company through its retention of stock therein. *Id.* art. 9(3).

³⁵¹ *Id.* art. 11(1).

³⁵² Other kinds of banking organizations which are failing or have failed can also be acquired. Such other kinds of banking organizations, for example, include long-term credit banks, and a foreign exchange bank. BL Administrative Ordinance art. 17-2(i)(ii).

³⁵³ Banking Law art. 16-2(1).

³⁵⁴ Securities and Exchange Law art. 65-3.

³⁵⁵ Anti-Monopoly Law art. 11(1).

the bank's securities firm subsidiary, and the bank's trust bank subsidiary.

No provision of the Banking Law nor other laws than the Anti-Monopoly Law³⁵⁶ regulates other affiliations between a bank and other domestic companies, except that the Banking Law requires a prior notice to the Minister of Finance when a bank acquires or retains more than fifty percent of the outstanding voting stock in any domestic company.³⁵⁷ However, the Banking Law prohibits a bank from engaging in activities other than banking business, which consists of the so-called *core banking business*, *incidental banking business* (including the so-called *non-listed incidental banking business*) and *other banking business*;³⁵⁸ thus, it has been generally considered that banks, even indirectly through their affiliates, cannot engage in activities completely unrelated to banking, such as real estate retail business, travel agency business, product sales,³⁵⁹ hotel business, warehouse business, marine courier business, and mining business.³⁶⁰ Based upon this construction, the Ministry of Finance by its non-statutory administrative rules regulates such other affiliations.³⁶¹

Definition of Affiliate

The administrative rules restrict activities and operations of bank's "affiliate," which is defined in the rule to mean "a company to which a bank has made and/or has maintained capital contributions

³⁵⁶ Banking Law art. 53(v); BL Administrative Ordinance art. 35(x).

³⁵⁷ As mentioned above, Article 11 of the Anti-Monopoly Law restricts banks' stock holding.

³⁵⁸ Banking Law art. 12. For banking business, *see supra* text accompanying and following note 25.

³⁵⁹ *Kin'yū Kikan To Sono Kanrengaisya Tono Kankei Ni Tsuite* [Regarding Relationships Between Financial Institutions and Their Affiliates] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 1968 (Jul. 3, 1975), as amended (hereinafter "MOF Domestic Affiliate Rule"); MOF Domestic Affiliate Notice, *supra* note 41.

³⁶⁰ *Kin'yū Kikan To Sono Shussisaki Kaigai Hōjin Tono Kankei Ni Tsuite* [Regarding Relationships Between Financial Institutions and Their Invested Foreign Companies] Jimu Renraku Administrative Notice (Apr. 23, 1976), as amended (hereinafter "MOF Foreign Affiliate Notice").

³⁶¹ MOF Domestic Affiliate Rule, *supra* note 354; MOF Domestic Affiliate Notice, *supra* note 41. As seen below, the coverage of the Ministry of Finance administrative rules is quite narrow, because of the definition of "affiliate." As a result, city banks have been affiliated to various extents with quite a few domestic companies which are engaged in activities impermissible for "affiliate" and constituted a group along with such companies. This affiliation is the so-called *Keiretsu*. Due to the restrictions under the Anti-Monopoly Law, bank, of course, has not owned more than five percent of the outstanding stock in each of such group member companies; thus, the affiliation has taken the form of personnel, financial and/or trade relationship rather than a capital relationship. In general, such group member companies have maintained independence of their group member bank to various extents, unlike "affiliates."

and which has close relationships to such bank, by virtue of circumstances of its establishment, financial and personnel relationships, etc." This definition appears to call more attention to non-capital relationships than to capital relationship, because the Anti-Monopoly Law, as mentioned above, limits a bank's stock investment in a domestic company to five percent or less of the outstanding stock therein.³⁶² On this point, the term "affiliate" here differs from the term "subsidiary"³⁶³ or "affiliate"³⁶⁴ as used in the United States' Bank Holding Company Act, where controlling five percent or less of any class of voting securities of any company produces a presumption that such company is not a subsidiary or affiliate,³⁶⁵ whereas controlling twenty-five percent or more is a conclusive evidence that such company is a subsidiary or affiliate.³⁶⁶

The concept of "affiliate" under the Ministry of Finance rules is possibly more narrow than the concepts of "subsidiary" and "affiliate" under the Bank Holding Company Act. First, the fact that a bank owns some stock would be an essential condition under the Ministry of Finance rules, although there is some uncertainty whether or not the Ministry of Finance has taken such a view. A company in which a bank owns stock directly in its own name, or beneficially and indirectly in the names of others, would be an affiliate, if other conditions are met. On the other hand, literally construed, a company none of whose stock is owned by a bank is not an affiliate of the bank under the Ministry of Finance rules, even though the bank controls the management and policies of the company, including decision makings on personnel, trade and financial affairs, unlike under the Bank Holding Company Act.³⁶⁷ Second, a bank's function in establishing a company might be another essential factor, although the Ministry of Finance's view is unclear here as well. Possibly, just as under the Bank Holding Company Act, controlling influences of a bank over the election of a majority of directors, or over other management and policies, of a company³⁶⁸ will be relevant in judging whether or not the company is an affiliate of the bank. However, literally construed, it is doubtful if

³⁶² Anti-Monopoly Law art. 11(1).

³⁶³ 12 U.S.C. § 1841(d) (1988) (defining "subsidiary"); 12 C.F.R. §§ 225.2(n) (defining "subsidiary"), 225.2(e) (1994) (defining "control").

³⁶⁴ 12 U.S.C. § 1841(k) (1988) (defining "affiliate"); 12 C.F.R. § 225.2(e) (1994) (defining "control").

³⁶⁵ 12 U.S.C. § 1841(a)(3) (1988); 12 C.F.R. § 225.22(c)(5) (1994).

³⁶⁶ 12 U.S.C. § 1841(a)(2)(A) (1988); 12 C.F.R. § 225.2(e)(1)(i) (1994).

³⁶⁷ 12 U.S.C. § 1841(a)(2)(B),(C) (1988); 12 C.F.R. § 225.2(e)(1)(ii),(iii) (1994).

³⁶⁸ *Id.*

only these facts would make a company an affiliate without regard to a bank's function in establishing such company.

Permissible Activities

The administrative rule permits an affiliate of a bank to engage in (a) the so-called *agency business* [*Dairi Gyōmu*], or activities of providing the bank with agency services relating to the bank's business;³⁶⁹ (b) activities of providing the bank with administration services regarding the bank's business;³⁷⁰ (c) activities which come under the so-called *incidental banking business*, including the so-called *non-listed incidental banking business*, and (d) activities which constitute the so-called *proximate nonbanking business* (*Shūhen Gyōmu*), or nonbanking activities which have substantial proximity with such *incidental banking business*.

An affiliate which conducts the *agency business* must be wholly owned by the bank with the Fair Trade Commission's approval under the Anti-Monopoly Law,³⁷¹ and may not concurrently engage in other activities or invest in stock in any other company. The same is true of an affiliate which provides the bank with the administrative services.³⁷²

The affiliated bank must limit its holding of stock in other affiliate (which engages in the so-called *incidental banking business* and/or *proximate nonbanking business*) to five percent or less of the outstanding stock therein.³⁷³ The administrative rule illustratively lists activities included in the *non-listed incidental banking business* and *proximate nonbanking business*. According to the rule, the *non-listed incidental banking business* includes (a) credit card financing, (b)

³⁶⁹ The agency services may cover only deposit taking, consumer credit, domestic exchange transactions, and/or other activities as incidental to, and necessary to conduct these activities. MOF Business Operation Rule, *supra* note 102.

³⁷⁰ The administration services may not include undertaking administrative functions which the bank must conduct itself in nature. Examples of the permissible administrative services that the rule lists include (a) cash or other calculation services; (b) collateral appraisal and inspection services; (c) bank premise maintenance services; (d) fringe-benefit-related services for bank employees; (e) operation and maintenance services of automatic teller machines; (f) services of cash collection or other routines; (g) consulting and brokerage services of consumer credit; (h) advertisement services; (i) brokerage services of part-time workers; and (j) computer-related services, such as developing computer systems, selling computer software and hardware as necessary to use such software, safekeeping back-up data, and data processing. MOF Domestic Affiliate Notice, *supra* note 41.

³⁷¹ Anti-Monopoly Law art. 11.

³⁷² At least ninety percent of such affiliate's revenue must be derived from its parent bank, with some exceptions. MOF Domestic Affiliate Notice Rule, *supra* note 41.

³⁷³ Anti-Monopoly Law art. 11(1).

guaranteeing residential or other consumer financing, (c) factoring, (d) selling asset-backed certificates covered by the Asset Securitization Law, and (e) selling commodity-fund certificates covered by the Commodity Fund Law. The *proximate nonbanking business* includes (a) property leasing, (b) venture capital activities, (c) management consulting, (d) investment advisory activities covered by the Investment Advisory Business Law, and (e) electronic communication services.³⁷⁴ Affiliates which engage in any of these activities may invest in stock in other domestic companies³⁷⁵ within the limitations set by the Anti-Monopoly Law.³⁷⁶ A bank is required to file a notice with the Ministry of Finance in advance of establishing an affiliate, and subsequently submit periodical reports to the Ministry of Finance.

Finally, the Anti-Monopoly Law prohibits any merchant from employing unfair transaction methods,³⁷⁷ and the prohibition restricts relationships among a bank and its affiliates (including its securities firm and trust bank subsidiaries).³⁷⁸ For instance, a bank may not force its customers to transact with its affiliate³⁷⁹ and not to transact

³⁷⁴ The electronic communication services, for example, include (a) information network services used for banking business and/or trade account settlements and (b) data processing services related to accounting, tax and/or fund management. MOF Domestic Affiliate Notice Rule, *supra* note 41.

³⁷⁵ If an affiliate of a bank, through retention of fifty percent or more of the outstanding stock or otherwise, controls another domestic company which engages in activities impermissible for affiliates of a bank, this control would violate the Ministry of Finance's administrative rule. See *infra* note 517.

³⁷⁶ The Anti-Monopoly Law, with some exceptions, prohibits a non-financial institution which has either the capital of at least ten billion yen or the net asset of at least thirty billion yen from acquiring or retaining stock in domestic companies, if the purchase price of such stock in the aggregate exceeds the greater of its capital or net asset. Anti-Monopoly Law art. 9-2. In addition, the law prohibits any company from acquiring or retaining stock in a domestic company, if such acquisition or retention restricts competition in a certain market segment, and from acquiring or retaining such stock in an unfair manner. *Id.* art. 10(1). Furthermore, the law requires a domestic company, other than a financial institution, which has the total asset of at least two billion yen to periodically file with the Fair Trade Commission a report on its stock holding. *Id.* art. 10(2).

³⁷⁷ Anti-Monopoly Law art. 19.

³⁷⁸ See *Ginkō, Shōken Tō No Sōgo San'nyū Ni Tomonau Fukōsei Na Torihiki Hōhō Tō Ni Tsuite* [Regarding Unfair Transaction Methods, etc. Relating to Mutual Entries by Banks and Securities Firms], Kōsei Torihiki Iinkai [Fair Trade Commission], Apr. 1993, reprinted in 1352 KIN'YŪ HŌMU JIJŌ [Financial Law Affairs], Apr. 25, 1993, (hereinafter "FTC Fair Transaction Notice") at 75-76.

³⁷⁹ A bank, for example, may not request its customer to purchase securities from, or sell them to, its securities firm subsidiary, indicating that the bank would otherwise disfavor the customer in connection with loans or other transactions in the future. Nor may a bank make a loan to its customer on the condition that the customer will select the bank's securities firm subsidiary as lead underwriter. The prohibition also applies where a bank forces customers to make capital contributions to its affiliate. FTC Fair Transaction Notice, *supra* note 373.

with competitors of its affiliate.³⁸⁰ In addition, an affiliate of a bank may not solicit customers to transact with the affiliate in exchange for benefits provided by the bank³⁸¹ nor provide customers with services at a extremely low price by receiving support from the bank.

2. Securities Firm Subsidiary

a. In General

As mentioned above, a city bank, with approvals of both the Minister of Finance and the Fair Trade Commission, can acquire and retain more than fifty percent of the outstanding voting stock in a *de novo* securities firm or an existing securities firm which is failing or has failed.

Under the Glass-Steagall Act, an affiliate of a bank may engage in underwriting and dealing in bank-ineligible securities, only if it derives no more than ten percent of its total gross revenue from such activities.³⁸² There is no such revenue limitation on securities activities of the securities firm subsidiary of a city bank. The five percent limitation on stock holding of financial institutions under the Anti-Monopoly Law applies to any securities firm;³⁸³ however, a bank securities firm subsidiary is subject to the five percent limitation as modified. That is, the Fair Trade Commission's guideline provides that a securities firm subsidiary of a bank (whether a newly established or existing one), *together with its parent bank and possibly its sibling trust bank*,³⁸⁴ may not invest in more than five percent of the outstanding stock in a domestic company.³⁸⁵

³⁸⁰ A bank, for example, may not request its customer to limit the portion of securities to be underwritten by other securities firm than the bank's securities firm subsidiary, indicating that the bank would otherwise disfavor the customer in connection with loan or other transactions in the future. Nor may a bank make a loan to its customer on the condition that the customer will not select such other securities firm as lead underwriter. FTC Fair Transaction Notice, *supra* note 373.

³⁸¹ A securities firm subsidiary of a bank may not solicit its customer to purchase securities from the subsidiary by offering the customer a benefit of a favorable loan from the parent bank. FTC Fair Transaction Notice, *supra* note 373.

³⁸² 12 U.S.C. § 377 (1988).

³⁸³ Anti-Monopoly Law art. 11(1). Stock holding of a securities firm arising from its dealing is exempted from the five percent limitation under the Anti-Monopoly Law. *Id.* art. 11(1)(ii). Thus, in general, a securities firm may hold for its dealing account more than five percent of the outstanding stock in any domestic company.

³⁸⁴ This modified five percent limitation clearly requires that stock holdings of a securities firm, and its parent bank be aggregated, but it is unclear whether or not stock holdings of its sibling trust bank should also be taken into account.

³⁸⁵ See *Kin'yūgaisha No Kabushiki Hoyō No Ninka Ni Kansuru Jimushori Kijun Ni Tsuite* [Regarding Standards for Administration Relating to Stock Holdings of Financial Institutions],

b. Permissible Activities

*Securities and Exchange Law Activities of Securities and Exchange
Law Securities*

If a city bank newly establishes a securities firm, such firm need to obtain license from the Minister of Finance in order to engage in Securities and Exchange Law Activities of Securities and Exchange Law Securities.³⁸⁶ The Securities and Exchange Law requires that the Minister of Finance, *for the time being*,³⁸⁷ grant the license to a bank subsidiary securities firm on the condition that such firm may not engage in brokerage activities of stock.³⁸⁸ There is no other limitation under the Securities and Exchange Law; however, in reality, more limitations are imposed on a bank securities firm subsidiary, so that primary market and dealing activities of stock,³⁸⁹ and dealing and brokerage activities of equity securities other than stock,³⁹⁰ are also temporarily³⁹¹ excluded from permissible activities.³⁹² Thus, a *de*

Kōsei Torihiki Iinkai Jimu Kyoku [Fair Trade Commission Administrative Bureau], (June 20, 1994), (hereinafter "FTC 5% Stock Holding Guideline").

³⁸⁶ Securities Exchange Law Activities of Securities and Exchange Law Securities may be engaged in only by a corporation which obtained license from the Minister of Finance. Securities and Exchange Law art. 28(1). There are four kinds of licenses: (a) license for dealing; (b) license for brokerage activities; (c) license for firm commitment underwriting (including distribution); and (d) license for best efforts underwriting, secondary distribution agency activities, and private placement agency activities. *Id.* art. 28(2). A securities firm can obtain any or all kinds of licenses, if conditions are met.

³⁸⁷ The Ministry of Finance has stated that this limitation would be reviewed for modification within a few years. See *Kin'yū Seido Kaikau Jisshi No Gaiyō Ni Tsuite* [Regarding Outline of Financial System Reform], 1309 SHŌJI HŌMU [COMMERCIAL LAW AFFAIRS], Jan. 5, 1993, at 82-84 (hereinafter "MOF Financial Reform Notice").

³⁸⁸ SEL Supplementary Rule art. 19(1). This prohibition applies not only to domestic stock but also foreign stock. It is said that this temporary limitation purports to protect existing small securities firms, whose major revenue has derived from brokerage activities of stock. There are some exceptions to the limitation: a bank subsidiary firm may, as intermediary, agent or broker of the holder, sell (a) stock that was purchased by the holder from the firm in the initial offering thereof and that has been deposited by the holder in the firm since the purchase; (b) stock to be acquired by the holder upon exercise of warrants that were purchased by the holder from the firm in the initial offering thereof and that have been deposited by the holder in the firm since the purchase; and (c) stock to be acquired by the holder upon exercise of conversion rights, or warrant, attached to the debentures that were purchased by the holder from the firm in the initial offering thereof and that have been deposited by the holder in the firm since the purchase.

³⁸⁹ The term "primary market activities" as used herein includes underwriting, distribution and private placement activities. Thus, a *de novo* securities firm subsidiary of a bank may not participate in issues, and secondary distributions, of stock as underwriter, distributor or private placement agent.

³⁹⁰ The phrase "equity securities other than stock" as used herein includes warrants, and debentures with rights of conversion into stock and with warrants.

³⁹¹ The Ministry of Finance has stated that this limitation would be reviewed for modification within a few years. See MOF Financial Reform Notice, *supra* note 382, at 82-84.

novo securities firm subsidiary of a bank may engage in all kinds of Securities and Exchange Law Activities of debt (non-equity) Securities and Exchange Law Securities and primary market activities of equity securities other than stock.³⁹³

On the other hand, if a bank acquires an existing firm, such firm's existing license is not affected by changes in stockholders; thus, a new license is not needed. However, even in this case, the Securities and Exchange Law allows, but does not require, the Minister of Finance to attach to such existing license the condition prohibiting brokerage activities of stock.³⁹⁴

Other Activities

In general, a securities firm must obtain approval of the Minister of Finance in order to concurrently engage in other activities than Securities and Exchange Law Activities of Securities and Exchange Law Securities.³⁹⁵ The Ministry of Finance's approval guideline lists such other activities to be permitted, if conditions are met.³⁹⁶ The listed permissible activities include those related to (a) sale of domestic certificates of deposit,³⁹⁷ (b) sale of asset-backed certificates covered by the Asset Securitization Law, (c) commodity funds covered by the Commodity Fund Law, including fund originator and truster activities

³⁹² There are some exceptions to the limitation on activities of non-stock equity securities: a bank subsidiary firm may, as intermediary, agent or broker of the holder, sell non-stock equity securities that were purchased by the holder from the firm in the initial offering thereof and that have been deposited by the holder in the firm since the purchase. See MOF Financial Reform Notice, *supra* note 382, at 82. For exceptions to the limitation on activities of stock, see *supra* note 383.

³⁹³ For some permissible incidental secondary market activities of equity Securities and Exchange Law Securities, see *supra* notes 383, 387.

³⁹⁴ SEL Supplementary Rule art. 19(2). *Daiwa Bank, Ltd.*, one of city banks, will acquire more than fifty percent of the outstanding voting stock in *Cosmo Securities Ltd.*, which is an existing failing securities firm engaging in full lines of Securities and Exchange Law Activities; however, reportedly, brokerage activities of stock will not be prohibited but continued. Tanigawa Haruo, 780 Okuyen No Shussi Ni Yori Sôgô Shôken Wo Kogaishaka [Acquisition of a General Securities Firm by Capital Contribution of Seventy-Eight Billion Yen] KIN'YŪ ZAISEI JIJŌ [FINANCIAL AND FISCAL AFFAIRS], Aug. 23, 1993, at 14-17.

³⁹⁵ Securities and Exchange Law art. 43.

³⁹⁶ *Shôken Torihiki Hô Dai 42 Jô Oyobi Dai 42 Jô No 2 Ni Motozuku Kenshoku Oyobi Shôkengaisya Tô No Kengyô No Shônin Ni Tsuite* [Regarding Approvals for Concurrent Offices, and Concurrent Business of Securities Firms, etc., under Articles 42 and 42-2 of the Securities Exchange Law], *Ôkurashô Shôken Kyoku* [MOF Security Bureau] No. 873 (June 25, 1992) (hereinafter "MOF Concurrent Office and Business Rule").

³⁹⁷ A securities firm may engage in Securities and Exchange Law Activities of foreign certificates of deposit, if the firm's license for securities business covers such activities, because foreign certificates of deposit are Securities and Exchange Securities. Securities and Exchange Law art. 2(1)(xi); SEL Administrative Order art. 1.

and sale of commodity-fund interests, and (d) beneficial certificates of a trust for residential mortgages that are not Securities and Exchange Law Securities but Monetary Claims.³⁹⁸ A securities firm, with the approval, may engage in these activities, generally to the same extent as a bank may do and subject to the same non-statutory restrictions as a bank must comply with.

If a bank newly establishes a securities firm subsidiary, such firm need to obtain the approval in order to engage in such other activities. On the other hand, an existing firm acquired by a bank need not obtain it, if it was obtained before the acquisition.

In sum, a city bank may indirectly through its securities firm subsidiary, whether newly established or otherwise, engage in at least the following activities in addition to securities activities in which the bank can directly engage: (a) primary market activities of non-stock equity securities; and (b) all kinds of Securities and Exchange Law Activities of (i) any debt Securities and Exchange Law Securities and (ii) beneficial interests in securities investment trusts and loan trusts.

c. Arm's Length Rules, Firewall Conditions and Personnel
Interlock Limitations

The Banking Law, the Securities and Exchange Law, and the Ministry of Finance's related administrative rules impose arm's length restrictions, firewall conditions, and personnel interlock limitations, on both a bank and its affiliated securities firm³⁹⁹ to avoid various hazards arising from affiliations between them, such as unsound business practices, conflicts of interest, and unfair competitions.

i. *Arm's Length Rules*

Any kind of transaction between a bank and its affiliated securities firm, including sale and purchase of securities or other assets, must be on an arm's length basis.⁴⁰⁰

³⁹⁸ See *supra* note 86; see also *supra* text accompanying note 269. The guideline does not include activities of such trust beneficial certificates; however, another administrative rule expressly permits a securities firm to conduct the activities. See MOF Loan Liquidation Rule, *supra* note 102.

³⁹⁹ Logically considered, the term "bank's affiliated securities firm" as used herein should include both subsidiary and sibling securities firms of a bank. Where a city bank owns both a securities firm subsidiary and a trust bank subsidiary, there is a sibling relationship between the two subsidiaries. But it is unclear whether such sibling firm is included. See SEL Administrative Order art. 15-2.

⁴⁰⁰ Banking Law art. 16-3; Ginkō Hō Shikōrei [Banking Law Administrative Order] Seirei [Cabinet Order] (hereinafter "BL Administrative Order"), art. 5-2(i), (iv), No. 40 (Mar. 27,

ii. Firewall Conditions⁴⁰¹

Underwriting Bank Securities

An affiliated securities firm of a bank may not underwrite, as lead underwriter, securities⁴⁰² issued by the bank.⁴⁰³

Bank's Purchase of Underwritten Securities

An affiliated securities firm of a bank may not sell, to the bank securities⁴⁰⁴ underwritten by the firm during a period of six months after the underwriting.⁴⁰⁵

This restriction is inapplicable where the affiliated firm privately places securities with the bank. On this point, Japan's firewall conditions differ from those of the United States', which limit the placement with affiliates to less than fifty percent of the issue.⁴⁰⁶

1982), as amended. BL Administrative Ordinance art. 17-6; Securities and Exchange Law art. 50-2(i), (iii); *Shōkengaisya No Kenzensei No Junsoku Tō Ni Kansuru Shōrei* [Ministry Ordinance Regarding Standards, etc. for Soundness of Securities Firms], *Ōkura Shōrei* [Ordinance of MOF] art. 2-2(vi), No. 60, (Nov. 5, 1965) (hereinafter "SEL Soundness Ordinance").

⁴⁰¹ It is said that unlike the United States firewall conditions, Japan's principally purport to avoid banks' unfair participation in their securities firm subsidiaries business which interfere with fair competition, rather than to limit transfer of risks involved in subsidiaries' securities activities to banks. *Iwashita Tadashi, Kin'yū Seido Kaikaku Hō Ni Kansuru Seishōrei No Kosshi Ni Tsuiteō* [Regarding Outline of Cabinet Orders and Ministry Ordinances under the Financial System Reform Law (I)], 1344 KIN'YŪ HŌMU JIJŌ [FINANCIAL LAW AFFAIRS], Feb. 5, 1993, at 10.

In addition, the Japan's firewall conditions regulate a relationship between a bank (possibly including the bank's subsidiary) and its affiliated securities firm, but not other relationships. On this point, the Japan's firewall conditions differ from those of the United States, which regulate relationships between a bank and all of its affiliates.

Finally, it should be noted that the Ministry of Finance has stated that the firewall conditions would be reviewed for modification within a few years. See MOF Financial Reform Notice, *supra* note 382, at 82-84.

⁴⁰² The prohibition does not apply to securities whose investment grade is rated by certain rating organizations, such as *Japan Investors Service Ltd.*, *Standard & Poors, Inc.*, or *Moody's Investors Service, Inc.* SEL Soundness Ordinance art. 2-2(ii).

⁴⁰³ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2-2(ii). The bank may not arrange this for its affiliated securities firm subsidiary. See *Shōken Torihiki Hō Tō No Heigai Bōshi Sochi No Junshu Ni Tsuite* [Regarding Compliance with the Firewall Conditions under the Securities and Exchange Law, etc.], *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau], No. 610, (Apr. 1, 1993), as amended (hereinafter "MOF Firewall Condition Rule").

⁴⁰⁴ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2(vii). The restriction does not apply to government bonds, regional government bonds or government-guaranteed bonds.

⁴⁰⁵ The bank may not arrange this for its affiliated securities firm subsidiary. See MOF Firewall Condition Rule, *supra* note 398. As described in the rule, the six-month period begins at the time the affiliated securities firm becomes an underwriter.

⁴⁰⁶ *J.P. Morgan & Co. Inc.*, 76 Fed. Res. Bull. 26 (1990).

Sale of Securities to Pay Bank Debt

An affiliated securities firm of a bank may not sell securities⁴⁰⁷ underwritten by the firm, if the issuer owes a debt to the bank and the affiliated firm knowingly does not notify the purchaser that the proceeds of the issue will be used to pay the issuer's debt to the bank.⁴⁰⁸

This or other firewall conditions would not cover bank's credit extensions to an issuer for purposes of repaying securities underwritten or privately placed by the affiliated firm, although such credit extensions could benefit the affiliated firm to the damage of the bank.⁴⁰⁹

Also, this or other firewall conditions would not cover bank's credit extensions to an issuer for purposes of enhancing the creditworthiness and marketability of securities underwritten or privately placed by the affiliated firm, unless such credit extensions are conditioned on the affiliated firm's underwriting or placement.⁴¹⁰

On these points, Japan's firewall conditions are different from those of the United States', which prohibit such lending practices in order to avoid transfer of risk of underwriting from a securities firm to its affiliated bank and/or unsound loan practice to improve the financial conditions of the securities firm.⁴¹¹

Tying Transactions

An affiliated securities firm of a bank may not agree to conduct any Securities and Exchange Law Activities of Securities and Exchange Law Securities for a customer, if the affiliated firm is aware

⁴⁰⁷ The restriction does not apply to (a) government bonds, regional government bonds, or government-guaranteed bonds, (b) domestic and foreign commercial paper, (c) foreign certificates of deposit, or (e) certain kinds of domestic and foreign trust beneficial certificates backed by residential mortgages which constitute Securities and Exchange Law Securities. SEL Soundness Ordinance art. 2-2(i). For such trust beneficial certificates, *see supra* note 86.

⁴⁰⁸ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2-2(i). The bank may not arrange this for its affiliated securities firm subsidiary. *See* MOF Firewall Condition Rule, *supra* note 398.

⁴⁰⁹ Only if such credit extensions are conditioned on the affiliated firm's underwriting, the credit extensions would be prohibited by the condition named "Tying Transactions" as mentioned next. Literally construed the arm's length rule, as mentioned above, does not apply to this kind of credit extension because the transaction is not between a bank and its affiliated securities firm.

⁴¹⁰ Literally construed the arm's length rule does not apply to this kind of credit extension, either, because the transaction is not between a bank and its affiliated securities firm.

⁴¹¹ However, the United States' firewall conditions permit a bank and its nonbank affiliates to extend credit to an issuer for the purpose of repaying securities privately placed by their securities firm affiliate, if at least three years have elapsed between the placement and the credit extension, and the credit extension meets prudent and objective lending standards. *J.P. Morgan & Co. Inc.*, 76 Fed. Res. Bull. 26 (1990).

that the bank extends credit, or gives other benefit,⁴¹² to the customer on the condition that the customer and the affiliated firm enter into the said transactions.⁴¹³

Purchase Money Financing

An affiliated securities firm of a bank may not sell securities underwritten by the firm during a period of six months after the underwriting, if the affiliated firm is aware that the bank extends credit to the purchaser for the purpose of purchasing such securities.⁴¹⁴

This restriction is applicable only where the affiliated firm acts as underwriter, not as private placement agent. On this point, Japan's firewall conditions differ from those of the United States', which prohibit any affiliate from extending credit to a customer for the purpose of purchasing bank-ineligible securities privately placed until thirty days after the placement.⁴¹⁵

Disclosure of Customer Information

An affiliated securities firm of a bank may not disclose to, or receive from, the bank non-public information on a customer (including an issuer)⁴¹⁶ without consent of the customer.⁴¹⁷

Cross Marketing

No person of an affiliated securities firm of a bank may visit a customer with any person of the bank without request of the customer

⁴¹² Such other benefit includes selling and/or purchasing assets, or entering into any other transaction, on the terms which are more favorable to the customer than ordinarily. SEL Soundness Ordinance art. 2-2(iii).

⁴¹³ Securities and Exchange Law art. 50-2(ii), (iii); SEL Soundness Ordinance art. 2-2(iii). The bank may not arrange this for its affiliated securities firm subsidiary. See MOF Firewall Condition Rule, *supra* note 398.

⁴¹⁴ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2-2(v). The bank may not arrange this for its affiliated securities firm subsidiary. See MOF Firewall Condition Rule, *supra* note 398.

⁴¹⁵ *J.P. Morgan & Co. Inc.*, 75 Fed. Res. Bull. 192 (1989).

⁴¹⁶ Such non-public information includes (a) such significant information on an issuer's operation, business or assets as has not been made public yet and would affect investment judgment (e.g., a plan of merger, fund raising, asset management or facility expansion, and bad financial affairs) and (b) special information on securities transaction orders or assets of customers that was gained in the course of business. MOF Firewall Condition Rule, *supra* note 398.

⁴¹⁷ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2-2(viii). The bank may not do this, either. See MOF Firewall Condition Rule, *supra* note 398. Such consent must be obtained each time of disclosure; thus, an advance consent covering several future disclosures is impermissible.

specifying the purpose of such co-visit.⁴¹⁸ No person of the bank, whether or not visiting with any person of the affiliated firm, may mention, or express an evaluation of, or opinion on, the affiliated firm's services,⁴¹⁹ nor use marketing literatures of such services that are made in the name of the affiliated firm or in the names of both the firm and the bank.⁴²⁰ These limitations are inapplicable if marketing activities are related only to Securities and Exchange Law Activities of government bonds, regional government bonds, or government-guaranteed bonds.⁴²¹

Main Bank Firewall

An affiliated securities firm of a bank may not be a lead underwriter of debentures,⁴²² if the issuer has the net asset of less than five hundred billion yen, and the bank acts as lead indenture trustee of the debentures.⁴²³ Such affiliated firm may not be a lead underwriter of debentures⁴²⁴ or stock, if the issuer has the net asset of less than five hundred billion yen, and the bank previously acted as lead indenture trustee in at least two of the last three issues of debentures which the same issuer publicly offered during the preceding two-year period.⁴²⁵

⁴¹⁸ Securities and Exchange Law art. 50-2(iii); SEL Soundness Ordinance art. 2-2(iv). The bank may not arrange this for a person of its affiliated securities firm subsidiary. See MOF Firewall Condition Rule *supra* note 398. The request of a customer must be voluntarily given by the customer, and may not be demanded or recommended by the bank or its affiliated securities firm. *Shōken Torihiki Hō Dai 65 Jō Oyobi Dai 50 Jō No 2 Dai 3 Gō Ni Motozuku Heigai Bōshi Sochi Tekiyō Ni Kansuru Jimu Tō Ni Tsuite* [Regarding Administrative Matters, etc. Relating to Application of Articles 65 and 50-2(iii) of the Securities and Exchange Law], *Ōkurashō Shōken Kyoku* [MOF Security Bureau] No. 491, (Apr. 1, 1993) (hereinafter "MOF Articles 65 & 50-2 Rule").

⁴¹⁹ MOF Firewall Condition Rule, *supra* note 398; see also MOF Articles 65 & 50-2 Rule, *supra* note 413. If a bank representative visits a customer without any person from the affiliated firm, the bank representative could be allowed to express an opinion on the firm's services to the extent necessary to perform that person's employment duties to the bank.

⁴²⁰ MOF Firewall Condition Rule, *supra* note 398.

⁴²¹ SEL Soundness Ordinance art. 2-2(iv).

⁴²² The restriction does not apply to debentures guaranteed by the government. *Id.* art. 2-2(ix).

⁴²³ The bank may not arrange this for its affiliated securities firm subsidiary. See MOF Firewall Rule, *supra* note 398.

⁴²⁴ The restriction does not apply to debentures guaranteed by the government. SEL Soundness Ordinance art. 2-2(ix).

⁴²⁵ Securities and Exchange Law art. 50-2(iii); SEL Sound Ordinance art. 2-2(x). The bank may not arrange this for its affiliated securities firm subsidiary. See MOF Firewall Condition Rule, *supra* note 398. If the same issuer issued debentures twice or less during the preceding two-year period, the bank must be a lead indenture trustee in all of such previous issue(s), for this restriction to be applicable. SEL Soundness Ordinance art. 2-2(x).

These limitations are inapplicable, when the affiliated firm acts as private placement agent.

This firewall condition is unique to Japan. In Japan, each of most companies has a so-called *main bank*, which is a bank with which the company has an especially deep relationship. Such bank has potential power of control over the company through this transactional relationship, so that it could force the company to transact with the bank's affiliated securities firm. This firewall condition purports to avoid this kind of hazard, or unfair competition. The reason why this condition does not apply to companies which have the net asset of five hundred billion yen or more⁴²⁶ is that such big companies are assumed to be free of the banks' power of control.

*Bank Agency Activities*⁴²⁷

As the agent of its affiliated securities firm, a bank is still subject to the prohibitions under the Banking Law and Securities and Exchange law. For example, a bank violates these laws if it conducts activities such as underwriting, dealing in, or brokerage activities of, stock, debentures or debentures with rights of conversion into stock or with warrants.

*Maintenance of Separateness*⁴²⁸

An affiliated securities firm of a bank basically may not locate its offices in office buildings of the bank, or share computer or other system with the bank.⁴²⁹

⁴²⁶ The number of Japanese companies which have the net asset of five hundred billion yen or more was about thirty in 1993, including *Toyota*, *Nissan*, *Toshiba*, and *Hitachi*. Iwasita, *supra* note 396, at 10-11.

⁴²⁷ MOF Articles 65 & 50-2 Rule, *supra* note 413.

⁴²⁸ *Shōkengaisya No Menkyo Oyobi Ninka Kijun, Tetsuzuki Tō Ni Tsuite* [Regarding Standards Procedures, etc. for License and Approval to Securities Firms], *Ōkurashō Shōken Kyoku* [MOF Security Bureau] No. 871, (June 25, 1992) (hereinafter "MOF License Standard Rule").

⁴²⁹ No office of an affiliated securities firm of a bank may be located in the bank headquarters or in branch buildings exclusively used by the bank. The firm's office may be in a building not exclusively used by the bank, only if the firm's office is on other floor(s) than the bank's office that can be accessed by the firm's customers through another entrance than that used by the bank's customers and there is a good reason for such location. The affiliated firm may share the bank's computer system, only if the firm and the bank cannot access each other's data base. The bank's dealing system cannot be used by the firm. See MOF License Standard Rule, *supra* note 423.

iii. *Personnel Interlock Limitations*

No director serving a bank on a full-time basis,⁴³⁰ without permission of the Minister of Finance, may concurrently hold a full-time office of any other company.⁴³¹ Also, full-time directors of a securities firm are subject to the same restriction.⁴³² In addition, no director or auditor of a securities firm, whether full or part-time, may concurrently be a director, an auditor, or an employee, serving its affiliated bank⁴³³ on a full or part-time basis, unless permitted by the Minister of Finance.⁴³⁴ Finally, banks established some other voluntary limits on personnel interlocks.⁴³⁵

3. *Trust Bank Subsidiary*

a. In General

As mentioned above, a city bank, with approvals of both the Minister of Finance and the Fair Trade Commission, can acquire and retain more than fifty percent of the outstanding voting stock in a *de novo* trust bank or an existing trust bank which is failing or has failed. Like a securities firm subsidiary of a bank, there is no revenue limitation. The five percent limitation on stock holding of financial institutions under the Anti-Monopoly Law⁴³⁶ applies to any trust bank;

⁴³⁰ A director is deemed to serve a bank on a full-time basis, if such director (a) actually participates in daily activities of the bank, regardless of how often the director is required by the bank to attend a board meetings or how long a day the director must serve the bank, (b) is a representative director, who has general authority to represent the bank in ordinary transactions or litigations, or (c) holds an office indicative of participation in daily activities of the bank (*e.g.*, president, deputy president, senior managing director, managing director).

⁴³¹ Banking Law art. 7.

⁴³² Securities and Exchange Law art. 42.

⁴³³ Logically construed, to phrase "affiliated bank of a securities firm subsidiary" as used herein should include a parent and sibling bank of a securities firm. Where a city bank owns both a securities firm subsidiary and a trust bank subsidiary, there is a sibling relationship between the two subsidiaries. However, it is unclear whether such sibling bank is included. See SEL Administrative Order art. 15-2.

⁴³⁴ Securities and Exchange Law art. 42-2. If a director or an auditor violates this, the Minister of Finance may order the person to be removed from the office. *Id.* art. 42-2(3).

⁴³⁵ Non-representative directors of a securities firm, who do not have general authority to represent the firm in ordinary transactions and litigations, may neither be directors of its affiliated bank, nor may have any office of the bank in which main responsibility is related to securities activities of the bank, within approximately two years after resigning as directors of the firm. An affiliated securities firm of a bank must increase its proper employees so that the number of them may reach fifty percent of the total number of its employees around five years after it is established. In no way may any representative director of such firm be a director of the bank even after resigning as director of the firm. See MOF Financial Reform Notice, *supra* note 382, at 82.

⁴³⁶ Anti-Monopoly Law art. 11(1). In general, a trust bank may hold for its trust account more than five percent of the outstanding stock in a domestic company. *Id.* art. 11(1)(iii).

however, a trust bank subsidiary of a bank is subject to the five percent limitation as modified. That is, the Fair Trade Commission's guideline provides that a trust bank subsidiary of a bank (whether a newly established or existing one), *together with its parent bank and possibly its sibling securities firm*,⁴³⁷ may not invest in more than five percent of the outstanding stock in a domestic company in the aggregate.⁴³⁸

b. Permissible Activities

A trust bank is a bank that is licensed by the Minister of Finance for banking business under the Banking Law,⁴³⁹ just like a city bank, and that is approved by the same minister for trust business under the Banks' Trust Business Law.⁴⁴⁰ Thus, if a city bank newly establishes a trust bank subsidiary, such subsidiary needs to obtain both the banking business license and the trust business approval. A *de novo* trust bank subsidiary of a bank, with the banking license, may engage in full lines of banking businesses, if it obtains any other required licenses, permissions, and approvals, of regulatory authorities.⁴⁴¹ On the other hand, the guideline of the Ministry of Finance⁴⁴² limits permissible trust activities of a bank's subsidiary to exclude services concerning many kinds of money trusts (*Kinsen Shintaku*), including loan trusts, pension trusts and collective management money trusts⁴⁴³ (*Gôdô Un'yô Kinsen Shintaku*).⁴⁴⁴ Thus, a trust bank subsidiary, with the trust business approval, may engage in trust activities concerning (a) other kinds of money trusts, including (i) securities investment trusts (mutual funds), and (ii) the so-called *fund trusts* (*Sitei Kingai*

⁴³⁷ This modified five percent limitation clearly requires that stock holdings of a trust bank and its parent bank be aggregated, but it is unclear whether or not stock holdings of its sibling securities firm should be taken into account.

⁴³⁸ See FTC 5% Stock Holding Guideline, *supra* note 380.

⁴³⁹ Banking Law art. 4.

⁴⁴⁰ Banks' Trust Business Law art. 1(1).

⁴⁴¹ For instance, many kinds of securities activities, as mentioned in the last subchapter, require approval of the Minister of Finance under the Securities and Exchange Law. Securities and Exchange Law art. 65-2(1).

⁴⁴² *Shintaku Ginkô Kogaisya No Gyômu Han'i Oyobi Chiiki Kin'yû Kikan Ga Hontai De Okonau Koto Ga Dekiru Shintaku Gyômu No Han'i Ni Tsuite* [Regarding the Scope of Trust Business Permissible for Trust Bank Subsidiaries and Regional Financial Institutions], *Ôkurashô Ginkô Kyoku* [MOF Bank Bureau] No. 617, (Apr. 1, 1993) (hereinafter "MOF Trust Business Rule").

⁴⁴³ A "collective management trust" as used herein is a trust wherein all funds entrusted by customers are commingled and managed collectively without separating each customer's funds.

⁴⁴⁴ The Ministry of Finance has stated that this limitation would be reviewed for modification within a few years. See MOF Financial Reform Notice, *supra* note 382, at 82-84.

Shintaku)⁴⁴⁵ which invest principally in securities,⁴⁴⁶ and (b) many kinds of non-money trusts, including (i) securities trusts (*Yūkashōken No Shintaku*), (ii) monetary claim trusts (*Kinsen Saiken No Shintaku*), (iii) personal property trusts (*Dōsan No Shintaku*), (iv) certain kinds of real estate trusts [*Fudōsan No Shintaku*], (v) certain kinds of leasehold trusts [*Chijōken, Chin'syakuken No Shintaku*], and (vi) charitable trusts.

On the other hand, if a bank acquires an existing trust bank, such trust bank's existing approval is not affected by changes in stockholders; thus, new approval is not needed. There is no limitation under the Banks' Trust Business Law on trust activities of such existing trust bank acquired by a bank, unlike a *de novo* trust bank subsidiary.

Thus, a city bank may indirectly through its trust bank subsidiary engage in the following activities in addition to securities activities in which the bank can directly engage: (a) activities of administering as trustee securities investment trusts covered by the Securities Investment Trust Law;⁴⁴⁷ (b) (i) activities of administering as trustee trusts for asset securitization covered by the Asset Securitization Law,⁴⁴⁸ and (ii) primary market activities, such as underwriting, distribution and private placement activities, of beneficial interests in such trusts;⁴⁴⁹ (c) activities of administering as trustee trusts for residential mortgages of a bank or other financial institution;⁴⁵⁰ and (d) (i) activities of administering as trustee trusts for domestic loans of a bank or other financial institution⁴⁵¹ and (ii) primary market activities of beneficial interests in such trusts that target only sophisticated institutional investors.⁴⁵² The Ministry of Finance's administrative rule requires

⁴⁴⁵ A "fund trust" as used herein is a trust wherein funds entrusted by a customer are managed separately from other customers' funds and in accordance with a management plan made by such customer when the trust is created. The trust distributes its assets to such customer without being cashed when the trust ends.

⁴⁴⁶ Other kinds of permissible money trust activities are activities of providing services concerning gold investment trusts [*Kin Shintaku*], and employee stock-sharing trusts [*Jūgyōin Mochikabu Shintaku*], which distribute trust assets to the beneficiaries without being cashed when the trusts end. MOF Trust Business Rule, *supra* note 437.

⁴⁴⁷ See *supra* text accompanying and following note 229.

⁴⁴⁸ As mentioned above in text, a trust bank subsidiary of a bank may engage in activities of monetary claim trusts; thus, the activities are permissible. See *supra* text accompanying notes 250, 441. Also see *Tokutei Saiken Tō Ni Kakaru Jigyō No Un'ei Ni Tsuite* [Regarding Operations of Business Related to Certain Monetary Claims, etc.] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 1232 (June 24, 1993).

⁴⁴⁹ See *supra* text accompanying note 264.

⁴⁵⁰ See *supra* text accompanying note 279.

⁴⁵¹ See *supra* text accompanying note 296.

⁴⁵² See *supra* text accompanying note 297.

commodity-fund trusts to be created in the form of collective management money trust,⁴⁵³ undertaking of which is prohibited to a trust bank subsidiary of a bank as mentioned above; thus, a trust bank subsidiary of a bank cannot administer as trustee commodity-fund trusts.

c. Arm's Length Rules, Firewall Conditions and Personnel Interlock Limitations

The Banking Law imposes arm's length restrictions on both a bank and its trust bank subsidiary. In addition, the related administrative rules of the Ministry of Finance impose firewall conditions and personnel interlock limitations to avoid various hazards arising from unsound business practices and conflicts of interest.

i. *Arm's Length Rules*

Any kind of transaction between a bank and its trust bank subsidiary must be on an arm's length basis.⁴⁵⁴

ii. *Firewall Conditions*⁴⁵⁵

Trusts of Monetary Claims

A trust bank may undertake trusts of monetary claims from its parent bank, except to the extent that the aggregated amount of the monetary claims trusted by the parent during a fiscal year exceeds fifty percent of the aggregated amount of all monetary claims trusted during the last fiscal year.⁴⁵⁶

⁴⁵³ MOF Commodity-Fund Trust Rule, *supra* note 319.

⁴⁵⁴ Banking Law art. 16-3; BL Administrative Order art. 5-2(ii); BL Administrative Ordinance art. 17-6. The same arm's length rules apply to transactions between a trust bank and its sibling securities firm. Banking Law art. 16-3; BL Administrative Order art. 5-2(v); BL Administrative Ordinance art. 17-6; Securities and Exchange Law art. 50-2(i), (iii); SEL Administrative Order art. 15-2(i)(D); SEL Soundness Ordinance art. 2-2(vi). See *supra* text accompanying note 395.

⁴⁵⁵ *Shintaku Kankei No Heigai Bôshi Sochi No Junshu Ni Tsuite* [Regarding Compliance with Firewall Conditions Related to Trusts] Ôkurashô Ginkô Kyoku [MOF Bank Bureau] No. 620 (Apr. 1, 1993) (hereinafter "MOF Trust Firewall Condition Rule"). Although this rule does not include it, a trust bank subsidiary of a bank could be instructed by the Ministry of Finance outside the rule basically not to locate its offices in office buildings of the parent bank, or to share computer or other systems with the parent bank. See MOF Financial Reform Notice, *supra* note 382, at 84. Finally, the Ministry of Finance has stated that the firewall conditions would be reviewed for modification within a few years. *Id.* at 82.

⁴⁵⁶ However, this restriction is mitigated during a period of three fiscal years following the establishment of a trust bank. See MOF Trust Firewall Condition Rule, *supra* note 450.

Loans and Deposits

A trust bank may not, for its trust account, make any gifts to, or borrow any money from, its parent bank. In addition, a trust bank may not make loans to, or deposit money with, its parent bank, unless the trust bank keeps written evidence showing some good reason for such transactions.

Purchases and Sales of Securities, etc.

Some limitations are imposed on a trust bank's management activities of the so-called *fund trusts* and other trusts wherein trust assets are to be managed in accordance with management plans made when the trusts are created.⁴⁵⁷ roughly stated, a trust bank may not, for its trust account (a) purchase stock or debentures issued by its parent bank during the issue period, or (b) purchase from, or sell to, the parent bank, securities, trust beneficial interests, or monetary claims, held by the parent for its trading or dealing account.⁴⁵⁸

Disclosure of Information

A trust bank may not disclose to, or receive from, its parent bank non-public information about a customer, without consent of the customer.⁴⁵⁹

*Securities Investment Trusts*⁴⁶⁰

A trust bank may undertake securities investment trusts from its trustor affiliate which has been licensed under the Securities Investment Trust Law,⁴⁶¹ except to the extent that the aggregated amount of money trusted to such trusts so undertaken during a fiscal year exceeds twenty-five percent of that of money trusted to all securities

⁴⁵⁷ For the meaning of the term "fund trusts" as used herein, see *supra* note 440.

⁴⁵⁸ This prohibition is not applicable where the trust bank purchases or sells such securities (a) through any stock exchange market with prior consent of the trustor, or by keeping written evidences to show that the parent bank's quotation was the most favorable (or only the parent's quotation was available) and obtaining prior consent of the trustor. A trust bank may not order its parent bank to sell or purchase securities through any market as intermediary, agent or broker of the trust bank, without consent of the trustor. MOF Trust Firewall Condition Rule, *supra* note 450.

⁴⁵⁹ See *supra* note 412.

⁴⁶⁰ For trustee activities of securities investment trusts, see *supra* text accompanying and following note 229.

⁴⁶¹ Securities Investment Trust Law arts. 6, 4(1). See *supra* text accompanying note 224.

investment trusts created by the trust affiliate during the same fiscal year.⁴⁶²

iii. *Personnel Interlock Limitations*

No director serving a bank or its trust bank subsidiary on a full-time basis⁴⁶³ may concurrently hold a full-time office of any other company without permission of the Minister of Finance.⁴⁶⁴ No director of a trust bank may concurrently be a director of the parent bank. There are some other limitations on personnel interlocks.⁴⁶⁵

4. *Other Affiliates*

A city bank must limit its holding of stock in a domestic company, other than a securities firm, a trust bank, and a company which provides the bank with agency or administrative services, to five percent or less of the outstanding stock therein.⁴⁶⁶ However, within this limitation, a bank can be affiliated with another domestic company, if such other company engages only in the so-called *incidental banking business* and/or *proximate nonbanking business*. A bank may indirectly through such affiliate engage in some securities activities which may or may not be permissible for the bank. This section describes what kinds of securities activities a bank may engage in indirectly through such affiliates.

a. *Advisory Activities*

i. *Investment Advice and Discretionary Investment Management Securities and Exchange Law Securities*

The administrative rule of the Ministry of Finance expressly permits an affiliate of a bank to engage in activities of providing investment advice on Securities and Exchange Law Securities,⁴⁶⁷ with prior registration with the Minister of Finance under the Investment Advi-

⁴⁶² See MOF Financial Reform Notice, *supra* note 382, at 84. See also Ujikane & Naka, *supra* note 31, at 250.

⁴⁶³ For the meaning of the term "full-time basis" as used herein see *supra* note 425.

⁴⁶⁴ Banking Law art. 7.

⁴⁶⁵ No employee of a trust bank may concurrently hold any office of its parent bank. A trust bank subsidiary of a bank must increase its proper employees so that the number of them may reach fifty percent of the total number of its employees around five years after it is established. See MOF Trust Firewall Condition Rule, *supra* note 450.

⁴⁶⁶ Anti-Monopoly Law art. 11(1).

⁴⁶⁷ Investment advisory activities on Securities and Exchange Law Securities constitute the so-called *proximate nonbanking business*. MOF Domestic Affiliate Notice, *supra* note 41.

sory Business Law.⁴⁶⁸ In addition, the Minister of Finance also has allowed an investment advisor affiliate to engage in discretionary management activities on investment in Securities and Exchange Law Securities,⁴⁶⁹ with approval of the Minister of Finance under the law.⁴⁷⁰ Such a discretionary investment manager affiliate, on the other hand, may not concurrently engage in other activities than investment advisory activities and discretionary investment management activities, regardless of whether or not such other activities constitute the so-called *incidental banking business* or *proximate non-banking business*.⁴⁷¹

In sum, a city bank may engage in investment advisory and discretionary investment management activities on Securities and Exchange Law Securities indirectly through its affiliate, in addition to activities in which the bank can directly engage.

However, the administrative rule and the law impose some fire-wall conditions. Basically, no office of such bank's affiliate may be located in any buildings of the bank's offices.⁴⁷² There are some limitations on personnel interlocks to ensure independent management and operation of the affiliate, if that affiliate engages in discretionary investment management activities.⁴⁷³ Furthermore, they impose other limitations on some kinds of transactions between the affiliate and the bank.⁴⁷⁴

⁴⁶⁸ Investment Advisory Business Law art. 4. See *supra* text accompanying note 190.

⁴⁶⁹ Thus, discretionary investment management activities on Securities and Exchange Law Securities possibly constitute the so-called *proximate nonbanking business*.

⁴⁷⁰ Investment Advisory Business Law art. 24(1). See *supra* text accompanying note 194.

⁴⁷¹ MOF Domestic Affiliate Notice, *supra* note 41. See also Investment Advisory Business Law art. 31, which prohibits a discretionary investment manager from concurrently engaging in other activities, without approval of the Minister of Finance. But see *infra* note 483.

⁴⁷² MOF Domestic Affiliate Notice, *supra* note 41.

⁴⁷³ No director serving a discretionary investment manager company on a full-time basis may concurrently serve its affiliated bank or any other company on a full-time basis. Investment Advisory Business Law art. 30. In addition, a majority of the board members of the affiliate may not serve the bank or other affiliates on a full-time basis. Furthermore, all representative directors of the affiliate must serve the affiliate on a full-time basis and none of them may serve any other company regardless of whether on a full- or part-time basis. *Tōshi Komon Gyōsha No Gyōmu Un'ei Ni Tsuite* [Regarding Business Operations of Investment Advisor Companies] *Ōkurashō Shōken Kyoku* [MOF Security Bureau] No. 993 (July 20, 1992).

⁴⁷⁴ A company engaging in activities of providing investment advisory and/or discretionary investment management services may not sell securities to, or purchase them from, its affiliate, nor order its affiliate to sell or purchase them on a market as intermediary, agent or broker if: (a) the affiliate, alone or together with (i) companies in which the affiliate retains more than fifty percent of the outstanding stock, and (ii) companies a majority of whose representative directors or directors are those who are or were directors or full-time employees of the affiliate, owns more than fifty percent of the outstanding stock in such discretionary investment manager company; or, (b) a majority of representative directors or directors of the discretionary investment

Other Monetary Claims

Investment advisory activities and discretionary investment management activities on Monetary Claims that are not Securities and Exchange Law Securities⁴⁷⁵ would constitute at worst the so-called *proximate nonbanking business*.⁴⁷⁶ In addition, the Investment Advisory Business Law does not apply to these activities.⁴⁷⁷ Thus, in addition to activities which a bank can directly engage in, a bank may engage in these activities indirectly through its affiliates, outside the limitations on the same activities affecting Securities and Exchange Law Securities, such as the firewall conditions.⁴⁷⁸

ii. Financial Transaction Advice

Activities of providing advice on financial transactions to those who raise funds in such transactions would constitute the so-called *non-listed incidental banking business*,⁴⁷⁹ unless such activities constitute Securities and Exchange Law Activities of Securities and Exchange Law Securities, such as underwriting, distribution or private placement activities thereof.⁴⁸⁰

On the other hand, activities of providing advice on financial transactions to those who provide funds in such transactions would constitute at worst the so-called *proximate nonbanking business*,⁴⁸¹ unless such activities constitute investment advisory activities on Securities and Exchange Law Securities.⁴⁸²

Thus, a city bank can indirectly through its affiliate engage in activities of providing advice on financial transactions to both fund raisers and fund providers, so long as such activities do not constitute

manager company are those who are or were directors or full-time employees of the affiliate or the above companies. Investment Advisory Business Law arts. 23, 33(iii); *Yūkashōken Ni Kakaru Tōshi Komongyō No Kisei Tō Ni Kansuru Hōritsu Shikō Kisoku* [Investment Advisory Business Law Administrative Ordinance] *Ōkura Shōrei* [Order of MOF] art. 26(2)(iii) No. 54 (Oct. 31, 1986).

⁴⁷⁵ See *supra* text accompanying note 94.

⁴⁷⁶ This is because the same activities on Securities and Exchange Law Securities constitute the so-called *proximate nonbanking business*. See *supra* notes 460, 462. See also *supra* note 197.

⁴⁷⁷ See *supra* text accompanying note 196.

⁴⁷⁸ See *supra* text accompanying notes 465-467.

⁴⁷⁹ See *supra* text accompanying and following note 198.

⁴⁸⁰ See *supra* text accompanying note 199.

⁴⁸¹ This is because it is generally considered that investment advisory activities, which involve essentially the same services as advisory activities on financial transaction for fund providers, constitute the so-called *proximate nonbanking business*. See *supra* note 460. See also *supra* note 201 and accompanying text.

⁴⁸² See *supra* text accompanying note 202.

Securities and Exchange Law Activities of, or investment advisory activities on, Securities and Exchange Law Securities.⁴⁸³

b. Commercial Paper and Certificates of Deposit Activities

The administrative rules of the Ministry of Finance⁴⁸⁴ permit an affiliate of a bank to engage in secondary market activities, such as dealing in, or brokerage activities of, domestic certificates of deposit and domestic commercial paper, subject to the same limitations as a bank must comply with.⁴⁸⁵ In addition, although it is ambiguous, one of the rules⁴⁸⁶ indicates that an affiliate of a bank may also engage in Securities and Exchange Law Activities of foreign certificates of deposit and foreign commercial paper, to the same extent and subject to the same limitations as a bank.⁴⁸⁷

c. Securities Investment Trust (Mutual Fund) Activities

The administrative rule of the Ministry of Finance⁴⁸⁸ permits an affiliate of a bank to engage in activities of originating (creating) securities investment trusts (mutual funds) and give trustees (trust banks) instructions on how to manage trust assets, with license from

⁴⁸³ In addition, activities of providing advice on corporate mergers and acquisitions constitute the so-called *non-listed incidental banking business*. See *supra* notes 41, 198. Furthermore, the administrative rule of the Ministry of Finance admits that management consulting constitutes *proximate nonbanking business*. MOF Domestic Affiliate Notice, *supra* note 41. Thus, an affiliate of a bank may engage in almost any advisory activities on not only financial affairs but also other matters, including day-to-day business operations of other companies, unless such advisory activities constitute Securities and Exchange Law Activities of, or investment advisory activities on, Securities and Exchange Law Securities.

⁴⁸⁴ For domestic certificates of deposit, see MOF Deposit Rule, *supra* note 102. This rule prohibits any participant from engaging in primary market agency activities of domestic certificates of deposit; thus, only underwriting and secondary market activities are permitted. Also, the rule requires that such secondary market activities domestic certificates of deposit be conducted by affiliates engaged in activities of property leasing, factoring, or consumer credit guaranteeing, and that the number of affiliates of a bank engaging in such activities be limited to be minimum.

For domestic commercial paper, see MOF CP Rule, *supra* note 102. This rule permits a commercial lending company affiliate of a bank to engage in secondary market activities, not primary market activities, of domestic commercial paper.

⁴⁸⁵ For the limitations on domestic certificate of deposit activities of a bank, see *supra* note 220 and following text. For the limitations on domestic commercial paper activities of a bank, see *supra* note 209 and following text.

⁴⁸⁶ MOF CP Rule, *supra* note 102.

⁴⁸⁷ For foreign certificate of deposit activities of a bank, see *supra* text accompanying and following note 221. See also *supra* note 220. For foreign commercial paper activities of a bank, see *supra* note 209 and accompanying and following text.

⁴⁸⁸ *Kin'yū Kanren Gyōmu Wo Itonamu Kaisya Ni Tsuite* [Regarding Companies Engaging in Finance-Related Activities], Jimu Renraku [Administrative Notice], (June 3, 1993) (hereinafter "MOF Finance-Related Activities Notice").

the Minister of Finance under the Securities Investment Trust Law.⁴⁸⁹ The Ministry of Finance's licensing guideline permits certain kinds of affiliates of a bank to be, or to establish a company engaging in the above activities (hereinafter "Truster Company").⁴⁹⁰ The guideline permits a Truster Company to publicly offer beneficial interests in securities investment trusts, if the company has abilities to do so, including human resources. A Truster Company may not engage concurrently in other activities without approval of the Minister of Finance, regardless of whether or not such other activities constitute the so-called *incidental banking business* or *proximate nonbanking business*.⁴⁹¹ Thus, a city bank may indirectly through its affiliate engage in Truster Company activities and distribution activities of beneficial interests in securities investment trusts, in addition to securities activities in which the bank can directly engage.

The law imposes firewall conditions on operations of such affiliate. There are some limitations on personnel interlocks and some kinds of transactions between a Truster Company and its affiliates, which could include its affiliated bank.⁴⁹²

⁴⁸⁹ Securities Investment Trust Law art. 6.

⁴⁹⁰ For the MOF's licensing guidelines, see *supra* note 226.

As mentioned in the note, the guideline permits (a) a securities firm or discretionary investment manager to establish a Truster Company or (b) such manager to directly obtain license for acting as Truster Company, if conditions are met. Also, as mentioned in text above, a bank may have a securities firm subsidiary and an affiliate engaging in discretionary investment management activities. For a securities firm subsidiary, see *supra* text following note 376. For discretionary investment manager affiliate, see *supra* text accompanying note 462. Thus, a bank can indirectly, through such subsidiary or affiliate, act as a Truster Company, if conditions are met.

⁴⁹¹ Securities Investment Trust Law art. 18. For instance, the approval is required for a Truster Company to engage in investment advisory activities on Securities and Exchange Law Securities covered by the Investment Advisory Business Law. Because the industry has strongly requested this concurrent engagement, the Ministry of Finance has allowed it. See *supra* note 483.

⁴⁹² No director serving a Truster Company on a full-time basis may concurrently serve its affiliated bank or any other company on a full-time basis, without approval of the Minister of Finance. Securities Investment Trust Law art. 20-3. A Truster Company may neither instruct the trustee (trust bank) to purchase, for trust account, securities held by the Truster Company, its directors, or those who own more than ten (10) percent of the outstanding stock in the Truster Company, nor to sell or to tend trust asset securities to any of them. Securities Investment Trust Law art. 17(2)(i).

A Truster Company may not instruct a trustee (trust bank) (a) to enter into any transaction (i) with its affiliate on unusual and unfair terms, (ii) for the purpose of benefiting its affiliated bank (trust bank) or securities firm and to the extent unjustifiably unnecessary in terms of frequency or scale, (iii) for the purpose of interfering with fair price making of securities to be underwritten by its affiliated securities firm as lead underwriter, or (b) to purchase, for trust account, an unsold portion or of securities to be underwritten, distributed or privately placed by its affiliated bank (trust bank) or securities firm. If a Truster Company concurrently engages in discretionary investment management activities, the company may not instruct a trustee to enter

d. Securitized Asset Activities

i. *Certificates Backed by Nonbank Lease and Credit Receivables*

The administrative rule of the Ministry of Finance permits an affiliate of a bank to engage in activities related to sale of asset-backed certificates covered by the Asset Securitization Law, to the same extent as the bank and subject to the same limitations as a bank.⁴⁹³ These activities are also subject to restrictions under the law,⁴⁹⁴ including the prior approval requirement,⁴⁹⁵ unless exempted by the law, like banks.⁴⁹⁶

In addition, the rule also permits an affiliate of a bank to act as special purpose companies in the assignment and partnership-type

into any transaction, for the purpose of benefiting its customers to which the company provides discretionary investment management services and damaging beneficiaries of the securities investment trusts. Securities Investment Trust Law art. 17(2)(iv); Yūkashōken Tōshi Shintaku No Itakugaisya No Kōi Junsoku Ni Kansuru Shōrei [Ministry Ordinance Regarding Operation Standards for Trustee Companies of Securities Investment Trusts] Ōkura Shōrei [Ordinance of MOF] art. 4(1)(i), (iii), (iv), (v), (x), No. 60 (Sept. 30, 1967) as amended (hereinafter "MOF Trustee Operation Standard Ordinance").

A company is an "affiliate" of a Trustee Company as used herein, if: (a) any person that is or was a director or employee of such company is a director of, and owns stock in, a Trustee Company, (b)(i) such a company, alone or together with its directors, principal shareholders or subsidiaries, owns more than fifty percent of the outstanding stock in a Trustee Company, or (ii) a majority of directors or representative directors of a Trustee Company consists of those who are or were directors, employees or principal shareholders of such company or its subsidiaries, etc., or (c)(i) a Trustee Company, alone or together with its directors, principal shareholders or subsidiaries, owns more than fifty percent of the outstanding stock in such company, or (ii) a majority of directors or representative directors of such company consists of those who are or were directors, employees or principal shareholders of a Trustee Company or its subsidiaries, etc. MOF Trustee Operation Standard Ordinance, art. 4(2).

In addition, as mentioned above, a trust bank may undertake securities investment trusts from its affiliated Trustee Company, except to the extent that the aggregated amount of money trusted to such trusts so undertaken during a fiscal year exceeds twenty-five (25) percent of that of money trusted to all securities investment trusts created by the Trustee Company during the same fiscal year. *See supra* text accompanying note 454.

⁴⁹³ MOF Domestic Affiliate Notice, *supra* note 41. For bank's activities related to sale of asset-backed certificates, *see supra* text accompanying and following note 252.

⁴⁹⁴ Bank affiliate's activities related to sale of asset-backed certificates are subject to restrictions under the Asset Securitization Law, while such activities of a bank are exempted from the restrictions. Asset Securitization Law art. 71. The Ministry of Finance's administrative rule, nevertheless, subjects a bank's activities related to sale of asset-backed certificates to almost the same restrictions as so exempted by the law. *See supra* note 255. *See also supra* text accompanying note 260. Thus, because an affiliate of a bank is subject to restrictions under the law, it does not follow that such affiliate must comply with stricter restrictions than a bank, except that such affiliate must obtain prior approval from the Ministers of Finance and of Commerce and Industry under the law, unlike a bank.

⁴⁹⁵ Asset Securitization Law art. 52. *See supra* text accompanying note 252.

⁴⁹⁶ *See supra* note 255 and accompanying text.

securitization schemes.⁴⁹⁷ Prior approval by the Ministers of Finance and of Commerce and Industry is required,⁴⁹⁸ unless exempted by the law, like banks.⁴⁹⁹ An affiliate engaged in the special purpose company activities may not engage concurrently in other activities, without another approval from the same ministers.⁵⁰⁰

Thus, a bank may indirectly, through its affiliate, engage in special purpose company activities, in addition to activities in which the bank can directly engage.

ii. Foreign Trust Beneficial Certificates Backed by Loans

Although it is ambiguous, the Ministry of Finance administrative rule⁵⁰¹ indicates that an affiliate of a bank may also engage in Securities and Exchange Law Activities of securities or certificates issued by a foreign judicial person and representing beneficial interests in a trust for loans of a bank or other financial institution,⁵⁰² to the same extent and subject to the same limitations as a bank.⁵⁰³

e. Commodity Fund Activities

The administrative rule of the Ministry of Finance permits an affiliate of a bank to engage in activities related to commodity funds, such as fund originator and truster activities and sale of commodity-fund certificates, to the same extent as the bank may do and subject to the same limitations as the bank must comply with.⁵⁰⁴ These activities

⁴⁹⁷ MOF Finance-Related Activities Notice, *supra* note 481.

⁴⁹⁸ Asset Securitization Law art. 30. *See supra* text accompanying note 247.

⁴⁹⁹ *Id.* art. 71. *See supra* note 249 and accompanying text.

⁵⁰⁰ *Id.* art. 41. *See supra* text accompanying note 248.

⁵⁰¹ MOF CP Rule, *supra* note 102; MOF New Securities & Private Placement Rule, *supra* note 102.

⁵⁰² Such foreign trust beneficial certificates constitute both Securities and Exchange Law Securities and Monetary Claims. Securities and Exchange Law art. 2(1)(x); SEL Definition Ordinance art. 2; BL Administrative Ordinance art. 12(vii). *See supra* note 87.

⁵⁰³ For such activities of a bank, *see supra* text accompanying and following note 283.

⁵⁰⁴ MOF Domestic Affiliate Notice, *supra* note 41. For bank's fund originator activities, *see supra* text accompanying and following note 312. For bank's activities related to sale of commodity-fund certificates, *see supra* text accompanying and following note 324.

are also subject to restrictions under the law,⁵⁰⁵ including the prior approval requirement,⁵⁰⁶ unless exempted by the law, like banks.⁵⁰⁷

IV. FOREIGN SECURITIES ACTIVITIES

As seen in the last chapter, Japanese city banks engage in domestic securities activities directly through their domestic offices or indirectly through their domestic affiliates, subject to various restrictions under Japanese laws and the Ministry of Finance's administrative rules. On the other hand, they are also conducting securities activities outside Japan directly through their foreign offices or indirectly through their foreign affiliates. These foreign activities, of course, are subject to local laws. Thus, activities of a Japanese bank's state-chartered branch in the United States are governed by not only state laws, including the chartering state's banking law, but also federal laws, such as Glass-Steagall Act. On the other hand, as to Japanese laws and Ministry of Finance's administrative rules, it is generally quite unclear whether or not they are extraterritorially extended to these foreign activities to the same extent as applied to the domestic activities. This chapter copes with this issue, or what kinds of restrictions under Japanese laws are applied to foreign securities activities of Japanese city bank's foreign operations.

A. Foreign Securities Activities of Banks (Foreign Offices)

This section focuses on what kinds of restrictions Japanese laws apply to the foreign securities activities of Japanese city bank's foreign offices. There is no provision under the Banking Law, the Securities and Exchange Law, or such other laws as cited in this article, that expressly targets foreign activities of foreign offices of a bank; thus, there arises an issue of whether or not the restrictions under these laws on domestic activities of domestic offices are extended to such foreign activities.

⁵⁰⁵ A bank affiliate's activities related to commodity funds are subject to restrictions under the Commodity Fund Law, while such activities of a bank are exempted from the restrictions. Commodity Fund Law art. 48(1). The Ministry of Finance's administrative rule, nevertheless, subjects activities bank's activities related to commodity funds to almost the same restrictions as so exempted by the law. See *supra* note 328. See also *supra* note 333 and accompanying text. Thus, because an affiliate of a bank is subject to restrictions under the law, it does not follow that such affiliate must comply with stricter restrictions than a bank, except that such affiliate must obtain prior approval from proper ministers under the law, unlike a bank.

⁵⁰⁶ Commodity Fund Law arts. 3, 49(1). See *supra* text accompanying notes 312, 324.

⁵⁰⁷ *Id.* art. 48(1). See *supra* notes 314, 328 text accompanying.

1. Banking Law

As seen in the last chapter, the Banking Law limits domestic securities activities of domestic offices of a city bank as a matter of its corporate power.⁵⁰⁸ Because foreign offices of a bank are a part of the bank, not separate legal entities from the bank, it is logical to consider that such limitations on corporate power are fully applied to foreign offices. Thus, foreign offices of a bank cannot conduct more securities activities outside Japan than its domestic offices can in Japan.⁵⁰⁹

2. Securities and Exchange Law

As seen in the last chapter, the Securities and Exchange Law generally prohibits domestic securities activities of city bank's domestic offices. While the law exempts some of them from this prohibition, it instead subjects many of such exempted activities to the prior approval requirement and some other restrictions. There is great uncertainty on whether or not these restrictions are fully applied to foreign activities of bank's foreign offices.⁵¹⁰

⁵⁰⁸ See *supra* note 25.

⁵⁰⁹ However, literal applications of the limitations under the Banking Law raise a difficult interpretative problem. The Banking Law permits a bank to directly participate in a private placement of all kinds of Securities and Exchange Law Securities as agent of the issuer, while it prohibits a bank from participating directly as best efforts underwriter in a public offering of certain kinds of Securities and Exchange Law Securities, such as stock and debentures; thus, the distinction between a private placement and a public offering is important in considering whether or not placement agency activities are permissible for a bank. Where securities are issued in Japan, the Securities and Exchange Law clearly provides the standard for such distinction for the Banking Law purposes. See *supra* text accompanying and following note 139. For an offering to be a private placement, the requirements under the Securities and Exchange Law must be met. Securities and Exchange Law art. 2(3), (8)(vi); Banking Law art. 10(6). See *supra* text following notes 140, 145. Literal application of the Banking Law requires that the same Securities and Exchange Law standard be used even in overseas offerings, or issues of securities by a foreign issuer exclusively outside Japan. Under this interpretation, a bank is permitted under the Banking Law to as placement agent participate in an overseas offering of stock or debentures, only if the Securities and Exchange Law, rather than the local law, recognizes such offering as a private placement. This, however, is unreasonable, because it is impractical to require a foreign issuer to comply with the Securities and Exchange Law. Thus, a reasonable interpretation should be that as to overseas offerings, so long as local law recognizes a distinction between a private placement and a public offering, such local law standard, not the Securities and Exchange Law standard, is used for the Banking Law purposes. In other words, if an overseas offering constitutes a private placement under local law, placement agency activities in such offering should be private placement activities permissible for a bank under the Banking Law, even though such offering does not qualify for a private placement under the Securities and Exchange Law. It is, nevertheless, unclear whether or not the Ministry of Finance has the same view.

⁵¹⁰ The question of whether or not the Securities and Exchange Law is applied to foreign securities activities of a bank's foreign offices is important only in that if the answer is affirma-

3. *Trust Business Law and Banks' Trust Business Law*

The Trust Business Law and the Banks' Trust Business Law permit only licensed trust companies and approved trust banks to engage in trust business. A city bank can engage in trust business, only with prior approval of the Minister of Finance under the Banks' Trust Business Law.⁵¹¹ There is considerable uncertainty on whether or not these laws are fully applied to foreign trust activities of bank's foreign offices.⁵¹²

4. *Other Laws*

The five percent limitation of stock holding of a bank under Anti-Monopoly Law⁵¹³ applies to foreign offices so far as the stock is in any domestic company; on the other hand, the law does not apply to stock in any foreign company, regardless of which office, domestic or foreign, retains and books it.

In general, the Investment Advisory Business Law, the Securities Investment Trust Law, the Asset Securitization Law, and the Commodity Fund Law, basically regulate only activities conducted in whole or part in Japan and/or involving any resident of Japan. Thus,

tive; many of the foreign securities activities permitted by the Banking Law are subject to the prior approval requirement under the Securities and Exchange Law, and other restrictions thereunder covering unfair transactions and personnel qualification. *See supra* text accompanying and following note 60. *See also supra* notes 90, 91, 119, 120, 174 and 175. The answer to the question does not affect the scope of permissible foreign securities activities. The Banking Law and the Securities and Exchange Law draw the same line between permissible and impermissible securities activities of a city bank; thus, even though the Securities and Exchange Law is not applied to foreign securities activities of a bank's foreign offices, the scope of permissible foreign securities activities does not expand due to the limitations on corporate power of a bank under the Banking Law. *See supra* text accompanying and following note 501.

The issue is illustrated as follows: The Banking Law permits a bank to engage directly through foreign offices in private placement agency activities of all kinds of Securities and Exchange Law Securities outside Japan. If the Securities and Exchange Law applies to foreign securities activities of foreign offices, the private placement agency activities outside Japan are subject to the above restrictions under the Securities and Exchange Law, even though the bank engages in no such activities in Japan. With respect to this issue, it is completely unclear whether or not the Ministry of Finance is of the opinion that the restrictions under the Securities and Exchange Law are extended to foreign securities activities.

⁵¹¹ Banks' Trust Business Law art. 1(1).

⁵¹² The Banks' Trust Business Law possibly limits the corporate power of a city bank; in other words, a city bank does not acquire trust power without prior approval under the law. If this is true, the law is applied to foreign trust activities of a bank's foreign offices, because foreign offices are not separate legal entities from a bank but a part of it. Under this interpretation, foreign offices may not, without the approval under the law, engage in trust activities, even though such foreign offices do them exclusively outside Japan and no Japanese offices do them in Japan.

⁵¹³ Anti-Monopoly Law art. 11(1).

so far as foreign offices conduct exclusively outside Japan and no resident of Japan is involved, these laws are generally not applicable.⁵¹⁴

5. Ministry of Finance Administrative Rules

Many administrative rules of the Ministry of Finance regulate domestic securities activities of domestic offices of a city bank. Whether or not such restrictions are applied to foreign activities of foreign offices of a bank depends upon their underlying objectives. In general, if such restrictions dictate only domestic considerations, such as protection of domestic investors and/or security of fair domestic market, they are not applied, although it is usually not easy to judge this.⁵¹⁵

B. Foreign Securities Activities of Foreign Affiliates

This section focuses on what kinds of restrictions under Japanese laws are applied to foreign securities activities of Japanese city bank's foreign affiliates.

1. In General

The Banking Law controls some of affiliations between a bank and foreign companies. The Banking Law expressly permits a bank to acquire and retain more than fifty percent of the outstanding voting stock in a foreign bank or a foreign securities firm with approval of the Minister of Finance.⁵¹⁶ The five percent limitation of stock holding of a bank under the Anti-Monopoly Law⁵¹⁷ is not applied to holding stock in any foreign company; thus, in order to acquire and retain such stock, the Fair Trade Commission's approval is not needed. There is no provision under the Banking Law that limits activities of these foreign subsidiaries or relationship between a bank and these foreign subsidiaries; instead, administrative rules of the Ministry of Finance set limitations, including firewall conditions, on foreign underwriting activities of these foreign subsidiaries, as mentioned below.

No provision of the Banking Law regulates affiliations between a bank and foreign companies, except that the law requires prior notice to the Minister of Finance when a bank acquires or retains more than

⁵¹⁴ Even though none of these laws regulate foreign activities of bank's foreign offices, for such foreign offices to be permitted to engage in certain foreign activities, such activities must be permissible both under applicable Japanese law, such as the Banking Law, and under local laws.

⁵¹⁵ Although it is impossible to generalize, it appears that many of the restrictions imposed by administrative rules of the Ministry of Finance intend to implement domestic considerations.

⁵¹⁶ Banking Law art. 16-4(1).

⁵¹⁷ Anti-Monopoly Law art. 11(1).

fifty percent of the outstanding voting stock in any foreign company other than foreign bank and securities firm subsidiaries.⁵¹⁸ As mentioned above, the administrative rules of the Ministry of Finance regulate affiliations between a bank and domestic companies, other than its securities firm and trust bank subsidiaries.⁵¹⁹ The rules permit domestic affiliates of a bank to engage only in activities of providing the bank with certain kinds of agency and administrative services, the so-called *incidental banking business* (including the so-called *non-listed incidental banking business*), and the so-called *proximate nonbanking business*.⁵²⁰ Such domestic affiliates are, for instance, prohibited from engaging in activities completely unrelated to banking, such as real estate retail business, travel agency business, product sales,⁵²¹ hotel business, warehouse business, marine courier business, and mining business.⁵²² Based upon similar considerations to those underlying the restrictions on bank's domestic affiliations, the Ministry of Finance, by its non-statutory administrative rules⁵²³ regulates affiliations between a bank and foreign companies other than its foreign bank and securities firm subsidiaries.

Under the administrative rules, a city bank is prohibited from beneficially acquiring or retaining more than fifty percent of the outstanding voting stock in any foreign company that is engaged in the kinds of activities impermissible for any domestic affiliates of a bank.⁵²⁴ This prohibition is not affected by whether such stock is owned in the name of the bank or in another person's name. In addition, even where a bank owns stock but less than fifty percent, it may not have power of significant control over financial affairs or business policies of any foreign company that is engaged in the kinds of activities impermissible for any domestic affiliates of a bank, by virtue of

⁵¹⁸ Banking Law art. 53(v); BL Administrative Ordinance art. 35(x).

⁵¹⁹ See *supra* text accompanying and following note 354.

⁵²⁰ MOF Domestic Affiliate Rule, *supra* note 354; MOF Domestic Affiliate Notice, *supra* note 41.

⁵²¹ MOF Domestic Affiliate Notice, *supra* note 41.

⁵²² MOF Foreign Affiliate Notice, *supra* note 355.

⁵²³ *Kin'yū Kikan To Sono Shussisaki Gaikoku Hōjin Tono Kankei Ni Tsuite* [Regarding Relationships between Financial Institutions and Their Invested Foreign Companies] *Ōkurashō Ginkō Kyoku* [MOF Bank Bureau] No. 1117 (Apr. 23, 1976); MOF Foreign Affiliate Notice, *supra* note 355.

⁵²⁴ This also prohibits a foreign company in which a bank owns more than fifty percent of the outstanding voting stock from, alone or together with the bank, beneficially acquiring or retaining more than fifty percent of the outstanding voting stock in another foreign company that is engaged in activities impermissible for any domestic affiliates of a bank. MOF Foreign Affiliate Notice, *supra* note 355.

personnel, financial, trade or other relationships.⁵²⁵ Literally construed, a bank may control to any extent and in any manner a foreign company that is engaged in such impermissible activities, if the bank owns no stock in such company, although the Minister of Finance's view is unclear. On the other hand, where a bank does not have any power of control over, but only passively invests in, a foreign company that is engaged in such impermissible activities, the bank is instructed by the Ministry of Finance to limit its stock holding in such foreign company to ten percent or less of the outstanding stock therein. A bank must file a notice with the Minister of Finance in advance of acquiring more than fifty percent of the outstanding voting stock in any foreign company that is not covered by the above prohibition,⁵²⁶ and subsequently submit periodical reports to the Ministry of Finance.

2. Foreign Bank & Securities Firm Subsidiaries

a. In General

The Banking Law expressly permits a city bank to acquire and retain more than fifty percent of the outstanding voting stock in a foreign bank or a foreign securities firm with permission of the Minister of Finance.⁵²⁷ No director serving a bank on a full-time basis may, without approval of the Minister of Finance, concurrently serve any other company on a full-time basis;⁵²⁸ thus, no full-time director of a bank (or its domestic trust bank subsidiary) may serve any of these foreign subsidiaries on a full-time basis.⁵²⁹ There is no other provision under the Banking Law that regulates relationships between a bank and these foreign subsidiaries, or activities or operations of these subsidiaries. Indeed, the arm's length rules under the Banking Law that regulate relationships among a bank and its affiliated domestic trust bank and securities firm⁵³⁰ are not applied to these foreign subsidiaries.⁵³¹ These foreign subsidiaries are separate legal entities from the parent bank; thus, it is generally construed that no restriction under

⁵²⁵ If any company that is not affiliated with a bank owns more than fifty percent of the outstanding voting stock in a foreign company, the bank is usually viewed as not having such power of control over such foreign company. MOF Foreign Affiliate Notice, *supra* note 355.

⁵²⁶ Banking Law art.53(v); BL Administrative Ordinance art. 35(ix).

⁵²⁷ Banking Law art. 16-4(1).

⁵²⁸ Banking Law art. 7. For the meaning of the term "full-time basis" as used herein, *see supra* note 425.

⁵²⁹ There is no other limitation under Japanese law on personnel interlocks between a bank (or its domestic trust bank subsidiary) and these foreign subsidiaries.

⁵³⁰ Banking Law art. 16-3; BL Administrative Ordinance 17-6. *See supra* text accompanying notes 395, 449.

⁵³¹ *See* BL Administrative Order art. 5-2; BL Administrative Ordinance art. 17-4.

the Banking Law is extended to these foreign subsidiaries, unless they conduct activities in any part inside Japan or any resident of Japan is involved in such activities.

The same things can be said in connection with the Securities and Exchange Law. No director serving a domestic securities firm on a full-time basis may, without permission of the Minister of Finance, concurrently serve any other company on a full-time basis under the Securities and Exchange Law;⁵³² thus, no full-time director of a domestic securities firm subsidiary of a bank may serve any of these foreign subsidiaries on a full-time basis.⁵³³ The Securities and Exchange Law has no other provision related to these foreign subsidiaries. The Securities and Exchange Law expressly admits that the arm's length rules, and the firewall conditions, which regulate relationships between a securities firm and its affiliated bank (which means its parent bank and possibly sibling trust bank),⁵³⁴ are not applied to these foreign subsidiaries, if these subsidiaries have no office or facility inside Japan.⁵³⁵ No prohibition of the Securities and Exchange Law, including the prohibition against financial institutions' securities activities, is extended to these subsidiaries, unless they conduct activities in any part inside Japan or any resident of Japan is involved in such activities.

Likewise, the Trust Business Law, the Banks' Trust Business Law, the Anti-Monopoly Law, the Investment Advisory Business Law, the Securities Investment Trust Law, the Asset Securitization Law, and the Commodity Fund Law, are not applicable to these subsidiaries, unless they conduct activities in any part inside Japan or any resident of Japan is involved in such activities.

The administrative rule of the Ministry of Finance,⁵³⁶ nevertheless, limits lead underwriter functions of these foreign subsidiaries outside Japan and imposes firewall conditions on such foreign underwriting activities.

⁵³² Securities and Exchange Law art. 42. See *supra* text accompanying note 425.

⁵³³ There is no other limitation under Japanese law on personnel interlocks between a domestic securities firm subsidiary of a bank and these foreign subsidiaries. See *Shōkengaisya Ni Kansuru Shōrei* [Ministry Ordinance Regarding Securities Firms] *Ōkura Shōrei* [Ordinance of MOF] arts. 2-6, 2-9(ii) No. 52 (Sept. 30, 1965) (hereinafter "SEL Securities Firm Ordinance").

⁵³⁴ Securities and Exchange Law art. 50-2(i), (ii); SEL Soundness Ordinance art. 2-2. See *supra* text accompanying and following note 395.

⁵³⁵ SEL Securities Firm Ordinance arts. 2-6, 2-9(ii).

⁵³⁶ *Kin'yūkikan No Kaigai Genchi Hōjin No Shōken Hiki'uke Gyōmu Ni Tsuite* [Regarding Securities Underwriting Business of Foreign Subsidiaries of Financial Institutions], Jimu Renraku [Administrative Notice], (Mar. 3, 1993) (hereinafter "MOF Foreign Underwriting Notice").

b. Limitations on Lead Underwriter Functions⁵³⁷

A foreign bank or securities firm subsidiary of a bank are, *for the time being*, prohibited from being lead underwriters in foreign issues of bonds (debentures) of Japanese companies,⁵³⁸ with the following exceptions: Such a foreign subsidiary may be a lead underwriter in a foreign issue of bonds (debentures) of a Japanese company, if (a) the issue is treated as a private placement under the local law, (b) such bonds (debentures) are guaranteed by the government, (c) the issuer is the parent bank or a subsidiary of the parent bank, (d) the total issue price is ten billion yen (or one hundred million dollars) or less,⁵³⁹ or (e) the issuer has net assets of at least five hundred billion yen.⁵⁴⁰

c. Firewall Conditions⁵⁴¹

The following firewall conditions are imposed on foreign underwriting activities of a foreign subsidiary of a bank: No person of a bank may visit a customer with any person of the foreign subsidiary without request of the customer specifying the purpose of such co-

⁵³⁷ This limitation was set in 1993 by the Ministry of Finance by mitigating the pre-existing restrictions, under which the Ministry of Finance instructed any foreign subsidiary of any Japanese bank not to be a lead underwriter of foreign bond issues of any Japanese company. This restriction is known as "three-bureau agreement" [*Sankyoku Gōi*]. Prior to 1993, no bank owned its domestic securities subsidiary, and could not directly or indirectly underwrite bonds as in present. Thus, this previous restriction purported to prevent banks from mutilating these prohibitions under the Securities and Exchange Law by directing Japanese companies to issue bonds in foreign markets and thereby, indirectly through their foreign subsidiaries, underwriting bonds. In 1993, the Ministry of Finance mitigated this previous restriction, and stated that it would be completely abolished in five years, at the same time the Banking Law and the Securities and Exchange Law were amended to permit a bank to own a domestic securities firm subsidiary.

⁵³⁸ The prohibition is applied to an issue not only of a Japanese company but also of a foreign company if: (a) Japanese companies or individuals own twenty-five or more of the outstanding stock in such foreign company; (b) another foreign company that meets the condition of (a) above, alone or together with any Japanese company or individual, owns all of the outstanding stock in such foreign company; or (c) such foreign company issues bonds on behalf of any Japanese company or individual or another foreign company that meets the condition of (a) or (b) above. MOF Foreign Underwriting Notice, *supra* note 529.

⁵³⁹ However, this exception is not available, if the total issue price, together with the aggregated issue price of other foreign public issues of bonds of the same issuer within the preceding three-month period in which foreign public issues any of foreign subsidiaries of the bank was retained as lead underwriter, exceeds ten billion yen (or one hundred million dollars). MOF Foreign Underwriting Notice, *supra* note 529.

⁵⁴⁰ However, this exception is not available, in the case of the issues of bonds (debentures) with rights of conversion into stock or with warrants. In addition, this exception can be relied on only once during any one (1)-year period beginning on April 1, throughout all foreign subsidiaries of a bank. MOF Foreign Underwriting Notice, *supra* note 529.

⁵⁴¹ Compare with Firewall conditions as applied to domestic relationships, *supra* text accompanying notes 413-16 and 422.

visit.⁵⁴² No person of the bank, whether or not visiting with any person of the foreign subsidiary, may mention, or express an valuation of, or opinion on, the foreign subsidiary's services,⁵⁴³ or use marketing literature of such services that are made in the name of the foreign subsidiary or in the names of both the foreign subsidiary and the bank. A bank may not negotiate with the customers on behalf of the foreign subsidiary to set the terms of underwriting agreements, or conduct any part of underwriting activities of the foreign subsidiary. These limitations are inapplicable, if underwriting activities are related only to government bonds, regional government bonds, or government-guaranteed bonds.

3. *Other Foreign Affiliates*

As mentioned above, a city bank can be affiliated with other foreign companies, unless such other companies are engaged in the kinds of activities impermissible for any domestic affiliates of a bank. No director serving a bank on a full-time basis may, without approval of the Minister of Finance, concurrently serve any other company on a full-time basis;⁵⁴⁴ thus, no full-time director of a bank (or its domestic trust bank subsidiary) may serve any of these foreign affiliates on a full-time basis.⁵⁴⁵ No director serving a domestic securities firm on a full-time basis may, without approval of the Minister of Finance, concurrently serve any other company on a full-time basis under the Securities and Exchange Law;⁵⁴⁶ thus, no full-time director of a domestic securities firm subsidiary of a bank may serve any of these foreign affiliates on a full-time basis.⁵⁴⁷ Neither any other provision of the Banking Law or the Securities and Exchange Law, nor any part of the

⁵⁴² The request of a customer must be voluntarily given by the customer, and may not be requested or solicited by a bank or its foreign subsidiary. MOF Foreign Underwriting Notice, *supra* note 529.

⁵⁴³ If a person of the bank visits a customer without any person of its foreign subsidiary, the bank personnel could be allowed to express a personal opinion on the subsidiary's services, to the extent requested by the customer or necessary to perform the personnel's employment duties to the bank. MOF Foreign Underwriting Notice, *supra* note 529.

⁵⁴⁴ Banking Law art. 7. For the meaning of the term "full-time basis" as used herein, *see supra* note 425.

⁵⁴⁵ There is no other limitation under Japanese law on interlocking personnel between a bank (or its domestic trust bank subsidiary) and these foreign affiliates. *See supra* text following note 522.

⁵⁴⁶ Securities and Exchange Law art. 42. For the meaning of the term "full-time basis" as used herein, *see supra* note 425.

⁵⁴⁷ There is no other limitation under Japanese law on interlocking personnel between a domestic securities firm subsidiary of a bank and these foreign affiliates. *See supra* text following note 528.

Trust Business Law, the Banks' Trust Business Law, the Anti-Monopoly Law, the Investment Advisory Business Law, the Securities Investment Trust Law, the Asset Securitization Law, and the Commodity Fund Law, regulates activities of these foreign affiliates or relationship between a bank's domestic operations and these foreign affiliates, unless these foreign affiliates conduct activities in any part inside Japan or any resident of Japan is involved in such activities.

V. CONCLUSION

Notwithstanding the above 1993 reform to the Japanese financial system, city banks are still prohibited from engaging directly in certain kinds of securities activities, such as underwriting, distribution, dealing and brokerage activities of stock, other equity securities and debentures. It is true that there remains the *specialization* system of the banking industry that separates it from the securities industry in this sense. However, banks are now allowed to engage directly in various kinds of securities activities, such as all kinds of Securities and Exchange Law Activities of government bonds and Monetary Claims, although the Ministry of Finance has imposed substantial non-statutory restrictions on some of the activities.⁵⁴⁸ More importantly, banks can conduct considerable kinds of securities activities impermissible for the banks themselves indirectly, through their securities from subsidiaries, trust bank subsidiaries and other affiliates. These securities activities, such as primary market activities of non-stock equity securities and all kinds of Securities and Exchange Law Activities of debentures, are subject to limitations on relationships between banks and their affiliates, or arm's length rules, firewall conditions and personnel interlock limitations. Thus, it can be said that the *specialization* system has significantly changed in substance. The prohibition against

⁵⁴⁸ Recall that the Ministry of Finance for example, has subjected private placement activities of Securities and Exchange Law Securities and other activities of Monetary Claims to substantial non-statutory restrictions. However, it appears that many of the restrictions are transitory in scope and degree; thus, they would be gradually mitigated, depending upon the scale of markets, experience of banks and investors in these activities, etc. Also, it should be noted that these restrictions can be amended without any parliament or cabinet action.

In a case where these non-statutory restrictions are substantially mitigated, some of the Monetary Claims that are not Securities and Exchange Law Securities at present might be added to the Securities and Exchange Law Security list, thereby subjecting banks' Securities and Exchange Law Activities of such Monetary Claims to the Securities and Exchange Law regulatory framework. See *supra* text accompanying note 52. However, this would not narrow banks' activities of such Monetary Claims, since such Monetary Claims are still Monetary Claims, with respect to which all kinds of Securities and Exchange Law Activities are permissible for banks under the Banking Law and the Securities and Exchange Law. Banking Law art. 10(2)(v), (5); Securities and Exchange Law art. 65(2)(ii), (iii). See *supra* note 39.

banks' securities activities, especially indirect activities, under the system has been substantially mitigated, while the system has required compliance with limitations on relationships between banks and their affiliates.

However, this change is not final. The *specialization* system would be further reduced in its regulatory significance from now on, and the final picture might be that the system functions only as limitations on relationships between banks and their affiliates. It is true that the *specialization* system will continue restrict the scope of banks' permissible direct securities activities. This is because future substantial expansion of banks' direct securities activities cannot be expected any longer.⁵⁴⁹ However, now that banks are allowed to enter the securities industry through their affiliates, banks' principal concern should not be there; rather, their concern should be to what extent (a) their affiliates will be permitted to engage in securities activities impermissible for banks themselves and (b) restrictions on relationships between banks and their affiliates will be mitigated. With respect to the first issue, banks' affiliates will ultimately be allowed to engage fully in securities activities impermissible for banks themselves, because this is what the 1993 financial system reform purports. For instance, banks' securities firm subsidiaries are now temporarily prohibited from engaging in any kinds of Securities and Exchange Law Activities of stock and secondary market activities of non-stock equity securities; however, the Ministry of Finance has stated that such restrictions would be reviewed for modification within a few years.⁵⁵⁰ Although it is not certain to what degree such restrictions will be mitigated at such first review, there is no doubt that banks' securities firm subsidiaries will

⁵⁴⁹ The 1993 financial system reform adopted the so-called *subsidiary system*, which allows banks to enter the securities industry only through their subsidiaries, and rejected the so-called *universal banking system*, which allows banks to engage directly in full lines of securities activities. Thus, banks would not be authorized from now on to engage substantially in securities activities now impermissible for banks themselves, e.g., underwriting, distribution, dealing and brokerage activities of stock, other equity securities and debentures.

In contrast to such traditional securities, new kinds of debt securities, such as new asset-backed securities, if arise, would be included in Monetary Claims, thereby permitting banks to engage directly in all kinds of Securities and Exchange Law Activities. Banking Law art. 10(2)(v), (5). It should be noted that the Banking Law has a list of Monetary Claims but the list is illustrative, not exclusive. New debt securities may or may not be added to the list. Even if not added, such new securities still can be included in Monetary Claims by interpretation. Also note that such new securities might also be added to the Securities and Exchange Law Security list. See *supra* text accompanying note 52. However, banks can still conduct all kinds of Securities and Exchange Law Activities thereof. Banking Law art. 10(2)(v), (5); see also *supra* note 39.

⁵⁵⁰ See *supra* notes 382, 386 and accompanying text. This review is true of the temporary restrictions on the scope of permissible trust activities of trust bank subsidiaries. See *supra* note 439.

ultimately be permitted to engage in all kinds of Securities and Exchange Activities of any Securities and Exchange Law Securities sometime in the future. Thus, taking into account such indirect securities activities of banks, it can be said that the *specialization* system will stop playing the important role of limiting the scope of banks' permissible securities activities. On the other hand, with respect to the second issue, limitations on relationships between banks and their affiliates will continue to exist. The Ministry of Finance has stated that such limitations would also be reviewed for modification within a few years⁵⁵¹ and they might be mitigated in the future; however, complete abolition of them cannot be expected, given the banks' potential power of control over economics. Thus, even reaching the point where all restrictions on the scope of banks' permissible indirect securities activities terminate, the *specialization* system would still limit relationships between banks and their affiliates, and the mitigation of such restrictions might be the last struggling point between the banking and securities industries.

⁵⁵¹ See *supra* notes 396, 450.

APPENDIX 1. *Ginkô Hô* [Banking Law] Law No. 59 of 1981

[Excerpt]

Article 10. (Scope of Business)

- (1) A bank may engage in the following businesses:
 - (i) Accepting deposits or installment savings, etc.;
 - (ii) Lending money or discounting bills and notes and;
 - (iii) Conducting exchange transactions.
- (2) In addition to such businesses as provided in the preceding paragraph, a bank may engage in the following businesses and other such businesses as incidental to banking business.
 - (i) Guaranteeing debts or accepting bills;
 - (ii) Purchasing and selling securities (excluding monetary claims represented by such certificates as prescribed in Item (v); the same in Item (vi)) or entering into securities index future transactions, securities option transactions or foreign market securities future transactions (limited to those activities entered into for the purpose of investment or upon written order, and for the account, of customers);
 - (iii) Lending securities;
 - (iv) Underwriting (excluding underwriting for the purpose of distribution) government bonds, regional government bonds and government-guaranteed bonds (hereinafter called "government bonds, etc." in this article) and/or handling public offerings of government bonds, etc. so underwritten;
 - (v) Acquiring and assigning monetary claims (including negotiable certificates of deposit and other monetary claims represented by such certificates as prescribed in an ordinance of the Ministry of Finance);
 - (vi) Handling private placements of securities;
 - (vii) Undertaking as indenture trustee to handle public offerings and administration of regional government bonds, debentures and other bonds;
 - (viii) Acting as agent for banks or other persons engaging in financial business (limited to such persons as prescribed in an ordinance of the Ministry of Finance);
 - (ix) Handling receipt, payment and other administration of money on behalf of the Government, regional governments or companies, etc.;
 - (x) Safekeeping securities, precious metals and other items;
 - (xi) Exchanging money; and
 - (xii) Acting as intermediary, broker or agent with respect to financial future transactions, etc.

* * *

(5) If such business as prescribed in Item (v) of Paragraph (2) involves monetary claims that are represented by such certificates as prescribed in the same item and that constitute securities, such business shall include such ac-

tivities as prescribed in each item of Paragraph (8) of Article 2 of Shôken Torihiki Hô [Securities and Exchange Law] Law No. 25 of 1948.

(6) The term "Handling private placements of securities" as used in Item (vi) of Paragraph (2) shall mean handling private placements of securities (which mean such private placements of securities as prescribed in Item (vi) of Paragraph (viii) of Article 2 of Shôken Torihiki Hô [Securities and Exchange Law] Law No. 25 of 1948.).

* * *

Article 11. (Ditto)

In addition to such businesses as prescribed in the preceding article, a bank may, except to the extent interfering with the performance of such businesses as prescribed in each item of Paragraph (1) of the same article, engage in such businesses as prescribed in each item of Paragraph (2) of Article 65 of Shôken Torihiki Hô [Securities and Exchange Law] Law No. 25 of 1948 with respect to such securities and transactions as prescribed in the said each item (excluding such business engaged in under Paragraph (2) of the preceding article).

Article 12. (Ditto)

A bank may not engage in other businesses than those engaged in under the preceding two (2) articles, *Tanpotsuki Shasai Shintaku Hô* [The Law of Trust for Secured Bonds] Law No. 52 of 1905 or any other laws.

APPENDIX 2. Shôken Torihiki Hô [Securities and Exchange Law] Law No. 25 of 1948

[Excerpt]

Article 2. (Definitions)

(1) The term "securities" as used in this law shall mean those prescribed in the following:

- (i) Government bonds,
- (ii) Regional Government bonds,
- (iii) Bonds issued by a judicial person in accordance with special law;
- (iv) Debentures;
- (v) Investment securities issued by a judicial person established under special law;

(v-2) Senior investment securities, or certificates representing subscription rights thereto, as prescribed in *Kyôdô Soshiki Kin'yû Kikan No Yûsen Shussi Ni Kansuru Hôritsu* [Law Relating to Senior Investments in Cooperative Association Financial Institutions] Law No. 44 of 1993 . . . ;

(vi) Share certificates (including odd lot; hereinafter the same) or securities or certificates representing subscription rights to new shares;

(vii) Beneficial certificates of securities investment trusts or loan trusts;

(viii) Promissory notes as designated in an ordinance of the Ministry of Finance among those issued by a judicial person to raise funds necessary for their businesses;

(ix) Securities or certificates issued by a foreign country or a foreign judicial person and having the same nature as the securities or certificates prescribed in each preceding item;

(x) Securities and certificates as designated in an ordinance of the Ministry of Finance among those issued by a foreign judicial person and representing beneficial interests, or similar rights thereto, in a trust for loans of a person engaged in banking business or other persons engaged in money lending as a business; and

(xi) In addition to those prescribed in each preceding item, securities or certificates as prescribed in a cabinet order on the ground that it is recognized as being necessary to ensure public interest or protection of investors, by virtue of their negotiability or other circumstances.

(2) The rights to be represented by such securities as enumerated in each item of the preceding paragraph shall be deemed to be securities, even though such securities are not issued. The enumerated rights in the following shall be deemed to be securities, and this law applies to them, even though such rights are not to be represented by securities.

(i) Beneficial interests as prescribed in a cabinet order among those in a trust for loans of a bank, a trust company, or such other financial institution as prescribed in a cabinet order, or a person engaging principally in business of lending long-term funds necessary for acquisitions of residences (including land to be used for such residences and interests in such land);

(ii) Claims against a foreign judicial person that have the same nature as those prescribed in the preceding item; and

(iii) In addition to those enumerated in the preceding two (2) items, monetary claims as designated in a cabinet order on the ground that circumstances of their negotiation are recognized as being identical to those of negotiation of such securities as prescribed in the preceding paragraph and that, taking into account their having the same economic nature as the securities prescribed in the preceding paragraph and other circumstances, such designation is recognized as being necessary and appropriate for public interest or protection of investors.

(3) The term "public offering" as used in this law shall mean such solicitation of offers for acquisitions of securities in an issue of securities (including such similar activities thereto as designated in an ordinance of the Ministry of Finance; hereinafter the same) as comes within the following:

(i) Solicitation prescribed in a cabinet order among that directed at many people (excluding solicitation directed only at persons prescribed in an ordinance of the Ministry of Finance as those who have special knowledge and experience on investment in securities (hereinafter called "qualifying institutional investors"));

(ii) In addition to such solicitation as prescribed in the preceding item, solicitation that does not come within either of the following:

(a) Solicitation directed only at qualifying institutional investors and prescribed in a cabinet order among that involving little possibility of transfer of the securities to persons other than qualifying institutional investors;

(b) Solicitation, other than prescribed in the preceding item and (a) above (excluding such solicitation as meeting the conditions prescribed in a cabinet order), that is prescribed in a cabinet order as involving little possibility of transfer of the securities to many people.

* * *

(8) The term "securities business" as used in this law shall mean any of the following businesses engaged in by a person other than a bank, a trust company or such other financial institution as prescribed in a cabinet order.

(i) Purchasing and selling securities, or entering into securities index future transactions, securities option transactions or foreign market securities future transactions;

(ii) Acting as intermediary, broker or agent with respect to purchases and sales of securities, securities index future transactions, securities option transactions or foreign market securities future transactions;

(iii) Acting as intermediary, broker or agent with respect to undertaking the following transactions:

(a) Purchases and sales of securities, securities index future transactions and securities option transactions in any securities market; and

(b) Purchases and sales of securities, or foreign market securities future transactions, in any foreign securities market (which means a market similar to a securities market and located in a foreign country; hereinafter the same);

(iv) Underwriting securities;

(v) Conducting secondary distribution of securities; and

(vi) Handling public offerings, or secondary distributions of securities, or solicitation of offers for acquisitions of securities that does not come within public offerings (hereinafter called "private placements").

* * *

Article 65 (Prohibition against Financial Institutions's Securities Business)

(1) No bank, trust company or such other financial institution as prescribed in a cabinet order may engage in as a business any of the activities enumerated in each item of Paragraph (8) of Article 2; *Provided, however, that* this shall not apply in the cases wherein a bank, upon written order, and for the account, of customers, purchases or sells securities, or enters into securities index future transactions, securities option transactions or foreign

market securities future transactions, or wherein a bank, a trust company or such other financial institution as prescribed in a cabinet order, for the purpose of investment, or for the account of a trustor pursuant to a trust agreement, purchases or sells securities or enters into securities index future transactions, securities option transactions or foreign market securities future transactions in accordance with any other law.

(2) The provision of the preceding paragraph, other than the *proviso*, shall not apply in the case wherein a bank, a trust company or such other financial institution as prescribed in a cabinet order conducts such activities as enumerated in each following item in connection with such securities or transactions as enumerated in the same item.

(i) Government bonds, regional government bonds and other bonds the payments of whose principals and interests are guaranteed by the Government (these bonds are called "government bonds, etc." in this paragraph . . .):

Such activities as enumerated in each item of Paragraph (8) of Article 2 (with respect to such activities as enumerated in Items (i) through (iii) thereof, limited to purchases and sales of such securities and activities conducted in connection with such purchases and sales);

(ii) Securities, other than enumerated in the preceding item, that are enumerated in Item (viii) of Paragraph (1) of Article 2 or otherwise designated in a cabinet order and that have shorter than a one (1)-year period from the issue date to the maturity date:

Such activities as enumerated in each item of Paragraph (8) of Article 2 (with respect to such activities as enumerated in Items (i) through (iii) thereof, limited to purchases and sales of such securities and activities conducted in connection with such purchases and sales);

(iii) Securities, other than those enumerated in Items (i) through (vii) of Paragraph (1) of Article 2 (including securities enumerated in Item (ix) thereof and having the same nature as those enumerated in Items (i) through (vii) thereof), that are enumerated in Item (x) thereof or otherwise designated in a cabinet order (excluding those enumerated in the preceding item):

Such activities as enumerated in each item of Paragraph (8) of Article 2 (with respect to such activities as enumerated in Items (i) through (iii) thereof, limited to purchases and sales of such securities and activities conducted in connection with such purchases and sales);

(iv) Securities other than enumerated in the preceding three (3) items:

Handling private placements;

(v) Transactions enumerated in the following:

Such activities as enumerated in Items (i) through (iii) of Paragraph (8) of Article 2.

(a) Securities index future transactions and securities option transactions relating to government bonds, etc. (including these transactions relating to securities indices of only government bonds, etc.);

(b) Foreign market securities future transactions (limited to those relating to government bonds, etc. or to securities indices of only government bonds, etc.);

(c) Securities future transactions relating to securities enumerated in Item (ix) of Paragraph (1) of Article 2 and having the same nature as government bonds (hereinafter “foreign government bonds”);

(d) Securities index future transactions and securities option transactions relating to foreign government bonds (including these transactions relating to securities indices of only foreign government bonds);

(e) Transactions, similar to securities future transactions, in a foreign securities market (limited to those relating to foreign government bonds); and

(f) Foreign market securities future transactions (limited to those relating to foreign government bonds or to securities indices of only foreign government bonds).

Article 65-2. (Approval of Securities Business Relating to Financial Institutions)

(1) If a bank, a trust company or such other financial institution as prescribed in a cabinet order intends to engage in as a business such activities as enumerated in each item of Paragraph (2) of the preceding article with respect to such securities or transactions as enumerated in each item, it shall obtain approval of the Minister of Finance in accordance with a cabinet order by specifying business to be intended and the operation method thereof, except in the cases wherein such activities as prescribed in the *proviso* of Paragraph (1) of the same article are to be conducted and wherein those activities, enumerated in Item (i) of Paragraph (2) of the same article, that are prescribed in Item (iv) of Paragraph (8) of Article 2 are to be conducted otherwise than for the purpose of secondary distribution.

* * *